Tutorial Letter 102/0/2024

ADVANCED FINANCIAL ACCOUNTING I

FAC4861/NFA4861/ZFA4861

Year Module

Department of Financial Governance

IMPORTANT INFORMATION:

This tutorial letter contains important information about your module.

Define tomorrow.

UNISA university of south africa

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DUE DATES

TEST 1 ON TUTORIAL 102:	**26 MARCH 2024**
TEST 1 REMARK DEADLINE:	**10 MAY 2024**

PERSONNEL AND CONTACT DETAILS

Personnel	Telephone Number
Lecturers	
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Please send an e-mail to: fac1postgrad@unisa.ac.za

PRESCRIBED METHOD TO STUDY

1. Please read the prescribed study material for every learning unit thoroughly before you study the additional information of every learning unit.

2. Answer the additional questions in the learning unit and make sure you understand the principles contained in the questions.

3. Consider whether you have achieved the specific outcomes of the learning unit.

4. After completion of all the learning units - attempt the self-assessment questions to test whether you have mastered the contents of this tutorial letter.

SUGGESTED WORKING PROGRAMME

FEBRUARY 2024						
MONDAY	**TUESDAY**	**WEDNESDAY**	**THURSDAY**	**FRIDAY**	**SATURDAY**	**SUNDAY**
12 The Conceptual Framework	13 Presentation of financial statements	14 Inventories	15 Income Taxes	16 Accounting policies, change in accounting estimates and errors	17	18
19 Self-assessment questions	20 Self-assessment Questions					

LEARNING UNIT 0 – INTRODUCTION TO myUNISA

INTRODUCTION

This learning unit will assist you in understanding the various functions available on myUnisa and also in obtaining your myUnisa login details, as well as creating your myLife e-mail account.

OBJECTIVES/OUTCOMES

After you have studied this learning unit, you should be able to do the following

1. Claim your myUnisa login details
2. Create your myLife e-mail account
3. Use the myUnisa tools and understand the functioning thereof.

myUnisa login

Once you have registered and have your myUnisa login details, you will have access to all the modules that you have registered for.

In order to join the online learning environment, you will need to claim your myUnisa login details by following the instructions at the following link:

https://my.unisa.ac.za/portal

myUnisa

FIGURE 1: myUnisa portal

myLife e-mail account

When claiming your myUnisa login details, you will also be creating your myLife e-mail account. Your myLife e-mail account will be the only e-mail account recognised by Unisa for official correspondence with you from the University. You may redirect your myLife e-mails to another, more preferred, e-mail account to which you have access. However, the myLife account will remain the official e-mail address for you on record at Unisa. The management of this e-mail account is solely your responsibility.

Should you experience any difficulty with the above, you are welcome to ask for assistance at:

- myUnisahelp@unisa.ac.za
- myLifeHelp@unisa.ac.za

What is myUnisa?

myUnisa was created to serve as a digital classroom and study space where you can engage with your studies, your lecturer and your fellow students. myUnisa makes it possible for you to use a digital device, such as a laptop, a tablet or even a smartphone to receive instructions and guidance, to obtain access to sources and resources, to listen to podcasts or view screencasts and to interact with your lecturers as well as other students.

> The myUnisa platform should be reserved strictly for Unisa academic (teaching and learning) purposes. Advertising and/or any other breach, as outlined in the Student Disciplinary Code, may lead to disciplinary action.

On this site, you will find the following material:

- an electronic copy of this document, under **Additional Resources**, as well as all your tutorial letters under **Official Study Material.**
- module-specific learning materials under **Learning Units**, as also contained in this document.

How does myUnisa work?

- In this brief overview, we refer to those functions of myUnisa that you may encounter and may need on a regular basis. On the left-hand side of your myUnisa module page, you will find a number of options as indicated below. These options are known as “buttons” because one can click on each of them in order to select and open the “tool” that the button represents. These buttons start with **Dashboard, Prescribed material** and so forth from the top down.

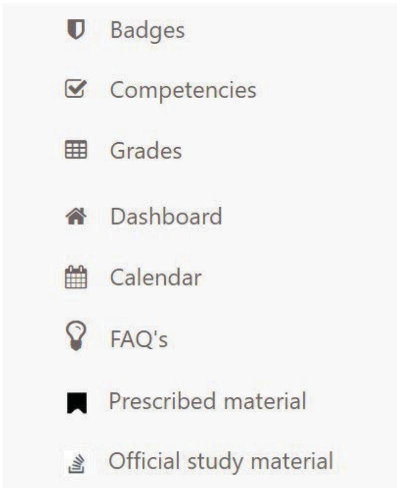


FIGURE 2: myUnisa toolbar

myUnisa tools

When you click on the myUnisa tools, there may or may not be a definition of the tool at the top of the page that is opened.

Each myUnisa tool has its own function and some are briefly explained below. You can open only one tool at a time and will have to learn how to move from one tool to the other and how to move from one option within a tool to another option within the same tool. Moving around in myUnisa is known as “navigating”.

The myUnisa page for certain modules may include a longer list of tools than others. The activation of tools depends on how the responsible lecturer and other role players envisaged the flow of information and how they intended you to be exposed to the learning experience. The supposed absence of a tool on a module page is therefore not an indication that myUnisa is not working as it should.

The following is a brief overview of the myUnisa tools for this module, how some of them are related to one another and how they will be useful to you:

Dashboard

Here you will find a welcome message from your lecturers.
The **Dashboard** tool also contains a calendar where important events have been indicated by a red-coloured block on the specific date, for example, test and exam dates. Once you have clicked on these blocks, additional information will appear at the top of the calendar, indicating the event.

Grades

Here you will be able to view your assignment (test) results.

Announcements

During the year, lecturers will place announcements on myUnisa to communicate important and relevant information to students, such as study school venue confirmation, new screencasts that have been uploaded to myUnisa, and so forth.

It is crucial that you have registered yourself correctly on myUnisa as, once you have, you will then receive an e-mail notification every time your lecturer posts a new announcement. Always check the list of previous announcements to ensure that you have not missed any important notices.

Once you have selected this tool, click on subject line of the relevant announcement to view the full details of the announcement.

Official Study Material

All tutorial letters for this module are uploaded here in PDF format. Once you have selected this tool, please follow the instructions at the top of this page to download a document to your personal computer or mobile device. You may also choose to print the document.

Previous exam papers are also made available on this tool. Please note that course curriculums are regularly updated and that, therefore, these past examination papers may be outdated. Using past examination papers as study material is done at your own risk. Your lecturer will not provide you with the solutions to these exam papers since previous exam papers are updated and made available in Tutorial Letter 107 (as case studies) only later in the year.

Additional Resources

Additional resources, such as tests, study school slides, additional comments on tutorial letters and so on that can contribute to your understanding of module contents will be uploaded here. A notification will be sent via e-mail to notify students when an upload has been made to this tool. Investigate this tool after you have registered for the module, as well as regularly during the course of the year. **Also view your Unisa e- mail account regularly for any notifications.**

Discussion Forums

This is a valuable and safe space where you can interact with fellow students about topics relating to the module that you have enrolled for. Either the lecturer or you can create a discussion about a topic.

Once you have selected this tool, you can either create a new forum or you can select an existing forum by clicking on the forum name. Under each forum name you can either create a new topic or select an existing topic.

Remember, online discussion forums are not the same as e-mail messages, or a letter to the lecturer, or a chat room. Therefore, the myUnisa discussion forums must not be used for personal messages to your lecturers or to one another.

Netiquette

"Netiquette" is simply "net etiquette". This refers to the way in which you should behave when you communicate on myUnisa and more specifically, on discussion forums. Netiquette outlines simple, polite online discussion behaviours that participants in an online discussion expect from one another.

Online discussions in module discussion forums are perhaps more formal than other public discussion forums. It helps to remember that in an online class, discussion forums are used instead of the face-to-face discussions or paper-based correspondence that you may be used to. We require you to behave online in the same manner in which you would if you were physically sitting in a classroom with your lecturer or e-tutor and all your classmates.

It is also important to understand that an online discussion in a university environment is more formal than a text message (SMS). Text messaging uses abbreviations such as "How R U?". This abbreviated language is **not appropriate** in an online discussion forum. You have to use full words and complete sentences.

Prescribed books

Contains details of the official Unisa Booksellers as well as the prescribed books for the year.

Please note: Although the most recent SAICA Handbook is prescribed and recommended, any previous version may be used in tests and exams (refer to the open book policy in tutorial letter 301).

Learning Units

The **Learning Units** tool contains all the learning units making up the syllabus for this module.

Screencasts and/or other information might also be uploaded under Additional Learning Activities.

LEARNING UNIT 1 – GENERAL

A. SAICA'S PRINCIPLE OF EXAMINATION LEVELS

Throughout the study material, we will refer you to the following principles of examination levels:

1. **Level 3**:

A topic is at Level 3 if meets one of the following criteria:

- it is based on a significant conceptual underpinning/foundation of current financial accounting (i.e., based on identification, recognition, measurement and presentation and disclosure of elements); or
- it is prevalent (i.e., issues and industries that would be commonly encountered in practice in the course of an entry-level Chartered Accountant's work). Here, the emphasis is on subject matter that are of a more general nature.

At Level 3, an entry-level Chartered Accountant must be able to identify the underlying problem, perform complex calculations and answer integrated questions relating to core level matters.

2. **Level 1**:

Level 1 means that the topic is not at Level 3 but that it is important for an entry-level Chartered Accountant to know about the topic. It is important for them to be able to identify that it is a topic that potentially has significant accounting implications and requires additional or specialist IFRS knowledge.

They would need to be able to **identify** and **describe** what the accounting issue is and further read-up on the matter. Students would also be expected to perform basic processing of the transaction when the relative figures (amounts) are supplied (e.g., obtained from an expert).

In example, students should be able to prepare the journal to capitalise any qualifying borrowing costs to Property, Plant and Equipment when the borrowing cost amount has been supplied.

3. Topics are **excluded:**
4.

The following standards are excluded from the syllabus:

a. IFRS 1 *First-time Adoption of International Financial Reporting Standards*
b. IFRS 4 *Insurance contracts*
c. IFRS 6 *Exploration for and Evaluation of Mineral Resources*
d. IFRS 8 *Operating Segments*
e. IFRS 14 *Regulatory Deferral Accounts*
f. IAS 20 *Government Grants*
g. IAS 26 *Accounting and Reporting by Retirement Benefit Plans*
h. IAS 29 *Financial Reporting in Hyperinflationary Economics*
i. IAS 33 *Earnings per Share*
j. IAS 34 *Interim Financial Reporting*
k. IAS 41 *Agriculture*

Please note that the **scope** of all standards is at **Level 1**, even if the standard is excluded from the syllabus. Exclusions within standards are specifically identified in your study material.

The treatment of any Interpretation Note will follow the principle of examination level of the related standard.

B. A STUDENT'S GUIDE TO SUCCESS

To all our FAC students.

We have prepared a guide for those FAC students who are embarking on their CTA studies. The guide contains general information for the FAC module and highlights important information you should take note of.

The following are important aspects of your studies

- Attitude.
- How to use the study material.
- The importance of tests myUnisa.
- Contacting your lecturer.

ATTITUDE

A positive attitude is the key to your success!!!

A positive attitude includes

Self-learning
A CTA student takes responsibility for his/her own learning experience.

Owners.hip
A CTA student has an attitude of responsibility for his/her own progress, planning and challenges.

Self-confidence
A CTA student attempts his/her tests and exams with self-confidence based on his/her consistent effort and commitment throughout the year

Commitment
A CTA student prioritises his/her studies by setting a study programme and keeping to the programme, even when faced with other pressures or commitments.

Consistency
A CTA student works consistently through the year and does not leave his/her studies for a last-minute crash course.

How to use the study material (tutorial letters

Step: Familiarise yourself with the relevant IFRS in the learning unit.
Use the INDEX in the learning unit to guide you through the IFRS.

Step: Do the additions questions in the learning unit.
HINT: Don't rush through these questions. Take your time and ensure that you understand the principles before you proceed to the next learning unit.

Step: After completing the learning units, proceed to the SELF ASSESSMENT QUESTIONS. Do the questions within the given time (simulate exam conditions).
Mark your solution.
Identify areas that you found difficult. Address these issues **immediately** by referring back to the relevant IFRS, learning unit or contact the lecturers.

Use the SUGGESTED WORKING PROGRAMME at the beginning of each tutorial letter to plan your studies for the week

The importance of tests

In order to obtain exam admission, a student requires a minimum year mark of 40%, based on his or her best three tests.

There are four tests during the year (refer TUT 101 for the test dates).

Don't miss a test!
There are no supplementary or sick tests.

Tests provide you with the opportunity to:

- Apply your knowledge
- Integrate your knowledge
- Revise important concepts
- Identify areas that need attention
- Build self-confidence

Important: Work through the suggested solution after each test.

myUnisa

View myUnisa regularly.	Important announcements are issued on the website.
The tests and their solutions, as well as comments from the markers, are posted after the tests.	Tutorial letters and important resources are available on the website.

Remember the CTA support website:
http://sites.google.com/site/ctasupport

How to contact your lecturer

Use the FAC mailbox: fac1postgrad@unisa.ac.za

Contact your lecturer telephonically, or Contact the College of Accounting Sciences (CAS) at: CASenquiries-CTA@unisa.ac.za.

C. EXAM TECHNIQUE – COMMENTS

1. Overall comments

All assessments are received and submitted **on-line**.

Communication is sent to students prior to each assessment, containing the necessary information pertaining to that assessment.

Submit your paper within the time allocated for submission.

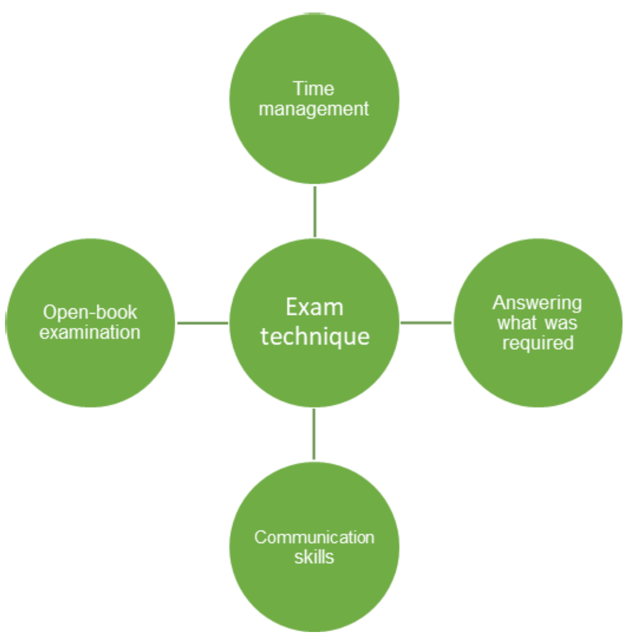
Submit your paper in the correct format (PDF). Ensure your submission contains all pages.

No e-mailed submissions will be accepted.

RE-MARKING of Tests
Refer to TUT 101 for re-mark deadline dates.
Indicate the areas in your test which you believe should be re-marked. Remember, your mark can **decrease** with a remark.

Academic Integrity and Consequences of Dishonesty
(Refer to point 3 below.)

2. Examination technique



Examination technique remains the key distinguishing factor between students who **PASS** and those who **FAIL**.

PRACTICE
your exam technique by answering the additional questions in each tutorial letter as well as the questions in Tutorial Letter 106 under test or exam conditions.

2.1 Time management

Students are advised to utilise their time wisely and allocate time for each question based on the number of marks out of which the question counts.

Students should be aware of the tendency to spend too much time on the first question attempted and too little time on the last – rather return to any incomplete answered questions after attempting all other questions.

2.2 Answering what was required

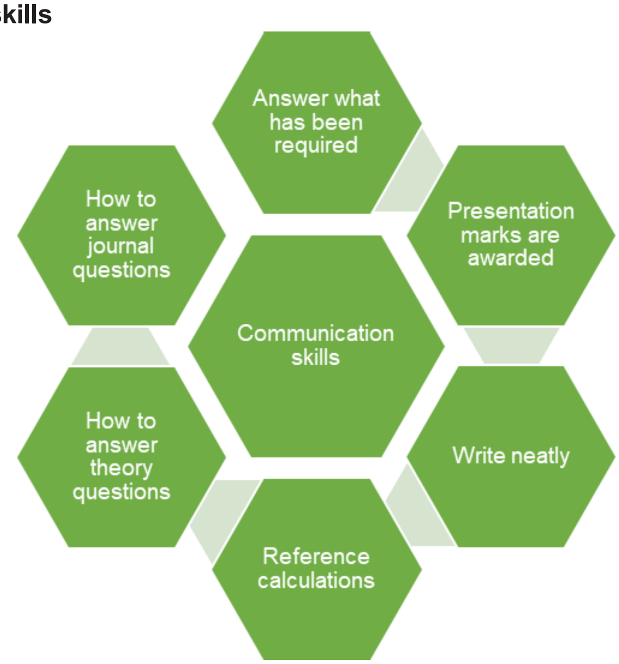
Marks can be awarded only for answers that were **required**.

E.g. if disclosure was required, no marks will be awarded for calculations that were not **reflected** in the required disclosure.

2.3 Open-book examination

Unisa follows the limited open-book policy as prescribed by **SAICA**. Please refer to tutorial letter 301 for the open-book policy. Students are also advised to familiarise themselves with the Unisa exam rules prior to writing the examination.

2.4 Communication skills



2.4.1 Answer what has been required

Many students do not address what has been required, for example, students provide calculations only where disclosure (notes to the financial statements) or presentation (financial statement/(s)) are required. Kindly note that if a student has shown only calculations and has not addressed what has been required, no marks can be awarded for the calculations.

2.4.2 Presentation marks are awarded

Students also need to bear in mind that this is a professional qualification and presentation marks are awarded in the tests and exams:

- **Logical flow and conclusion/layout:** Marks are awarded in theory questions for the systematic flow of a logical argument and conclusion (where applicable). Use bullet points and write to the point.
- **Presentation and layout:** Marks are awarded for disclosure and presentation as required by the International Financial Reporting Standards (IFRS).

2.4.3 Write neatly

Students need to **write neatly** and structure their answers. Should you type your answer:

- Ensure that your answer is well structured,
- Do not write over more than the width of one page when using Excel,
- Do not use formulas for which the inputs thereto are not visible, otherwise marks cannot be awarded.

Marks can not be awarded if it is not possible to read a student’s handwriting.

2.4.4 Reference calculations

It is essential that students supply and reference detailed calculations to support the figures in their answers.

Students need to ensure that their calculations are properly and neatly **cross-referenced** to the final solution. Ensure that the answer to your calculation is the amount that has been transferred to the solution. If a different amount is used in your solution, your calculation cannot be marked.

Remember we mark from your solution to the calculations!

2.4.5 Theory questions

Marks are awarded for *applying* the theory to the content of the question. **No marks** are awarded for writing the theory from the Accounting Standards.
Write neatly, use bullet points where possible so as to ensure that you obtain the presentation marks!

2.4.6 Journal entries

	Increase	Decrease
Asset	Debit	Credit
Liability	Credit	Debit
Income/Revenue	Credit	Debit
Expense	Debit	Credit
Equity/Capital	Credit	Debit

Students need to indicate Dr and Cr on top of the columns where the amounts are written. Students also need to indicate whether the statement of profit or loss (P/L), other comprehensive income (OCI) or the statement of financial position (SFP) are debited or credited. Also note whether the required section requires dates and journal narrations.

IF REQUIRED

		Dr R	Cr R
	31 December 20.17		
J1	Deferred tax expense **(P/L) [C1]**	14 000	
	Deferred tax **(SFP)**		14 000
	Provide deferred tax for the current financial year		

ALWAYS REMEMBER

3. Importance of Academic Integrity and Consequences of Dishonesty

We refer you to the CAS news article ***Zero-tolerance approach towards plagiarism or cheating in the College of Accounting Sciences*** of 1 July 2021 available at:
https://www.unisa.ac.za/sites/corporate/default/Colleges/Accounting-Sciences/News/Articles

Please read the article and familiarise yourself with its content. Cheating is a violation of academic integrity.

As a CTA student, you write **limited** open-book assessments. This means **access to only** the SAICA Handbook or SAICA Legislation Handbook and **no access** to any other material or any other person to assist in completing the online assessments.

Any use of unauthorised material or assistance from any third party before or during the online assessment constitutes cheating and is serious misconduct. Also, as a student, you declare that the work is your own work. Any false declaration as part of the honesty statement constitutes a fraudulent activity.

We appeal to you to revisit the *Unisa rules for students*, the *Students' Disciplinary Code*, as well as the *Policy on Copyright Infringement and Plagiarism*, available on the University website and ensure that you are familiar with the contents thereof. Ignorance of these rules and related policies of the Institution will not be accepted as an excuse for any transgression.

Please read chapter 7 of the *Students' Disciplinary Code* for the sanctions that may be imposed on a student who is found guilty of academic dishonesty. These sanctions range from being issued with a warning and/or written reprimand (and a zero mark for the assessment) to as severe as being expelled and denied the opportunity to enrol again as a student at the University for a specified period.

It is your future at stake, and we appeal to you to protect it.

LEARNING UNIT 2 – 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.

OBJECTIVES/OUTCOMES

After you have studied this learning unit, you should be able to do the following:

1. Discuss the objectives, usefulness and limitation of general-purpose financial reporting.
2. Define and discuss the qualitative characteristics of useful information.
3. Discuss the information financial statements provide.
4. Define the elements of financial statements.
5. Describe the recognition criteria of the elements of financial statements.
6. Determine when to derecognise of all or part of a recognised asset or liability from an entity's statement of financial position.
7. Apply measurements basis to elements of financial statements.
8. Consider the nature of the information that the measurement basis will produce.
9. Consider various factors when selecting a measurement basis.
10. Discuss presentation and disclosure objectives and principles.
11. Apply classifications.
12. Describe the concepts of capital maintenance and the determination of profit.

PRESCRIBED STUDY MATERIAL

You **must** study the following before you attempt the questions in this learning unit:

1. The Conceptual Framework for Financial Reporting.

INDEX

1. Overview of the Conceptual Framework

	Conceptual Framework	SAICA Level	Learning unit section
Background	The International Accounting Standards Board (Board) issued the revised Conceptual Framework for Financial Reporting (Conceptual Framework) in March 2018. The previous Conceptual Framework was issued in 1989 and partly revised in 2010. Although the previous Conceptual Framework was useful, it was incomplete and therefore required improvement. In revising the Conceptual Framework, the Board sought a balance between providing high-level concepts and providing enough detail for the Conceptual Framework to be useful to the Board and others. The Board views the Conceptual Framework as a practical tool to help it develop Standards. Hence, the Conceptual Framework includes concepts that help the Board develop Standards and discusses the factors the Board needs to consider in making judgements when application of the concepts does not lead to a single answer.		
Status and purpose of the Conceptual Framework	**Status and purpose** The Conceptual Framework is a comprehensive set of concepts for financial reporting. It describes the objective of and the concepts for financial reporting. The purpose of the Conceptual Framework is to: - assist the Board to develop IFRS Standards (Standards); - to assist preparers of financial reports to develop consistent accounting policies for transactions or other events when no Standard applies, or when a Standard allows a choice of accounting policies; and - to assist all parties to understand and interpret Standards. The Conceptual Framework is not a Standard and cannot override any specific IFRS. The Board uses the Conceptual Framework to develop future Standards and review existing IFRSs. The Conceptual Framework contributes to the stated mission of IFRS foundation and Board.	Level 3	2.1

	Conceptual Framework	SAICA Level	Learning unit section
Chapter 1: Objective of general-purpose financial reporting	**Chapter 1** 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.	Level 3	2.2
Chapter 2: Qualitative characteristics of useful financial information	**Chapter 2** Introduction. The qualitative characteristics of useful information. The **fundamental** qualitative characteristics are: • Relevance • Materiality • 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.	Level 3	2.3
Chapter 3: Financial statements and the reporting entity	**Chapter 3** 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.	Level 3	2.4

	Conceptual Framework	SAICA Level	Learning unit section
Chapter 4: Elements of the financial statements	**Chapter 4**	Level 3	2.5
	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 a potential to produce economic benefits. This section discusses three aspects of the definition: • Right. • Potential to produce economic benefits. • Control.		
	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		
	Assets and Liabilities • Unit of account. • Executory contract. • Substance of contractual rights and contractual obligations.		
	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.		

	Conceptual Framework	SAICA Level	Learning unit section
Chapter 5: Recognition and Derecognition	**Chapter 5** 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	Level 3	2.6
Chapter 6: Measurement	**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.	Level 3	2.7
Chapter 7: Presentation and Disclosure	**Chapter 7** Presentation and disclosure as communication tools. Presentation and disclosure objectives and principles. Classification. Aggregation.	Level 3	2.8
Chapter 8: Capital	**Chapter 8** Concepts of capital. Concepts of capital maintenance. Capital maintenance adjustments.	Level 3	2.9

2.1 Status and purpose of the Conceptual Framework (Level 3)

Refer to SP1.1 - SP1.5.

2.2 Chapter 1: The objective of general-purpose financial reporting (Level 3)

Refer to Conceptual Framework (CF) 1.1 – 1.23.

2.3 Chapter 2: Qualitative characteristics of useful financial information (Level 3)

Refer to CF 2.1 – 2.43.

2.4 Chapter 3: Financial statements and the reporting entity (Level 3)

Refer to CF3.1 – 3.18.

2.5 Chapter 4: Elements of financial statements (Level 3)

Refer to CF4.1 – 4.72.

2.6 Chapter 5: Recognition and Derecognition (Level 3)

Refer to CF5.1 – 5.33.

2.7 Chapter 6: Measurement (Level 3)

Refer to CF6.1 – 6.95.

2.8 Chapter 7: Presentation and disclosure (Level 3)

Refer to CF7.1 – 7. 22.

2.9 Chapter 8: Concepts of capital and capital maintenance (Level 3)

Refer to CF8.1 – 8.10.

ADDITIONAL QUESTIONS

QUESTION 2.1 (20 marks)

You are employed by Expert Ltd (Expert). Expert provides accounting and tax consulting services to various clients. The International Accounting Standards Board (Board) issued the revised Conceptual Framework for Financial Reporting (Conceptual Framework), a comprehensive set of concepts for financial reporting in March 20.18. Your portfolio includes the following two allocated clients who have approached you regarding the recognition of assets and liabilities in terms of the revised Conceptual Framework.

Client 1: Mogala Ltd

On 13 June 20.16, Mogala Ltd (Mogala) purchased a holographic touch screen patent from Innovation Ltd (Innovation) at a cost of R250 million. This patent will give Mogala access to all the patents internationally and locally for the design and manufacture of holographic touch screens. Only Mogala can utilise the patent to design and manufacture the holographic touch screens. This will result in Mogala selling the first holographic touch screen smartphones and it will ensure that Mogala is the only designer and manufacturer of such smartphones.

Mogala will manufacture all the other components of the smartphones and it will assemble the holographic touch screen smartphones and it is estimated that 90 million holographic touch screen smartphones will sell within the next financial year at a satisfactory profit margin.

Client 2: Sea Homes Ltd

Sea Homes Ltd (Sea Homes) is a new real estate agency that specialises in selling beachfront holiday homes for the upper middle-class market. Sea Homes is operating on the South Coast of the KwaZulu-Natal region of South Africa. As part of its expansion strategy, a decision has been taken by the directors of the company to open a new office on the North Coast of the KwaZulu-Natal region.

Sea Homes paid R40 000 to Umhlanga News to advertise holiday homes for sale in the newspaper to appear during January 20.19. This amount was paid on 15 December 20.18.

REQUIRED	**Marks**
Discuss, in terms of The Conceptual Framework for Financial Reporting 2018, whether the patent (refer to client 1) and payment to Umhlanga News (refer to client 2) may each be recognised as an asset in the financial statements of Mogala Ltd and Sea Homes Ltd for the year ended 31 December 20.18.	18
Communications skills: logical argument	1
Please note: • Ignore any normal income tax implications. • Ignore Value Added Taxation (VAT) implications. • Your answer must comply with International Financial Reporting Standards (IFRS).	

QUESTION 2.1 – Suggested solution

Discuss, in terms of The Conceptual Framework for Financial Reporting 2018, whether the patent (refer to client 1) and payment to Umhlanga News (refer to client 2) may each be recognised as an asset in the financial statements of Mogala Ltd and Sea Homes Ltd for the year ended 31 December 20.18.

An item can be recognised only if it meets the definition of an asset (Conceptual Framework 4.3) and only if recognition of the asset provides users of financial statements with information that is useful. (Conceptual Framework 5.6 – 5.7)

An **asset** is a present economic resource controlled by an entity as a result of past events (Conceptual Framework 4.3).

An **economic resource** is a right that has the potential to produce economic benefits (Conceptual Framework 4.4).

MOGALA LTD - Client 1

Definition of an asset Right

Mogala purchased the patent and has a right to use the patent (intellectual property) to design and manufacture holographic touch screens (Conceptual Framework 4.6 (ii)). (1)

Potential to produce economic benefits

The right to design and manufacture holographic touch screens has the potential to produce economic benefits, since the holographic touch screens produced will be sold to generate revenue that will give rise to an asset (either cash or a trade receivable) which is an economic benefit (Conceptual Framework 4.16 (d)). (2)

Control

The patent can be used by Mogala only, therefore, it has the ability to direct the use of the right to manufacture holographic touch screens by using the patent (Conceptual Framework 4.20). (1)

Mogala will obtain all the revenue from the sale of the holographic touch screens (Conceptual Framework 4.20). (1)

The patent can be used by Mogala only; it has the present ability to prevent other entities from directing the use of the patent in the production of touch screens (Conceptual Framework 4.20). (1)

All revenue from the sale of holographic touch screens will be legally in the name of Mogala, therefore, Mogala has the present ability to prevent others from obtaining the revenue from sales of the touch screen (Conceptual Framework 4.20). (1)

Past event

The past event is the acquisition of the holographic touch screen patent by Mogala from Innovation Ltd that gives Mogala the right to use the patent to manufacture touch screens. (1)

Recognition criteria Relevant nformation

The patent was acquired at a cost, therefore, there is no uncertainty that the patent exists (Conceptual Framework 5.12 (a)). (1)

The probability of the inflow of future economic benefits is not low as the analysis of the current customer base and target customers; it is forecast that 90 million holographic touch screen smartphones will sell in the first year and at a satisfactory profit (Conceptual Framework 5.12 (b)). (1)

Faithful representation
The holographic touch screen patent was acquired by Mogala at a cost of R250 million, therefore there is no measurement uncertainty associated with the patent (Conceptual Framework 5.18).
Conclusion
The patent will be recognised as an asset in terms of the *Conceptual Framework for Financial* (1)
Reporting in the financial statements for the year ended 31 December 20.18. (1)

Total (12)
Maximum (10)
Communication skills: logical argument (1)

SEA HOMES LTD - Client 2
Definition of an asset

Right
Sea Homes has a right to receive services from Umhlanga News, in the form of the adverts to appear in the newspaper in the following financial year (Conceptual Framework 4.6(a)(ii)). (1)
Potential to produce economic benefits
The right has the potential to produce economic benefits, in the form of both cash inflows, through potential clients being attracted to the homes being advertised for sale and in the form of reduced future cash inflows, since the cash payment for the newspaper adverts have already been made (a prepayment) (Conceptual Framework 4.16 (d)). (2)
Control
The control arises through the underlying contract with the newspaper (Conceptual Framework 4.20) (1)

Past event
The past event is the prepayment of cash for the advertising on 15 December 20.18, before the reporting period. (1)
Recognition criteria Relevant information

There is no uncertainty about the existence of the payment to Umhlanga News.

The probability of the inflow of economic benefits are not low. Refer to the discussion of the two potential economic benefits below: (1)

1. The potential to produce economic benefits through cash inflows from the future sales of homes has a low probability that there will be an inflow of economic benefits (i.e., we cannot quantify the number or value of the sales that will occur as a direct result of the newspaper advert) (Conceptual Framework 5.18). (1)
2. However, the second potential economic benefit identified, being the reduced future cash outflow (i.e., reduced advertising cash outflows), the probability of inflow of economic benefits is not low (we know the amount that has been prepaid). (Conceptual Framework 5.18). (1)

Faithful representation

There is no measurement uncertainty as the prepayment was R40 000.
Conclusion
The payment will be recognised as an asset in terms of the *Conceptual Framework for* (1)

Financial Reporting in the financial statements for the year ended 31 December 20.18. (1)

Total (10)
Maximum (8)
Communication skills: Logical argument and clarity (1)

COMMENT

Things to remember when answering discussion questions:

- Plan your answer.
- Apply the theory (applicable IFRS or Conceptual Framework) to the scenario.
- Always provide a conclusion.
- Do not use SMS language.

LEARNING UNIT 3 – PRESENTATION OF FINANCIAL STATEMENTS

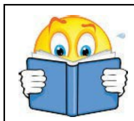
INTRODUCTION

The objective of this Standard is to provide guidelines for the structure and content of general-purpose financial statements, as well as to explain certain underlying principles

OBJECTIVES/OUTCOMES

After you have studied this learning unit, you should be able to do the following:

1. Identify the objective and scope of IAS 1 *Presentation of financial statements.*
2. Identify under which circumstances the standard should be apply.
3. Discuss the objective of financial statements.
4. Specify the components of financial statements.
5. Specify and discuss the overall considerations with the preparation of financial statements.
6. Prepare financial statements in accordance with the requirements in IAS *Presentation of Financial Statements*.
7. Disclose relevant information as required by IAS 1 *Presentation of Financial Statements*.



PRESCRIBED STUDY MATERIAL

The following **must** be studied before you attempt the questions in this learning unit

1. IAS 1 *Presentation of financial statements*

INDEX

Overview of IAS 1

	Presentation of Financial Statements	SAICA Level	Learning unit section
Definitions	**Definitions** General purpose financial statements Impracticable International Financial Reporting Standards Material omissions or misstatements Notes Other comprehensive income Owners Profit or loss Reclassification adjustments Total comprehensive income	Level 3	3.2
Financial statements	Purpose of financial statements A complete set of financial statements General features of financial statements	Level 3	3.3
Structure and content	Introduction Identification of the financial statement Statement of financial position Statement of profit or loss and other comprehensive income Statement of changes in equity Statement of cash flows Notes, comprising a summary of significant accounting policies and other explanatory information	Level 3	3.4

3.1 Scope (Level 1)

Refer to IAS 1.2 – 1.6.

3.2 Definitions (Level 3)

Refer to IAS 1.7 – 8A.

Components of other comprehensive income (IAS 1.7) include:

Component	IAS/ IFRS	Description	Re-classified to profit or loss
(a) Changes in the reva- luation surplus.	IAS 16.39	Property, plant and equipment	May **not** be reclassified to profit and loss.
(b) Remeasurements of de- fined benefit plans.	IAS 19.57(d)	Employee benefits	May **not** be reclassified to profit and loss.
(c) Gains and losses arising from translating the finan- cial statements of a foreign operation.	IAS 21.32/37/ 38.-.49	The effects of changes in foreign exchange rates	May be reclassified to profit and loss. (IAS21.32 and 48)
(d) Gains and losses from investments in equity instruments measured at fair value through other comprehensive income in accordance with para- graph 5.7.5 of IFRS 9.	IFRS 9.5.7.5	Financial instruments	May **not** be reclassified to profit and loss. (IFRS 9B5.7.1)
(e) Gains and losses on financial assets measured at fair value through other comprehensive income.	IFRS 9.4.1.2A	Financial instruments	May be reclassified to profit and loss. (IFRS 9B5.7.1A) May **not** be reclassified to profit and loss. (IFRS 9B5.7.1)
(f) The effective portion of gains and losses on hedging instruments in a cash flow hedge.	IFRS 9.5.7.5	Financial instruments	Non-financial item (e.g. inventory): • May not be reclassified to profit and loss. (IFRS 9.6.5.11(d)) Financial item (e.g. loans): • May be reclassified to profit and loss. (IFRS 9.6.5.11(d))
(g) For particular liabilities designated as at fair value through profit or loss, the amount of the change in fair value that is attributable to changes in the liability's credit risk.	IFRS 9.5.7.7	Financial instruments	May **not** be reclassified to profit and loss. (IFRS 9B.5.7.9)

3.3 Financial statements (Level 3)

Refer to IAS 1.9 – 1.46.

3.4 Structure and content (Level 3)

Refer to IAS1.47 – 1.138.

Disclosure requirements according to IAS 1

In addition to the disclosure requirements of other IFRSs, IAS 1 may also require additional disclosure, which includes the following:

Information to be presented either in the **Statement of Financial Position** or in the **Notes**:

IAS 1	Description
1.77	Further sub classifications of the line items presented, classified in a manner appropriate to the entity's operations
1.78 (a)	Items of property, plant and equipment are disaggregated into classes in accordance with IAS16
(b)	Receivables are disaggregated into amounts receivable from: • trade customers • related parties • prepayments • other amounts
(c)	Inventories are disaggregated into classifications such as: • merchandise • production supplies • materials • work in process • finished goods
(d)	Provisions are disaggregated into provisions for: • employee benefits and • other items
(e)	Equity capital and reserves are disaggregated into various classes, such as: • paid-in capital • share premium and reserves

Information to be presented either in the **Statement of Financial Position, Statement of Changes in Equity** or in the **Notes:**

IAS 1	Description
1.79	For each class of share capital:
1.79 (a)	(i) number of authorised shares (ii) number of shares issued and fully paid, and issued but not fully paid (iii) par value per share, or that the shares have no par value (iv) reconciliation at beginning and end of the period of the number of shares outstanding (v) the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital (vi) shares in the entity held by the entity or by its subsidiaries or associates (vii) shares reserved for issue under options and contracts for the sale of shares, including terms and amounts
	**COMMENT** According to the new South African Companies Act, shares do not have a par value; hence there will also not be any share premium.
1.79 (b)	A description of the nature and purpose of each reserve within equity: • Revaluation reserve • Translation reserve • Fair value adjustment reserve • Cash flow hedge reserve • Share-based payment reserve
1.80	An entity without share capital shall disclose information equivalent to that required by par 79(a), showing changes during the period in each category of equity interest, and the rights, preferences and restrictions attaching to each category of equity interest
1.80A (a) (b)	If an entity has reclassified: A puttable financial instrument classified as an equity instrument, or An instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument between financial liabilities and equity, it shall disclose the amount reclassified into and out of each category (financial liabilities or equity), and timing and reason for that reclassification

Information to be presented in the **Statement of Profit or Loss and other Comprehensive Income** or in the **Notes**:

IAS 1	Description
1.97	When items of income or expense are **material**, an entity shall disclose their nature and amount separately
1.98	Circumstances that will lead to separate disclosure include the following:
(a)	Write-down of inventories to net realisable value and reversals of such write-downs
(b)	Write-down of property, plant and equipment to recoverable amount and reversals of such write-downs
(c)	Restructurings of activities of an entity and reversals of any provisions for cost of restructuring
(d)	Disposals of items of property, plant and equipment
(e)	Disposals of investments
(f)	Discontinued operations
(g)	Litigation settlements
(h)	Other reversals of provisions
1.104	An entity classifying expenses by **function** shall disclose additional information on the nature of expenses, including: • Depreciation • Amortisation expense • Employee benefit expense

Information to be presented in the **Statement of Changes in Equity** or in the **Notes**:

IAS 1	Description
1.106A	For each component of equity an entity shall present an analysis of other comprehensive income by item
1.107	An entity shall present the amount of dividends recognised as distributions to owners during the period, and the related amount of dividends per share

Information to be presented in the **Notes:**

IAS 1	Description
112	The notes shall:
(a)	Present information about the basis of preparation of financial statements and accounting policies used
(b)	Disclose the information required by IFRSs that is not presented elsewhere in the financial statements, and
(c)	Provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them
Disclosure of accounting policies:	
117	An entity shall disclose in the summary of significant accounting policies:
(a)	The measurement basis used in preparing the financial statements
(b)	Other accounting policies used that are relevant to an understanding of the financial statements
122	The judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements

IAS 1	Description
Source of estimation uncertainty	
125	An entity shall disclose information about the assumptions it makes about the future and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Notes should include details of their: • Nature, and • Carrying amount as at the end of the reporting period
Capital	
134	An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.
Other disclosures	
137 (a)	Amount of dividends proposed or declared before the financial statements were authorised for issue but not recognised as distribution to owners during the period, and the related amount per share, and
(b)	The amount of any cumulative preference dividends not recognised
138	Disclose the following, if not disclosed elsewhere in information published with the financial statements:
(a)	The domicile (the place at which the entity is registered) and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different)
(b)	Description of the nature of the entity's operations and its principal activities
(c)	The name of the parent and the ultimate parent of the group, and
(d)	If it is a limited life entity, information regarding the length of its life

ADDITIONAL QUESTIONS

QUESTION 3.1 (33 marks)

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

3. Raw materials amounting to R920 200 and consumables amounting to R18 900 were purchased during the year.

4.

5. The following salaries were paid during the 20.11 year:

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

6. Stationery amounting to R11 000 was used by the administrative personnel during the 20.11 year, while advertising costs amounted to R14 800.

7. 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.

8. 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.

9. Interest paid on the bank overdraft amounted to R33 300 for 20.11.

10. Rock Ltd was paid for the use of their trademark for six months during the 20.11 year at R500 per month.

11. Donations (not deductible for tax purposes) amounting to R6 000 were made to various charity organisations during the 20.11 year.

12. The non-controlling shareholders' interests in the subsidiaries' profit for the 20.11 year amounted to R45 100.

13. The normal income tax rate is 28%. 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 profit or loss and other comprehensive income of the Rock Ltd Group for the year ended 31 December 20.11. Expenses should be classified according to their *function*. All notes to the statement of profit or loss and other comprehensive income, excluding accounting policy notes, should be supplied.	19
(b) Prepare the consolidated statement of profit or loss and other comprehensive income of the Rock Ltd Group for the year ended 31 December 20.11. Expenses should the classified by their *nature*. Only the note relating to profit before tax should be supplied.	14
Please note: • Comparative figures are not required. • Ignore any Value-Added Taxation (VAT) implications. • Your answer must comply with International Financial Reporting Standards (IFRS).	

QUESTION 3.1 - Suggested solution

(a) Classification of expenses by function

ROCK LTD GROUP

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.11

	Note	R	
Revenue		2 311 200	(½)
Cost of sales [C1]		(1 046 600)	(3)
Gross profit		1 264 600	
Other income [(500 x 6) + 7 000]		10 000	(1½)
Distribution costs [C2]		(147 800)	(2)
Administrative expenses [C3]		(113 000)	(1½)
Other expenses		(6 000)	(½)
Finance costs		(33 300)	(½)
Share of profit of associates		150 000	(½)
Profit before tax	2	1 124 500	
Income tax expense [C4]	3	(274 876)	(½)
PROFIT FOR THE YEAR		849 624	
Profit attributable to:			
- Owners of the parent (balancing figure)		804 524	(½)
- Non-controlling interests (given)		45 100	(½)
		849 624	

COMMENT

1. Note that the allocation of costs between the different functions is, in some instances, subjective. (It could, for instance, be debated that advertisement costs represent administrative or other costs rather than distribution costs.) Consequently, IAS 1.103 states that cost of sales should be disclosed separately from other costs as a minimum requirement. In this question, it would therefore be acceptable to combine distribution costs, administrative expenses and other expenses in one line- item (i.e. other expenses). Cost of sales must, however, be shown separately.

2. Also note that the line-item ‘other income’ includes both operating income and investment income.

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.

ROCK LTD GROUP

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.11

2. Profit before tax

The following items are included in profit before tax:

	R	
Income		
Dividends received – unlisted (IAS 18.35(b)(v))	7 000	(½)
Expenses		
Depreciation on property, plant and equipment		
(54 300 + 26 700 + 8 200) (IAS 16.75(a); IAS 1.104)	89 200	(½)
Donations (IAS 1.112(c))	6 000	(½)
Employee benefit expense (67 800 + 84 200 + 93 800) (IAS 1.104)	245 800	(½)

COMMENT

Note that IAS 1.104 requires that when expenses are classified by function, total depreciation, amortisation and employee benefit expenses should be disclosed in a note.

3. Income tax expense

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

Tax rate reconciliation

Accounting profit	1 124 500	
Tax at 28%	314 860	(½)
Tax effect of non-deductible/non-taxable items:		
- Depreciation on office buildings (8 200 x 28%)	2 296	(½)
- Donations (6 000 x 28%)	1 680	(½)
- Dividends received (7 000 x 28%)	(1 960)	(½)
- Share of profit of associates (150 000 x 28%)	(42 000)	(½)
Income tax expense	274 876	
	Total	(19)

(b) Classification of expenses by nature

ROCK LTD GROUP

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.11

	Note	R	
Revenue		2 311 200	(½)
Other income [(500 x 6) + 7 000]		10 000	(1)
Changes in inventories of finished goods and work in progress [C5]		12 300	(1½)
Raw materials and consumables used [C6]		(936 800)	(3)
Employee benefit expense (67 800 + 84 200 + 93 800)		(245 800)	(1½)
Depreciation and amortisation expense (54 300 + 26 700 + 8 200)		(89 200)	(1½)
Other expenses [C7]		(53 900)	(2)
Finance costs		(33 300)	(½)
Share of profit of associates		150 000	(½)
Profit before tax	2	1 124 500	
Income tax expense [C4]	3	(274 876)	(½)
PROFIT FOR THE YEAR		849 624	
Profit attributable to:			
- Owners of the parent (balancing figure)		804 524	(½)
- Non-controlling interests (given)		45 100	(½)
		849 624	

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.11

2. Profit before tax

The following items are included in profit before tax:

Income		
Dividends received – unlisted (IAS 18.35(b)(v))	7 000	(½)
	Total	(14)

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	(94 800)	[½]
	1 046 600	
		[3]

C2. Distribution costs

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

C3. Administrative expenses

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

C4. Taxation

Profit before tax	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	(150 000)	[½]
Taxable profit	981 700	
Current tax at 28%	274 876	[½]
		[3]

C5. Change in inventory levels

Opening inventories (28 900 + 25 600)	(54 500)	[½]
Closing inventories (35 600 + 31 200)	66 800	[½]
Increase in inventories results in an increase in profit	12 300	[½]
		[1½]

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)	(28 000)	[1]
Consumed during the year	936 800	
		[3]

C7. Other operating expenses

Stationery utilised	11 000	[½]
Delivery costs	22 100	[½]
Advertising costs	14 800	[½]
Donations	6 000	[½]
	53 900	
		[2]

QUESTION 3.2 (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**	**Aging completed**	**Cost**	**Market value**
			R	**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
			2 354 000	4 690 000

(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**	**Market value**
	R	**R**
Variety of white wines	500 000	630 000
Rosé and blush wines	450 000	575 000
	950 000	1 205 000

(c) Investment wines

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 Dumand increases, rather than decreases, when the price thereof rises.

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

Mr Tage is known for his prestigious collection of investment wines which has been collected over many years. It is only a rare few 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.	4
ii. The disclosure of the line item itself.	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 International Financial Reporting Standards (IFRS).	

QUESTION 3.2 - 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		7 904	
		Total	(6)
		Communication skills: presentation and layout	(2)

(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
- an operating cycle which exceeds twelve months, for the wines which need to mature before they are sold. (1)

According to IAS1.66 (a), 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. Note E7 to this paragraph indicates that the wording "operating cycle" should be read in both the singular and the plural and that it is the nature of inventories in relation to the operating cycle that is relevant to classification (current versus non-current). (1)

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

ii. Disclosure of items:

Investment wines

IAS 1.57(b) 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)

COMMENT

Additional information will be provided in the notes to the financial statements.

If Vintage Ltd was also the owner of other investments, then the company would have separately disclosed the investment in wines on the face of the statement of financial position, due to its nature and size in accordance with IAS1.57 (a) (refer below).

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 IAS 1.57(a) requires disclosure of further information. (1)

IAS 1.57(a) indicates that line items are included in the statement of financial position if the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position. (1)

It is not customary for wine traders to sell wine only after it has matured. 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, IAS 1.65 indicates that the expected dates of realisation of assets and liabilities are useful information in assessing the liquidity and solvency of an entity. Thus, an entity will disclose the amount of inventories that are expected to be recovered more than twelve months after the reporting period. (1)

Total (10)

Communication skills: layout and conclusion (2)

CALCULATIONS

C1. Inventory

Twelve-month operating cycle

Description	**Aging completed**	**Cost** R	**Total**	
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]
		2 354 000	917 000	
Variety of white wines			500 000	[½]
Rose and blush wines			450 000	[½]
			1 867 000	

Operating cycle more than twelve months

Description	**Aging completed**	**Cost** R	**Total**	
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]
		2 354 000	1 437 000	

LEARNING UNIT 4 – INVENTORIES

INTRODUCTION

Inventory usually comprises a major component of an entity's current assets. It's initial and subsequent recognition, measurement and disclosure can have a substantial impact on the presentation of the financial position and results of operations of an entity. The Standard therefore lays down requirements for:

- the determination of the carrying amount of inventory, and
- the presentation of useful and understandable information in respect of inventory in the financial statements

OBJECTIVES/OUTCOMES

After you have studied this learning unit, you should be able to do the following:

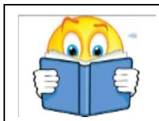
1. Determine the amount of cost in respect of inventories to be recognised as an asset and the amount carried forward until the related revenues are recognised.

2. Determine the cost of sales recognised in the statement of profit or loss and other comprehensive income.

3. Determine any write-down to net realisable value and any reversal of the write-down.

4. Use the different cost allocation techniques and cost formulas to assign costs to inventories.

5. Disclose all information in respect of inventory in the financial statements.



PRESCRIBED STUDY MATERIAL

The following **must** be studied before you attempt the questions in this learning unit:

1. IAS 2 *Inventories.*

INDEX

Overview of IAS 2

	Inventories	SAICA Level	Learning unit section
Definitions	**Definitions** Inventories are assets: • held for sale in the ordinary course of business • in the process of production for such sales; or • in the form of materials or supplies to be consumed in the production process or in the rendering of services Net realisable value Fair value	Level 3	4.2
Measurement	**Cost** Purchase price Conversion cost Other cost Deferred settlement Service provider	Level 3	4.3
	Cost formulas Specific identification First-in-first-out (FIFO) Weighted average cost	Level 3	4.3
	Net realisable value Write-down item by item or group by group Estimates of net realisable value Firm sale commitment, NRV is contract price Raw materials not written below cost Reversal of NRV write-down	Level 3	4.3
Recognition as an expense	Recognition as an expense	Level 3	4.4
Disclosure	Disclosure	Level 3	4.5

4.1 Scope (Level 1)

Refer to IAS 2.2 – 2.5.

4.2 Definitions (Level 3)

Refer to IAS 2.6. – 2.8.

4.3 Measurement of inventories (Level 3)

Refer to IAS 2.9 – 2.33.

Example

Company A purchased inventory from Company B on 1 February 20.12 at a cost of R5 000 000 and took delivery of the goods on 28 February 20.12. Company B agreed to defer settlement of the purchase price to 31 October 20.12, which is 6 months beyond normal settlement terms of two months from delivery date. Company B took a market related interest rate at 14% per annum, monthly compounded, into consideration in determining the cost price of the inventory for Company A. Company A has a 31 December year end. Company A settled the purchase price on 31 October 20.12.

REQUIRED	
(a)	Discuss whether IAS 2.18 is applicable in this situation.
(b)	Calculate the cost price of the inventory and the financing element, if any, that should be recognised in the books of Company A, in terms of IAS 2.18.
(c)	Provide the journal entries to account for the inventory transaction for the financial year ended 31 December 20.12. Narrations are required.
(d)	How would the journal entries in (c) change if Company A has a 30 September year end.

EXAMPLE 1 - Suggested solution

(a) IAS 2.18 states that inventory may be purchased on deferred settlement terms, and that the financing element contained in the agreement is then recognised as interest over the financing period.

Deferred settlement terms:

Company A purchased inventory on 1 February 20.12 and took delivery of the goods on 28 February 20.12. Normal credit terms is payment made two months after delivery date, ie. 30 April 20.12. Company B, however, agreed to a 31 October 20.12 settlement date, which is six months **beyond** normal credit terms.
This constitutes deferred (8 months) settlement terms.

Financing element

Company B took an interest rate of 14% per annum, monthly compounded, into consideration to determine the purchase price of the inventory for Company A.

There is a financing element contained in the agreement.

IAS 2.18 is therefore applicable to this transaction.

(b) Calculation of cost price and financing element

	R
Cash price	5 000 000
Interest [C2]	(443 090)
Cash price equivalent [C1]	4 556 910

(c) Journal entries

		Dr R	Cr R
	1 February 20.12		
J1	Inventory (SFP) [(b)]	4 556 910	
	Trade payables - Company B (SFP)		4 556 910
	Purchase of inventory on deferred credit terms		
	31 October 20.12		
J2	Finance charges (P/L) [C2]	443 090	
	Trade payables – Company B (SFP)		443 090
	Recognition of financing element over financing period		
J3	Trade payables - Company B (SFP)	5 000 000	
	Bank (SFP)		5 000 000
	Settlement of creditor		

(d) Journal entries if Company A has a 30 September year end

		Dr R	Cr R
	1 February 20.12		
	No change		
	30 September 20.12- Year end		
J1	Finance charges (P/L) [C3]	385 429	
	Trade payables – Company B (SFP)		385 429
	Recognition of financing element over financing period		
	31 October 20.12		
J2	Finance charges (443 090 [C2] – 385 429 [C3]) (P/L)	57 661	
	Trade payables – Company B (SFP)		57 661
	Recognition of financing element over financing period		
	Settlement of creditor - no change		

CALCULATIONS

C1.

SHARP EL-733A		**SHARP EL-738**		**HPB11**	
1. 5 000 000	FV	1. 1 2nd F 1/Y	(1 P/Y)	1. 1 2nd F	(1 P/Y)
2. 14/12	I	2. 5 000 000	FV	2. 5 000 000	FV
3. 8	N	3. 14/12	I/YR	2. 14/12	I/YR
4. COMP PV ⇒	R4 556 910	4. 8	N	3. 8	N
		5. COMP PV ⇒	R4 556 910	4. PV ⇒	R4 556 910

C2.

SHARP EL-733A	SHARP EL-738		HPB11	
1. 1 P_1/P_2	1. AMRT	1 ENT	1. 1	INPUT 8
2. 8 P_1/P_2	ϖ	8 ENT	2. 2nd F FV	(AMORT)
3. ACC, ACC = 443 089,71	2. ϖϖϖ	443 089,71	3.	443 089,71

C3.

SHARP EL-733A	SHARP EL-738		HPB11	
1. 1 P_1/P_2	1. AMRT	1 ENT	1. 1	INPUT 7
2. 7 P_1/P_2	ϖ	7 ENT	2 2nd F FV	(AMORT)
3. ACC, ACC = 385 429,08	2. ϖϖϖ	385 429,08	3.	385 429,08

4.4 Recognition as an expense (Level 3)

Refer to IAS 2.34 – 2.35.

4.5 Disclosure (Level 3)

Refer to IAS 2.36 – 2.39.

ADDITIONAL QUESTIONS

QUESTION 4.1 (37 marks)

Motoro Ltd, a motor vehicle manufacturer and dealer, is in the process of preparing its financial statements for the year ended 31 December 20.12.

The following extract was taken from the trial balance as at 31 December 20.12:

	R'000
Sales	1 800 000
Purchases – raw materials (components)	300 000
Purchases – second-hand vehicles	32 360
Labour costs – hourly paid employees	
Factory staff	360 000
Administration and selling staff	100 000
Salaries and commissions	
Factory staff	140 000
Administrative and sales staff	285 000
Depreciation	159 000
Interest paid	128 000
Dividends received	49 000
Other expenses	121 000
Retained earnings as at 31 December 20.11	320 000

Manufacturing process

The normal capacity of the factory is 10 000 motor vehicles per year. As a result of significant labour stayaways during the second half of the year, actual production for the year was 80% of normal production levels. The company has a "no work no pay" policy for employees paid at hourly rates. Staff members paid salaries on a monthly basis did not take part in the stayaways.

Inventories as at 31 December	**20.11** **R'000**	**20.12** **R'000**
Raw materials, at cost	15 000	24 500
Work in progress, at cost	80 000	See note 1

Note 1: The company values spare parts, raw materials and work in progress on a FIFO basis.

The cost of work in progress on 31 December 20.12 has not yet been calculated. Detailed production records indicate that only 24% of this year's allocated production expenditure and material used (you may assume that there were no raw material spillages which incurred during the year), relate to motor vehicles that were still under production at the year end. The Dumand for the product is so high that all manufactured vehicles are sold as soon as the production process is completed.

Dealerships

The following information relates to second-hand vehicles traded:

Motor vehicle number	**Date of purchase**	**Purchase price (excluding VAT)**	**Date of sale**	**Estimated selling price at year end (excluding VAT)**	
				20.11	**20.12**
		R'000		**R'000**	**R'000**
216	30/10/20.11	80	-	70	80
217	30/04/20.11	110	30/06/20.12	130	-
218	30/11/20.11	160	-	180	170
219 – 425	During 20.12	32 000	During 20.12	-	-
426	30/06/20.12	155	-	-	170
427	25/11/20.12	205	-	-	250

The only second-hand motor vehicle inventories on hand as at 31 December 20.11 were vehicle numbers 216, 217 and 218.

Sales staff earn a commission of 10% of the selling price.

Accounts receivable

The debtors listing reflected accounts receivable of R125 million on 31 December 20.11 and R226 million at 31 December 20.12. The allowance for credit losses was R11 million at 31 December 20.11 and R21 million at 31 December 20.12. In terms of the Income Tax Act section 11(j), the South African Revenue Services (SARS) grants a doubtful debt allowance amounting to 25% of the company's provision. Bad debts of R1 million were written off during the year ended 31 December 20.12. No bad debts were written off during the 20.11 year.

These costs are included in other expenses.

Property, plant and equipment

The asset clerk has finalised schedules relating to the carrying amounts and tax bases of property, plant and equipment. The information has been summarised as follows:

	Plant and machinery R'000	Office equipment R'000	Distribution vehicles R'000	Total R'000
Carrying amount				
31 December 20.11	550 000	3 000	40 000	593 000
31 December 20.12	700 000	2 000	42 000	744 000
Depreciation for 20.12	150 000	1 000	8 000	159 000
Tax base				
31 December 20.11	450 000	3 000	40 000	493 000
31 December 20.12	550 000	2 000	42 000	594 000
Capital deductions for 20.12	200 000	1 000	8 000	209 000

Depreciation is written off on the straight-line basis over the useful life of the assets. Distribution vehicles are used to transport manufactured inventory to customers.

Additional information

There are no temporary differences other than those arising from the information presented above. The normal income tax rate is 28%. Ignore any Value-Added Taxation (VAT) implications.

REQUIRED	**Marks**
(a) Prepare the journal entries to recognise the cost of sales for the year ended 31 December 20.12. **Please note:** • Journal narrations are not required.	21
(b) Calculate the deferred tax balance for Motoro Ltd as at 31 December 20.12. **Please note:** • Deferred tax should be calculated by using the statement of financial position method.	4
(c) Prepare the statement of profit or loss and other comprehensive income of Motoro Ltd for the year ended 31 December 20.12. **Please note:** • Comparative figures are not required. • Round off all amounts to the nearest Rand. • Your answer must comply with International Financial Reporting Standards (IFRS).	12

QUESTION 4.1 - Suggested solution

(a)

		Dr R'000	Cr R'000	
J1	Cost of sales (P/L)	982 360		(½)
	Purchases - raw materials (P/L)		300 000	(½)
	Labour costs - factory staff (P/L)		360 000	(½)
	Salaries - factory staff (P/L)		140 000	(½)
	Depreciation - plant and machinery (P/L)		150 000	(½)
	Purchases - second hand vehicles (P/L)		32 360	(½)
	Transfer of purchases to cost of sales			
J2	Cost of sales (P/L)	95 333		(½)
	Inventory - raw materials (SFP)		15 000	(½)
	Inventory - work-in-progress (SFP)		80 000	(½)
	Inventory - second hand vehicles [C1] (SFP)		333	(2½)
	Transfer of opening inventory to cost of sales			
J3	Inventory - raw materials (SFP)	24 500		(½)
	Cost of sales (P/L)		24 500	(½)
	Recognising raw materials at year end			
J4	Inventory – work-in-progress [C2] (SFP)	211 800		(6)
	Cost of sales (P/L)		211 800	(½)
	Recognising work-in-progress at year end			
J5	Inventory - second hand vehicles [C3] (SFP)	583		(2)
	Cost of sales (P/L)		583	(½)
	Recognising the closing balance of second-hand vehicles on hand			
J6	Cost of sales	9		(½)
	Inventory second-hand vehicles: no 218 (160 – 153)		7	(1)
	no 426 (155 – 153)		2	(1)
	Write-down of inventory to NRV			
J7	Inventory second-hand vehicles no 216 (63 – 72)	9		(1)
	Cost of sales		9	(½)
	Reversal of inventory write-down			
			Total	(21)

(b) Deferred taxation

	Carrying amount R'000	Tax base R'000	Temporary difference R'000	Deferred tax at 28% assets/ (liability) R'000	
20.11					
Allowance account for credit losses	(11 000)	(2 750)[a]	(8 250)	2 310	(1)
Plant and machinery	550 000	450 000	100 000	(28 000)	(1)
Deferred tax liability			91 750	(25 690)	
20.12					
Allowance account for credit losses	(21 000)	(5 250)[a]	(15 750)	4 410	(1)
Plant and machinery	700 000	550 000	150 000	(42 000)	(1)
Deferred tax liability			134 250	(37 590)	
				Total	(4)

[a] 20.12: (21 000 x 25%) = 5 250
20.11: (11 000 x 25%) = 2 750

COMMENT

The carrying amount and tax base of the combined property, plant and equipment account may also be used instead of only the plant and machinery. The temporary difference will, however, be the same, since the carrying amounts and tax bases for the other two asset categories are equal.

(c) MOTORO LTD

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.12

	R'000	
Revenue	1 800 000	(½)
Cost of sales (982 360 + 95 333 – 24 500 – 211 800 – 583 +–9 - 9)	(840 810)	(3)
Gross profit	959 190	
Other income	49 000	
Other expenses (121 000 + 9 000* + 100 000 + 285 000))	(515 000)	(1)
Finance cost	(128 000)	(½)
Profit before tax	365 190	
Income tax expense [C4]	(88 533)	(7)
PROFIT FOR THE YEAR	276 657	
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	276 657	
	Total	(12)

* (1 000 + 8 000 depreciation on office equipment and distribution vehicles)

CALCULATIONS

C1. Opening inventory – second-hand vehicles

(Lower of cost or NRV)

	Cost R'000	NRV 20.11 R'000	Carrying amount 20.11 R'000	
216	80	63*	63	[1]
217	110	117#	110	[1]
218	160	162@	160	[½]
			333	
				[2½]

* (70 – (10% x 70))
\# (130 – (10% x 130))
@ (180 – (10% x 180))

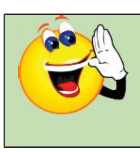
C2. Work-in-progress

	R'000	
Material (15 000 + 300 000 – 24 500) x 24%	69 720	[3]
Labour cost (360 000 x 24%)	86 400	[1]
Salaries (140 000 x 80% x 24%)	26 880	[1]
Depreciation (150 000 x 80% x 24%)	28 800	[1]
	211 800	
		[6]

C3. Closing inventory = second-hand vehicles

	Cost R'000	NRV 20.12 R'000	Carrying amount 20.12 R'000	
216	63	72*	72	[½]
218	160	153#	153	[½]
426	155	153#	153	[½]
427	205	225@	205	[½]
			583	
				[2]

* (80 000 – (10% x 80 000))
\# (170 000 – (10% x 170 000))
@ (250 000 – (10% x 250 000))



COMMENT

The reversal of the write-down to net realisable value on second-hand vehicle 216 is limited to the original cost of R80 000.

C4. Tax calculation

Profit before tax	365 190	
Dividends received	(49 000)	[1]
Taxable temporary differences (91 750 – 134 250) (refer (b))	(42 500)	[4]
Taxable income	273 690	
Current taxation (273 690 x 28%)	76 633	[1]
Deferred taxation (37 590 – 25 690) (refer (b))	11 900	[1]
	88 533	
		[7]

C5. Closing balances (Alternative calculation)

Description	Raw materials R'000	WIP R'000	Finished products R'000	Second-hand vehicles R'000	
Opening balances	15 000	80 000	-	**[C1]**	333 000
				216	63 000
				217	110 000
				218	160 000
Purchases	300 000				32 360 000
Overheads					
Fixed					
Salaries (140 000 x 80%)		112 000			
Depreciation (150 000 x 80%)		120 000			
Variable		360 000			
To WIP (balancing)	(290 500)	290 500			
To finished products (balancing)		(750 700)	750 700		
Vehicles written off to net realisable value					(9)
Reversal of vehicle inventory write-down					9
Sold			(750 700)	217	(110 000)
				219-425	(32 000 000)
Closing Balances	**24 500**	**211 800**	**-**		**583 000**
	Given	**[C2]**	**Given**		**[C3]**

QUESTION 4.2 (22 marks)

The accountant of one of your clients approached you with the following questions regarding inventory to be included in the financial statements for the year ended 31 December 20.12.

(a) During the 20.12 financial year, the company was approached by a customer to manufacture a product for a specific purpose. As this product was completely different from the products produced by the company at this stage, it was necessary to appoint a consultant to design the product.

The consultant's fees amounted to R350 000. This is a once-off order and, at year end, the product was 40% complete at a production cost of R8 000 000. The accountant wants to know whether he can include the R350 000 in the carrying amount of inventory at year end.

(b) From the beginning of the current year, the company has been manufacturing product A. The normal production level is 200 000 units per annum and variable costs are R1,50 per unit. The fixed production overhead cost for the year was R500 000 and was debited to "fixed overhead control account". The variable overhead costs were debited to the "variable overhead control account". The actual production was 170 000, of which 150 000 units were sold. The accountant requests you to prepare the journal entries to account for inventory and cost of sales.

(c) With reference to (b), the accountant also asks that you show the journal entries requested in (b) if the actual production was 220 000 units.

(d) Included in inventory at year end are raw materials which were delivered by airfreight. The cost of delivery was R300 000 more than the normal delivery cost but had to be incurred to avoid a halt in production. The accountant wants to know whether this R300 000 can be included in the cost of inventory.

(e) At year end, an amount of R55 000 was written off as a result of net realisable value being less than cost. The accountant wants to know how this R55 000 should be accounted for in the 20.12 financial statements.

<table>
<tr><th>REQUIRED</th><th>Marks</th></tr>
<tr><td>Answer all of the accountant's questions and provide reasons for your answers, as well as calculations (if applicable).

Please note:

• Journal narrations are not required.
• Ignore any normal income tax implications.
• Ignore any Value-Added Taxation (VAT) implications.
• Your answer must comply with International Financial Reporting Standards (IFRS).</td><td>22</td></tr>
</table>

QUESTION 4.2 - Suggested solution

(a) Yes, the R350 000 can be added to the R8 000 000 production cost. In terms of IAS 2.15, other cost of inventories to the extent that they are incurred in bringing the inventories to their present location and condition must be included in the cost of inventory. The cost of designing products for specific customers is cited as an example of such non-production overheads and it can, therefore, be added to the cost of inventory at year end. (3)

(b) **Journal entries**

		Dr R	**Cr R**	
J1	Inventories (170/200 x 500 000) (SFP)	425 000		(1)
	Cost of sales (30/200 x 500 000) (P/L)	75 000		(1)
	Fixed overhead control account (SFP)		500 000	(1)
	Allocation of fixed production overheads			
J2	Inventory (170 000 x R1,50) (SFP)	255 000		(1)
	Variable overhead control account (SFP)		255 000	(1)
	Allocation of variable costs			
J3	Cost of sales [150/170 x (425 000 + 255 000)/1] (P/L)	600 000		(1½)
	Inventory (SFP)		600 000	(1)
	Transfer cost of inventory sold to cost of sales			

Alternative journals

		Dr R	**Cr R**	
J1	Cost of sales (P/L)	500 000		(1)
	Fixed overhead control account (SFP))		500 000	(1)
	Allocation of fixed production overheads to cost of sales			
J2	Cost of sales (P/L) (170 000 x R1,50)	255 000		(1)
	Variable overhead control account (SFP)		255 000	(1)
	Allocation of fixed production overheads to cost of sales			
J3	Inventory (SFP) (20/170 x [(170/200 x 500 000) + 255 000]	80 000		(2½)
	Cost of sales (P/L)		80 000	(1)
	Transfer closing balance to inventory			

COMMENT

In this question, the entity uses control accounts to allocate all production costs until it is known where these overhead costs will be allocated to (capitalised or expensed).

The alternative journals indicate the allocation of all costs to cost of sales, whereafter only the closing inventory balance is transferred to inventory.

(c) Journal entries

		Dr R	Cr R	
J1	Inventory ((500 000 ÷ 220 000) x 220 000) (SFP)	500 000		(1)
	Fixed overhead control account (SFP)		500 000	(1)
	Allocation of fixed production overhead costs			
J2	Inventory (220 000 x R1,50) (SFP)	330 000		(1)
	Variable control account (SFP)		330 000	(1)
	Allocation of variable costs			
J3	Cost of sales [150/220 x (500 000 + 330 000)] (P/L)	565 909		(1½)
	Inventories (SFP)		565 909	(1)
	Transfer of inventories sold to cost of sales			

(d) The R300 000 additional cost is excessive and may not be included in inventory. In this instance, the test of net realisable value needs to be considered specifically (IAS 2.16(a)). (2)

(e) In terms of par 34 of IAS 2, any write-down of inventories to net realisable value shall be recognised as an expense in the period the write-down occurs, and IAS 2 par 36 (e) requires that the amount of such a write-down should be disclosed. Furthermore, the carrying amount of the inventory, which is carried at fair value less cost to sell must be disclosed separately (IAS 2.36(c)). (3)

Total (22)

LEARNING UNIT 5 – 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.

OBJECTIVES/OUTCOMES

After you have studied this learning unit, you should be able to do the following:

1. Identify the objective of IAS 12 and be able to apply IAS 12.

2. Understand and apply the following definitions:

   (a) Tax base of assets and liabilities;
   (b) Taxable and deductible temporary differences; an
   (c) Deferred tax assets and liabilities.

3. Understand and calculate current tax.

4. Understand and calculate deferred tax by:

   (a) Calculating the tax base of assets and liabilities,
   (b) Calculating the temporary differences for each asset and liability,
   (c) Calculating the movements in temporary differences and deferred tax.

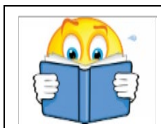
5. Understand and calculate the implications of tax losses (recognised and unrecognised) on current and deferred tax.

6. Calculate and recognise the income tax line in the statement of profit or loss and other comprehensive income.

7. Disclose the income tax expense in the notes to the statement of profit or loss and other comprehensive income.

8. Calculate and recognise all tax balances for the statement of financial position, for example, the deferred tax balance and tax payable.

9. Disclose income tax and deferred tax in the notes to the financial statement



PRESCRIBED STUDY MATERIAL

The following **must** be studied before you attempt the questions in this learning unit:

1. IAS 12 *Income Taxes.*

2. FRG 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.*

INDEX

Overview of IAS 12

	Income Taxes	SAICA Level	Learning unit section
Definitions	**Definitions** Accounting profit Taxable profit (tax loss) Tax expense (tax income) Current tax Deferred tax liabilities Deferred tax assets Taxable temporary differences Deductible temporary differences Tax base	Level 3	5.2
Recognition	**Current tax liabilities and current tax assets** Unpaid tax expense recognised as liability If amount paid exceeds amounts due, excess is recognised as an asset	Level 3	5.3
	Deferred tax liabilities and deferred tax assets Taxable temporary differences Deductible temporary differences Unused tax losses and used tax credits Reassessment unrecognised deferred tax assets	Level 3	5.4
	Current and deferred tax Recognised to profit or loss Recognised outside profit or loss Shared based payments	Level 3	5.5
Measurement	**Measurement** Tax rates to be used for current and deferred tax Manner of recovery of non-depreciable assets using the revaluation model in IAS 16 Manner of recovery on non-depreciable assets using the revaluation model of IAS 40 Deferred tax assets and liabilities shall not be discounted Review of deferred tax assets at end of each reporting period	Level 3	5.6

	Income Taxes	SAICA Level	Learning unit section
Presentation and disclosure	**Presentation**	Level 3	5.7
	Offsetting of current tax assets and current tax liabilities Offsetting of deferred tax assets and deferred tax liabilities Tax expense or tax income related to profit or loss from ordinary activities		
	Disclosure	Level 3	5.8
	Major components of tax expense (income) shall be disclosed separately List of separate disclosures Disclosure required for a deferred tax asset Other disclosure	Excluded	

2. **The principles of examination of IAS 12 are at Level 3 to the extent that it supports transactions or topics included in both the financial accounting and tax syllabus, or when students are given the tax treatment.**

The following paragraphs in IAS 12 are **excluded** from the syllabus:

- Paragraphs 38 to 45 relating to group temporary differences
- Paragraphs 52A and B
- Paragraph 68 relating to equity-settled share-based payments, and
- Disclosures required by paragraphs 82A to 88

The principles of examination of FRG1 is at **level 3**.

5.1 Scope (Level 1)

Refer to IAS 12.1 – 12.4

5.2 Definitions (Level 3)

Refer to IAS 12.5. – 12.11.

5.3 Recognition of current tax liabilities and current tax assets (Level 3)

Refer to IAS 12.12 – 12.14.

5.4 Recognition of deferred tax liabilities and deferred tax assets (Level 3)

Refer to IAS 12.15 – 12.45

Example

Land measured using the revaluation model in IAS 16

The accounting profit before tax for the year ended 31 December 20.12 is R500 000. Included in the accounting profit before tax are dividends received of R10 000 that are not taxable and a penalty of R15 000 that is not deductible for tax purposes. Prepaid expenses on 31 December 20.11 amounted to R40 000 and R30 000 on 31 December 20.12. Both these prepaid expense balances were tax deductible in the years in which the expenses were incurred, in accordance with section 23H of the Income Tax Act.

Deasy Ltd acquired land in Midrand for R1 000 000 on 1 January 20.11 and plans to construct a factory thereon. For the financial year ended 31 December 20.11, the land was measured using the cost model of IAS 16. In 20.12 Deasy Ltd changed its accounting policy to the revaluation model in IAS 16. The land was revalued to R1 200 000 on 31 December 20.12. The revaluation surplus before taxation amounted to R200 000. The deferred tax relating to the revaluation surplus amounted to R44 800.

The deferred tax balance as at 31 December 20.10 was Rnil. There were no temporary differences on 31 December 20.11 or on 31 December 20.12, other than those arising from the information provided above.

CALCULATIONS

C1.	**Current tax**	**20.12** **R**
	Profit before tax	500 000
	Non-taxable/non-deductible items:	
	Dividends received not taxable	(10 000)
	Fine not deductible	15 000
	Taxable profit before temporary differences	505 000
	Movement in temporary differences (reversal of taxable) [C2]	10 000[1]
	Taxable profit	515 000
	Tax at 28%	144 200

C2.	Deferred tax	Carrying amount	Tax base	Temporary difference at 100% or 80%	Deferred tax at 28% asset/ (liability)
		R	R	R	R
	31 December 20.11				
	Prepaid expenses	40 000	-[1]	40 000	(11 200)
	Land in Midrand	1 000 000	1 000 000[2]	-[2]	-
	Deferred tax liability			40 000	(11 200)
	31 December 20.12				
	Prepaid expenses	30 000	-[1]	30 000	(8 400)
	Land in Midrand (through OCI) (200 000 x 80%)	1 200 000	1 000 000	160 000[3]	(44 800)[3]
	Net deferred tax liability			190 000	(53 200)
	Movement in temporary differences (through P/L)			(10 000)[4]	2 800
	Movement in temporary differences (through OCI)			160 000	(44 800)

[1] Section 23H of the Income Tax Act limits the tax deductibility of prepaid expenses, however, since these expenses fall within the R100 000 exclusion provided in section 23H, the total expense will be tax deductible in the financial year in which the expense was incurred. The tax base of these prepaid expenses (i.e., the amount that is tax deductible in future) is Rnil, since the expenses have been deducted for tax purposes, even though they have been capitalised to be expensed at a later stage for accounting purposes.

[2] Land at cost model:
Kindly refer to IAS12.BC6 which contains the following –
Recognition of depreciation implies that the carrying amount of a depreciable asset is expected to be recovered through use to the extent of its depreciable amount, and through sale at its residual value. Consistent with this, the carrying amount of a non-depreciable asset, such as land having an unlimited life, will be recovered only through sale. In other words, because the asset is not depreciated, no part of its carrying amount is expected to be recovered (i.e. consumed) through use.
Therefore, the tax base would then be equal to the base cost for CGT purposes, as this amount will be allowed as a deduction against the proceeds from the sale when calculating the capital gain on disposal.

[3] In accordance with IAS 12.47, deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised, or the liability is settled. The deferred tax on the temporary difference on revalued land is therefore raised at the CGT inclusion rate of 80% which is, thereafter, taxed at 28%.

[4] The movement in temporary differences excludes items that do not affect P/L. As a result, the revaluation of the land (which affects OCI) is **not** included in the movement in temporary differences disclosed in the income tax expense note. Note that the movement in temporary differences of R10 000 is a **reversal** of the taxable temporary difference related to prepaid expenses from R40 000 to R30 000 which is **added** to the taxable profit. It has the same effect as a deductible temporary difference.

Example

Deferred tax on items carried at fair value through profit or loss

The accounting profit before tax for the year ended 31 December 20.12 is R500 000. Included in the accounting profit before tax are dividends received of R10 000 that are not taxable and a penalty of R15 000 that is not deductible for tax purposes.

On 1 January 20.11, Deasy Ltd acquired shares in Cappy Ltd as a long-term investment. The shares are carried in terms of IFRS 9 at fair value through profit or loss. The shares were acquired for R800 000, and transaction costs were R20 000. The fair value of the shares was R920 000 on 31 December 20.11 and R990 000 on 31 December 20.12. Assume that the investment in shares is subject to Capital Gains Tax (CGT) and that transaction costs are included in base cost of the shares for CGT purposes.

Deasy Ltd acquired new machinery on 1 January 20.12 for R300 000, which is depreciated over four years on the straight-line basis (the residual value is Rnil). The depreciation has been included in the accounting profit before tax. In terms of the Income Tax Act, the South African Revenue Services (SARS) allows a section 12C allowance of 40% in the first year and 20% per year for the subsequent three ross. This allowance is not apportioned for part of a year.

The deferred tax balance as at 31 December 20.10 was Rnil. There were no temporary differences on 31 December 20.11 or on 31 December 20.12, other than those that are apparent from the information provided above.

CALCULATIONS

C1.	**Current tax**	**20.12** **R**
	Profit before tax	500 000
	Non-taxable/non-deductible items:	
	Dividends received not taxable	(10 000)
	Fine not deductible	15 000
	Fair value adjustment on investment not taxable (20%)	(14 000)[1]
	Taxable profit before temporary differences	491 000
	Movement in temporary differences (taxable in future) [C2]	(101 000)
	Taxable profit	390 000
	Tax at 28%	109 200

[1] The fair value adjustment on the investment in shares on 31 December 20.12 is R70 000 (R990 000 – R920 000) and is included in P/L. 80% of this fair value adjustment will be subject to CGT in the future when the shares are sold. The balance of 20% will never be taxable and is therefore a non-taxable item in the tax rate reconciliation.

C2. Deferred tax	**Carrying amount**	**Tax base**	**Temporary difference at 100% or 80%**	**Deferred tax at 28% asset/ (liability)**
	R	**R**	**R**	**R**
31 December 20.11				
Investment in shares (100 000 x 80%)	920 000	820 000	80 000	(22 400)
Deferred tax liability			86 000	(22 400)
31 December 20.12				
Investment in shares (170 000 x 80%)	990 000	820 000	136 000	(38 080)
Machinery	225 000	180 000	45 000	(12 600)
Deferred tax liability			181 000	(50 680)
Movement in temporary differences (through P/L) (taxable) (181 000 – 80 000); (50 680 – 22 400)			101 000	(28 280)

5.5 Recognition of current and deferred tax (Level 1)

Refer to IAS 12.57 – 12.68C.

5.6 Measurement (Level 1)

Refer to IAS 12.46 – 12.56.

5.7 Presentation (Level 1)

Refer to IAS 12.69 – 12.78.

5.8 Disclosure (Level 1)

Refer to IAS 12.79 – 12.88.

Example

Deasy Ltd which has a 31 December financial year end. The normal income tax rate is 28% and the inclusion rate for capital gains tax (CGT) is 80%.

The accounting profit before tax for the financial year ended 31 December 20.12 is R500 000. Included in the accounting profit before tax are dividends received of R10 000 that are not taxable and a penalty of R15 000 that is not deductible for tax purposes.

Deasy Ltd raised a provision for current tax payable of R121 000 for the financial year ended 31 December 20.11. The final assessment issued by the SARS on 30 April 20.12 (relating to the financial year ended 31 December 20.11), reflected income tax payable of R126 000. Deasy Ltd accepted the assessment issued by the SARS as correct.

The income tax note to the financial statements of Deasy Ltd for the year ended 31 December 20.12 will be as follows:

DEASY LTD
NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 20.12

3.	**Income tax expense**	**20.12** **R**
	Major components of tax expense	
	SA normal tax	
	Current tax	
	-Current year [C1]	141 400
	-Underprovision for prior year –126 000 - 121 000)	5 000
		146 400
	Tax rate reconciliation	
	Accounting profit	500 000
	Tax @ 28%	140 000
	Tax effect of non-taxable items/non-deductible items:	
	- Dividends not taxable (10 000 x 28%)	(2 800)
	- Penalty not deductible (15 000 x 28%)	4 200
	Underprovision for current tax for prior year –126 000 - 121 000)	5 000[a]
	Income tax expense	146 400

[a] Note that the amount of the underprovision in the tax rate reconciliation is not multiplied by 28% as it already represents 28%.

CALCULATIONS

C1.	**Current tax**	**20.12**
	Profit before tax	500 000
	Non-taxable/non-deductible items:	
	Dividends not taxable	(10 000)
	Penalty not deductible	15 000
	Taxable profit	505 000
	Tax at 28% (505 000 x 28%)	141 400[a]

[a] The current tax of R141 400 is income tax payable to the South African Revenue Service (SARS) in respect of the taxable profit for the year ended 31 December 20.12.

THE PURPOSE OF A TAX RATE RECONCILIATION

Profit before tax of R500 000 in the statement of profit or loss and other comprehensive income multiplied by 28% is R140 000. Why is the income tax expense R146 400 and not R140 000?

The reasons are as follows:

- Included in profit before tax are dividends received that were not taxable, and
- Included in profit before tax is a penalty paid that was not deductible for tax purposes.
- The taxable profit of 20.11 (not 20.12) gave rise to the R5 000 current tax. As a result, the under provision will be a reconciling item in the tax rate reconciliation.

The reasons above are the reconciling items in the tax rate reconciliation, which provides additional information to users of the financial statements as to how the profit before tax figure and the tax expense figures are reconciled.

UNDERPROVISION RELATING TO THE PRIOR YEAR

The current tax payable that was calculated by Deasy Ltd for the financial year ended 31 December 20.11 was R121 000. The final assessment issued by the SARS reflected income tax payable of R126 000. As a result, current tax in the prior year financial statements was underprovided for by R5 000 (R126 000 – R121 000). This additional R5 000 will increase the current tax in the current year and must be paid to the SARS.

The under provision will be accounted for as follows:

	Dr	Cr
	R	R
Income tax expense (current tax) (P/L)	5 000	
Other payables: SARS (SFP)		5 000

The under provision relating to the prior year will be disclosed in the income tax expense note as an increase in current tax.

ADDITIONAL QUESTIONS

QUESTION 5.1 (26 marks)

The following information was extracted from the books and records of April Ltd for the year ended 29 February 20.12:

1. The deferred tax liability as at 28 February 20.11 was made up as follows:

	R	
Property, plant and equipment (accelerated deductions for tax purposes)	(271 150)	Cr
Contract liability (revenue received in advance)	13 340	Dr
	(257 810)	Cr

2. Profit before tax for the year ended 29 February 20.12 amounted to R735 000 and included, inter alia, the following items:

	R
Foreign income (not taxable in South Africa as tax is payable on this income at 35% in the foreign country)	132 000
Dividends received (not taxable)	175 000
Profit on sale of land (capital gain for tax purposes)	210 000
Fines and donations (not tax deductible)	700
Legal fees	
- Not tax deductible	900
- Tax deductible	1 100
Depreciation on vehicles	150 000

3. The profit on sale of land relates to land that was sold during the 20.12 financial year. The land was measured using the cost model.

4. The carrying amount of the remaining property, plant and equipment as at 29 February 20.12 was R2 550 000 and the tax base was R1 360 000. Property, plant and equipment does not include any other land (except as referred to in paragraph 3 above) or any assets which are being recovered through sale.

5. The contract liability (revenue received in advance account) in the trial balance reflected a credit balance of R62 000 on 29 February 20.12.

6. The creditor account for the South African Revenue Services (SARS) (relating to income tax) in the accounting records of April Ltd as at 29 February 20.12 was made up as follows:

	Dr/(Cr) R
Balance on 1 March 20.11 (provision in respect of 20.11 tax assessment)	(31 000)
Payments actually made in **final** settlement of 20.11 tax assessment (no interest or penalties were charged)	29 500
Provisional tax payments made in respect of 20.12	38 000
	36 500

7. The foreign tax payable account in the trial balance had a credit balance of R46 200 on 28 February 20.12. This amount of tax relates to the foreign income received of R132 000 in the financial year ended 29 February 20.12. No foreign tax was paid over during the financial year.

Additional information

1. No objection was made by April Ltd in respect of the 20.11 tax assessment. April Ltd has no unused capital losses or unused tax losses carried forward from prior years.

2. The Minister of Finance announced in March 20.11 that the tax rate decreased from 29% to 28% for financial years that started on or after 1 March 20.11. The inclusion rate for capital gains tax is 80%.

REQUIRED	**Marks**
(a) Present the abovementioned information in the statement of profit or loss and other comprehensive income (commencing from the profit before tax line) and in the statement of financial position of April Ltd for the year ended 28 February 20.12. **Please note:** Only present tax-related account balances in the statement of financial position of April Ltd for the year ended 28 February 20.12.	4
(b) Disclose the notes to the financial statements of April Ltd for the year ended 28 February 20.12 as required by IAS 12 *Income taxes*. **Please note:** • The movement in temporary differences in the current tax calculation must be calculated using the statement of financial position method. • Comparative figures are not required. • Round off all amounts to the nearest Rand. • Ignore any Value-Added Taxation (VAT) implications. • Your answer must comply with International Financial Reporting Standards (IFRS).	22

COMMENTS ON INFORMATION GIVEN IN THE QUESTION

- The provision in respect of the 20.11 assessment of R31 000 in point 6 relates to the current tax calculation that has been done for the financial year ended 28 February 20.11.
- The payments actually made in the **final** settlement of the 20.11 assessment of R29 500 represent the income tax for 20.11, per the assessment issued by the SARS.
- Point 1 in the additional information states that April Ltd did not object to the 20.11 assessment that was issued by the SARS, which means that the correct amount payable to the SARS was R29 500 and not R31 000. The current tax for 20.11 was therefore overprovided for by R1 500 (31 000 – 29 500).

QUESTION 5.1 - Suggested solution

(a) APRIL LTD

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 28 FEBRUARY 20.12

	Notes	**20.12 R**	
Profit before tax		735 000	(1)
Income tax expense	3	(144 338)	(1)
PROFIT FOR THE YEAR		590 662	(1)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		590 662	

APRIL LTD

STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.12

	Notes	**20.12 R**	
EQUITY AND LIABILITIES			
Non-current liabilities			
Deferred tax	10	315 840	(½)
Current liabilities			
Other payables:			
SARS and tax payable in foreign country (3 608 + 46 200)		49 808	(½)
		Total	(4)

OFFSETTING OF CURRENT TAX ASSETS AND LIABILITIES

Tax receivable and tax payable may only be set off against one another if there is a legally enforceable right to set off the recognised amounts (IAS 12.71-.72). The tax payable on the foreign income is payable to the tax authority of the foreign country and **not** to the SARS. As a result, the assessment issued by the SARS is separate from the tax payable in the foreign country and thus these two amounts cannot be set off against each other. If the SARS account had a debit balance at year end, then the two accounts would not have been allowed to be set off against each other. However, as the balances are both credit balances, they may be grouped together as part of other payables.

(b) APRIL LTD

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 20.12

3. Income tax expense

Major components of tax expense

	20.12 R	
SA normal tax		
Current tax	40 108	
- Current year [C1]	41 608	(5)
- Overprovision in prior year–(31 000 - 29 500)	(1 500)	(1)
Deferred tax	58 030	
- Movement in temporary differences [C2] (239 000 x 28%)	66 920	(3)
- Change in tax rate [C2]	(8 890)	(1)
SA normal tax	98 138	
Foreign tax (132 000 x 35%)	46 200	(1)
	144 338	

Tax rate reconciliation

Accounting profit	735 000	(½)
Tax at 28%	205 800	(½)
Tax effect of non-taxable/non-deductible items:		
- Dividends received not taxable (175 000 x 28%)	(49 000)	(1)
- Capital gain on sale of land not taxable (210 000 x 20% x 28%)	(11 760)	(1)
- Fines and donations not deductible (700 x 28%)	196	(1)
- Legal fees not deductible (900 x 28%)	252	(1)
Change in tax rate [C2]	(8 890)	(1)
Effect of different tax rate on foreign income (132 000 x (35% - 28%))	9 240	(1½)
Overprovision for current tax in prior year (31 000 – 29 500)	(1 500)	(½)
Income tax expense	144 338	

The income tax rate was decreased from 29% to 28% by the Minister on Finance in March 20.11 for financial years starting on or after 1 March 20.11. (IAS 12.81(d)) (1)

FOREIGN TAX IN THE TAX RATE RECONCILIATION

The foreign income is included in the accounting profit of R735 000. The foreign income is taxed at 35% (46 200 / 132 000) while tax is paid in South Africa at 28%. This additional 7% represents a reconciling item in the tax rate reconciliation.

10. Deferred tax

Analysis of temporary differences:		
Property, plant and equipment		
- Accelerated deductions for tax purposes [C2]	333 200	(1)
Revenue received in advance [C2]	(17 360)	(1)
Net deferred tax liability	315 840	
Total		(22)

CALCULATIONS

C1. Current tax

	R	
Profit before tax (given)	735 000	[½]
Non-deductible/non-taxable items:[a]		
- Dividends received not taxable	(175 000)	[½]
- Fines and donations not deductible	700	[½]
- Legal fees not deductible	900	[½]
- Foreign income not taxable in SA	(132 000)[b]	[½]
- Portion of capital gain that is not taxable: (210 000 x 20%)	(42 000)	[1]
Taxable profit before temporary differences	387 600	
Movement in temporary differences (taxable) [C2] (see comment below)	(239 000)	[1]
Taxable profit for the year	148 600	
Tax at 28%	41 608	[½]
		[5]

[a] Note that no separate adjustment as a non-deductible item is necessary for depreciation, as the movement in temporary differences of R239 000 already includes the effect of adding back depreciation and deducting the income tax capital allowances.

[b] The foreign income should be deducted from profit before tax, as it is not taxable in South Africa. The tax that was paid in the foreign country will be shown separately in the income tax expense note and, because it was taxed at 35% and not 28%, it will cause a reconciling item in the tax rate reconciliation for the difference of 7%.

MOVEMENT IN TEMPORARY DIFFERENCES

A **taxable** temporary difference will only be **taxable in future** and will result in a tax liability payable to the SARS in future. In the current year, this taxable temporary difference is not taxable and must be **deducted** from the taxable profit.
A **deductible** temporary difference will only be **deductible in future** and will result in a tax saving in future. In the current year, this deductible temporary difference is not deductible and must be **added** to the taxable profit.

C2. Deferred tax

28 February 20.11	**Carrying amount**	**Tax base**	**Temporary difference**	**Deferred tax asset/ (liability) 29%**	
	R	**R**	**R**	**R**	
Property, plant and equipment	?	?	[a]935 000	(271 150)	[½]
Contract liability (revenue received in advance)	(46 000)	[c]–	[b](46 000)	13 340	[½]
Net deferred tax liability at 29%			889 000	(257 810)	
Change in tax rate (889 000 x 1%) or (257 810 x 1/ 29)				8 890	[1]
Net deferred tax liability at 28%				(248 920)	
29 February 20.12				**28%**	
Property, plant and equipment	2 550 000	1 360 000	1 190 000	(333 200)	[1]
Contract liability (revenue received in advance)	(62 000)	[d]–	(62 000)	17 360	[1]
Net deferred tax liability			1 128 000	(315 840)	
Movement in temporary differences (taxable) (1 128 000 – 889 000); (315 840 – 248 920)			[e]239 000	(66 920)	
					[4]

[a] 271 150 (given) / 29% = 935 000
[b] 13 340 (given) / 29% = 46 000

[c] The tax base of revenue received in advance is the carrying amount minus amounts NOT taxable in future (46 000 – 46 000 = 0). The revenue received in advance is taxed in the financial year ended 29 February 20.11 and will not be taxable again in future.
[d] 62 000 – 62 000 = 0 (refer to note c)
[e] The deferred tax liability **increases** for the year ended 29 February 20.12 which means that the movement in temporary differences is **taxable**.

C3. Creditor account for the SARS

The overprovision of R1 500 is corrected by passing the following journal:

	Dr	**Cr**
	R	**R**
Other payables: SARS (SFP)	1 500	
Income tax expense (current tax) (P/L)		1 500

The current tax for the year is then accounted for by passing the following journal:

	Dr	**Cr**
	R	**R**
Income tax expense (current tax) (P/L) [C1]	41 608	
Other payables: SARS (SFP)		41 608

The balance of the creditor account for the SARS on 29 February 20.12 is as calculated as follows:
R36 500 (dr) (given) + 1 500 (dr) – 41 608 (cr) = R3 608 (cr).
The R3 608 is a credit balance (amount payable to the SARS) which means it is a **current liability** and not a current asset.

QUESTION 5.2 (25 marks)

The accounting profit before tax for Super Ltd for the year ended 31 December 20.12 is R450 000. Included in the accounting profit before tax are dividends received of R10 000 that are not taxable and a penalty of R15 000 that is not deductible for tax purposes. On 31 December 20.11 prepaid expenses amounted to R60 000 and the unused tax loss was R550 000. Prepaid expenses were tax deductible in the 20.11 year in accordance with section 23H of the Income Tax Act. The South African Revenue Services (SARS) assessment also reflects an assessed tax loss of R550 000 for the 20.11 financial year.

Super Ltd acquired new machinery on 1 January 20.12 for R300 000 which is depreciated over four years on the straight-line basis (the residual value is Rnil). The depreciation has been included in the accounting profit before tax. The SARS grants a section 12C allowance of 40% in the first year and 20% per year for the subsequent three years, which is not apportioned for part of a year.

There are no temporary differences other than those that are apparent from the information provided. The normal income tax rate is 28%.

<table>
<tr><th>REQUIRED</th><th>Marks</th></tr>
<tr><td>Prepare the income tax expense note and deferred tax notes of Super Ltd for the financial year ended 31 December 20.12 for the following three scenarios:</td><td></td></tr>
<tr><td>Scenario 1
Future taxable profits are probable for both financial years ending 31 December 20.11 and 20.12 as the budget for 20.13 reflects new contracts that will increase the taxable profit in the future by R1 000 000.</td><td>14</td></tr>
<tr><td>Scenario 2
Assume that future taxable profits were probable as at 31 December 20.11 but when re-evaluated as at 31 December 20.12, they are not.</td><td>6</td></tr>
<tr><td>Scenario 3
Future taxable profits were not probable as at 31 December 20.11 but are probable as at 31 December 20.12 as the budget for 20.13 reflects new contracts that will increase the taxable profit in the future by R1 000 000.</td><td>5</td></tr>
<tr><td>Please note:
• The movement in temporary differences in the current tax calculation must be calculated using the statement of financial position method.
• Comparative figures are not required.
• Ignore any Value-Added Taxation (VAT) implications.
• Your answer must comply with International Financial Reporting Standards (IFRS).</td><td></td></tr>
</table>

ASSESSED TAX LOSS VERSUS UNUSED TAX LOSS

Please note that an unused tax loss that has been assessed by the SARS for the prior year is referred to as an **assessed tax loss**.

The tax loss calculated as part of the current tax calculation has not yet been assessed by the SARS and will be referred to as an **unused tax loss**.

The difference between the assessed tax loss calculated by the SARS and the unused tax loss calculated by the company will result in an overprovision or underprovision of income tax that will be corrected in the following financial year.

QUESTION 5.2 – Suggested solution

SUPER LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.12

	Scenario 1 20.12 R		Scenario 2 20.12 R		Scenario 3 20.12 R	
3. Income tax expense						
Major components of tax expense						
SA normal tax						
Current tax						
- Current year [C1]	-	(3½)	-		-	
Deferred tax						
- Movement in temporary differences [C2] [C3] [C4]	(4 200)	(4)	(4 200)		(4 200)	
- Recognition of unused tax loss not previously recognised	-		-		[b](137 200)	(1)
- Unused tax loss utilised	[C2]131 600	(1)	[C3]141 400	(2)	[c]131 600	(1)
	127 400		137 200		(9 800)	
Tax rate reconciliation						
Accounting profit	450 000	(½)	450 000		450 000	
Tax @ 28%	126 000	(½)	126 000		126 000	
Tax effect of non-taxable/non-deductible items:						
- Dividends received not taxable (10 000 x 28%)	(2 800)	(1)	(2 800)		(2 800)	
- Penalty not deductible (15 000 x 28%)	4 200	(1)	4 200		4 200	
Unused tax loss not recognised	-		[a]9 800	(1)	-	
Unused tax loss utilised that was not previously recognised	-		-		[b] (137 200)	(1)
Income tax expense	127 400		137 200		(9 800)	
10. Deferred tax						
Analysis of temporary differences:						
Property, plant and equipment						
- Accelerated deductions for tax purposes	[C2](12 600)	(½)	[C3](12 600)		[C4](12 600)	
Unused tax loss for normal tax	[C2]22 400	(½)	[C3]12 600	(½)	[C4]22 400	(½)
Net deferred tax asset / (liability)	[C2]9 800	(½)	[C3] -	(½)	[C4]9 800	(½)
		(13)		(4)		(4)

Additional disclosure in the deferred tax calculation
Scenario 1:
The company has an unused tax loss for which a deferred tax asset has been recognised because the budget for 20.13 reflects new contracts that will increase the taxable profit in future. The deferred tax asset recognised is presented in the analysis of temporary differences above. (IAS 12.82) (1)

Scenario 2:
The company has an unused tax loss in the current year for which no deferred tax asset has been recognised due to uncertainty regarding the probability of future taxable profits. The unused tax loss is as follows: (1)

Unused tax loss for which no deferred tax asset has been recognised (80 000 – 45 000) (IAS 12.81(c))	35 000	(1)

Scenario 3:
The company has an unused tax loss for which a deferred tax asset has been recognised because the budget for 20.13 reflects new contracts that will increase the taxable profit in future. The deferred tax asset recognised is presented in the analysis of temporary differences above. (IAS 12.82) (1)

– [a] (80 0–0 - 45 000) [C3] x 28% = 9 800
[b] (550 000 – 60 000) [C4] x 28% = 137 200
[c] (550 000 – 80 000) [C4] x 28% = 131 600

ADDITIONAL DISCLOSURE REQUIRED FOR DEFERRED TAX ASSET

Please take note of the additional disclosure required by IAS 12 for each of the three Scenarios that have been provided above.

TAX RATE RECONCILIATION

Scenario 2
As at 31 December 20.12, a deferred tax asset can only be raised for R45 000 of the R80 000 unused tax loss, since future taxable profits are not probable. The remaining balance of R35 000 that is **not recognised at all** gives rise to a reconciling item in the tax rate reconciliation. Refer to C3.

Scenario 3
Only R60 000 of the unused tax loss of R550 000 can be recognised as at 31 December 20.11. The unused tax loss of R490 000 (R550 000 – R60 000) was **not recognised at all** as at 31 December 20.11 because future taxable profits were not probable). The unrecognised portion of R490 000 will be reflected as a reconciling item in the 20.11 tax rate reconciliation.

The unrecognised unused tax loss of R490 000 must now be recognised in order to reflect the true movement in the unused tax balance from R490 000 to R80 000 and not from R60 000 to R80 000 as reflected in C4. This unrecognised unused tax loss that is now recognised will be a reconciling item in the tax rate reconciliation.

CALCULATIONS

C1.	Current tax (Current tax is the same for Scenarios 1, 2 and 3)	R
	Profit before tax	450 000
	Non-taxable/non-deductible items:	
	Dividends received not taxable (given)	(10 000)
	Fine not deductible (given)	15 000
	Taxable profit before temporary differences	455 000
	Movement in temporary differences (deductible) [C2] [C3] [C4]	15 000
	Taxable profit before unused tax loss	470 000
	Unused tax loss of prior year (given)	(550 000)
	Cumulative unused tax loss as at 31 December 20.12	(80 000)
	Tax at 28%	-

UNUSED TAX LOSS OF PRIOR YEAR

It is important to note that, for the purposes of the current tax calculation, the SARS does not consider whether Super Ltd recognised the unused tax loss for deferred tax purposes. Therefore, even though the entire unused tax loss was not recognised for deferred tax purposes (accounting purposes), the SARS will allow Super Ltd's **full unused tax loss** of R550 000 as a deduction against taxable profits in the current tax calculation. The R80 000 remaining unused tax loss will be carried forward and may be deducted from future taxable profit.

C2. Deferred tax (Scenario 1)	Carrying amount R	Tax base R	Temporary difference at 100% R	Deferred tax at 28% asset/ (liability) R	
31 December 20.11					
Prepaid expenses	60 000	-	60 000	(16 800)	[1]
			60 000	(16 800)	
Unused tax loss	-	550 000	(550 000)	154 000	[1]
Deferred tax asset			(490 000)	137 200	
31 December 20.12					
Machinery	[1]225 000	[2]180 000	45 000	(12 600)	[1]
			45 000	(12 600)	
Unused tax loss	-	80 000	(80 000)	22 400	[1]
Net deferred tax asset			(35 000)	9 800	
Movement in temporary differences (excluding tax loss) (deductible) (45 000 – 60 000); (16 800 – 12 600)			(15 000)	4 200	
Movement in unused tax loss (reversal of deductible)– ((80 00–) - (550 000)); (154 000 – 22 400)			470 000	(131 600)	[1]
Total movement in temporary difference– ((45 0–0 - (550 000)); (9 800 – 137 200)			455 000	(127 400)	
					[5]

1 300 000 – (300 000/4) = 225 000
2 300 000 – (300 000 x 40%) = 180 000

RECOGNITION OF A DEFERRED TAX ASSET (IAS 12.34-35)

In order to recognise a deferred tax asset for an unused tax loss which can be used to decrease taxable profit in future, the normal recognition criteria for an asset as per the Conceptual Framework must be met. IAS 12.34-35 states that if it is not probable that future taxable profits will be available against which the unused tax loss can be utilised, the deferred tax asset recognised must be limited to the extent that future taxable profits are probable.

On 31 December 20.11 and 20.12 future taxable profits are probable against which the unused tax loss can be utilised. As a result, the full unused tax loss can be recognised as a deferred tax asset. The unused tax loss can be seen as an asset as it will reduce future taxable profit and income tax expense. The tax base is greater than the carrying amount which gives rise to a **deductible temporary difference** and a **deferred tax asset**.

C3. Deferred tax (Scenario 2)	Carrying amount R	Tax base R	Temporary difference at 100% R	Deferred tax at 28% asset/ (liability) R	
31 December 20.11					
Prepaid expenses	60 000	-	60 000	(16 800)	
			60 000	(16 800)	
Unused tax loss	-	550 000	(550 000)	154 000	
Deferred tax asset			(490 000)	137 200	
31 December 20.12					
Machinery	1 225 000	2 180 000	45 000	(12 600)	
			45 000	(12 600)	
Unused tax loss	-	80 000	**(45 000)**	**12 600**	[1]
Net deferred tax asset			-	-	
Movement in temporary differences (excluding tax loss) (deductible) (45 000 – 60 000); (16 800 – 12 600)			(15 000)	4 200	
Movement in unused tax loss (reversal of deductible)– ((45 00–) - (550 000)); (154 000 – 12 600)			505 000	(141 400)	[1]
Total movement in temporary differ–nces ((–) - (490 000)); (0 – 137 200)			490 000	(137 200)	
					[2]

1 300 000 – (300 000/4) = 225 000
2 300 000 – (300 000 x 40%) = 180 000

LIMITATION OF DEFERRED TAX ASSET ON 31 DECEMBER 20.12

As at 31 December 20.12, future taxable profits are not probable, which means that the future utilisation of the unused tax loss must be limited. The taxable temporary difference of R45 000 relating to the machinery represents future taxable profits. In terms of IAS 12.35, the deferred tax asset on the unused tax loss of R80 000 must be limited to the extent that Super Ltd expects future taxable profits. Super Ltd has taxable temporary differences which will be taxable in future, and as a result, the unused tax loss that can be recognised is limited to R45 000. The net deferred tax balance is therefore Rnil for the year ended 31 December 20.12.

C4. Deferred tax (Scenario 3)	**Carrying amount R**	**Tax base R**	**Temporary difference at 100% R**	**Deferred tax at 28% asset/ (liability) R**	
31 December 20.11					
Prepaid expenses	60 000	-	60 000	(16 800)	
			60 000	(16 800)	
Unused tax loss	-	550 000	**(60 000)**	**16 800**	
Deferred tax asset			-	-	
31 December 20.12					
Machinery	[1]225 000	[2]180 000	45 000	(12 600)	
			45 000	(12 600)	
Unused tax loss	-	80 000	(80 000)	22 400	[1]
Net deferred tax asset			(35 000)	9 800	
Movement in temporary differences (excluding tax loss) (deductible) (45 000 – 60 000); (16 800 – 12 600)			(15 000)	4 200	
Movement in unused tax loss (reversal of deductible) – ((80 000) – (60 000)); (22 400 – 16 800)			(20 000)	*5 600	[1]
Total movement in temporary differences – ((35 000) – 0); (0 – (9 800))			(35 000)	9 800	
					[2]

1 300 000 – (300 000/4) = 225 000
2 300 000 – (300 000 x 40%) = 180 000

LIMITATION OF UNUSED TAX LOSS ON 31 DECEMBER 20.11

As at 31 December 20.11, future taxable profits were not probable. The taxable temporary difference of R60 000 relating to the prepaid expenses represents **future taxable profits**. In terms of IAS 12.35, the deferred tax asset on the unused tax loss of R550 000 must be **limited** to the extent that future taxable profits are probable, and as a result, the unused tax loss that can be recognised is limited to R60 000. The net deferred tax balance on 31 December 20.11 is therefore Rnil.

As at 31 December 20.12, the unused tax loss of R80 000 is not limited as future taxable profits are probable and the full R80 000 is recognised as a deferred tax asset.

MOVEMENT IN UNUSED TAX LOSS

- Please note that the movement in the unused tax loss disclosed above as part of the income tax expense note reconciles to the total movement in the unused tax loss calculated in C4:

	R
Unused tax loss not previously recognized (154 000 – 16 800) [C2] OR (550 000 – 60 000) x 28%	(137 200)
Unused tax loss utilised (550 000 – 80 000) x 28%	131 600
Total movement per deferred tax calculation	5 600

QUESTION 5.3 (34 marks)

1. The balance of the deferred tax account of Spring Ltd was R2 240 (credit) on 1 January 20.10. The unused tax loss as at 31 December 20.10 is R12 000.

   There was no unused tax loss as at 31 December 20.09.

2. The net temporary differences are as follows at the end of the respective years: 31 December 20.10: R11 000 (taxable)
   31 December 20.11: R9 000 (taxable)
   31 December 20.12: R9 000 (taxable)

3. All temporary differences are subject to the normal income tax rate of 28%, with no capital gains tax (CGT) implications.

4. Profit before tax for the year ended 31 December 20.11 amounted to R7 000 while the accounting loss before tax for the year ended 31 December 20.10 amounted to R9 000. All items included in the profit/(loss) before tax for both years are taxable or deductible for tax purposes.

5. As at 31 December 20.10 there were doubts as to whether Spring Ltd would generate future taxable profits. As from 31 December 20.11 it is probable that Spring Ltd will generate future taxable income for the next three years in excess of R13 000 per year.

REQUIRED	**Marks**
(a) Calculate the deferred tax balance on 31 December 20.10.	2
(b) Calculate the taxable profit for the year ended 31 December 20.11 before utilisation of the unused tax loss.	2
(c) Calculate the cumulative tax loss on 31 December 20.11.	2
(d) Calculate the deferred tax balance on 31 December 20.11.	2
(e) Calculate the current tax for the year ended 31 December 20.12. Assume that the profit	4
before tax for the year ended 31 December 20.12 amounted to R10 000.	
(f) Calculate the deferred tax balance on 31 December 20.12.	1
(g) Prepare the income tax expense note for Spring Ltd for the financial year ended 31 December 20.10, 20.11 and 20.12.	11
Please note:	
• The movement in temporary differences in the current tax calculation must be	
calculated using the statement of financial position method.	
• Ignore any Value-Added Tax (VAT) implications.	
• Your answer must comply with International Financial Reporting Standards (IFRS).	

QUESTION 5.3 - Suggested solution

(a) Deferred tax

	Carrying amount	Tax base	Temporary differences	Deferred tax at 28% asset/ (liability)	
	R	R	R	R	
31 December 20.10					
Taxable temporary differences (given)	?	?	11 000	(3 080)	(1)
Unused tax loss (12 000 limited to 11 000)	-	12 000	(11 000)	3 080	(1)
Deferred tax balance				-	
				Total	(2)

LIMITATION OF UNUSED TAX LOSS

On 31 December 20.10, the total tax loss amounted to R12 000. As there is uncertainty regarding future taxable profits, the deferred tax asset created in respect of this tax loss is limited to the taxable temporary differences (R11 000). As a result, the deferred tax balance on the statement of financial position is Rnil (consisting of an asset of R3 080 in respect of the unused tax loss and a liability of R3 080 in respect of the taxable differences). The unused tax loss still amounts to **R12 000** (which will be deductible from future taxable income), of which R11 000 is **recognised** and R1 000 is **unrecognised**.

(b) Taxable profit for the year ended 31 December 20.11 before utilisation of unused tax loss

	R	
Profit before tax (given)	7 000	(½)
Movement in temporary differences (11 000 – 9 000) (reversal of taxable)	2 000	(1)
Taxable profit before unused tax loss	9 000	(½)
	Total	(2)

(c) Cumulative tax loss as at 31 December 20.11

Unused tax loss of prior year (given)	(12 000)	(1)
Cumulative unused tax loss as at 31 December 20.11	(3 000)	(1)
	Total	(2)

(d) Deferred tax

	Carrying amount	Tax base	Temporary differences	Deferred tax at 28% asset/ (liability)	
	R	R	R	R	
31 December 20.11					
Taxable temporary differences (given)	?	?	9 000	(2 520)	(1)
Unused tax loss	-	3 000(c)	(3 000)(c)	840	(1)
Deferred tax liability				(1 680)	
				Total	(2)

(e) Current tax for the year ended 31 December 20.12

	R	
Profit before tax	10 000	(½)
Movement in temporary differences (9 000 – 9 000)	-	(1)
Taxable profit before unused tax loss	10 000	
Unused tax loss of prior year(c)	(3 000)	(1)
Taxable profit after utilisation of unused tax loss	7 000	(½)
Current tax at 28%	1 960	(1)
	Total	(4)

(f) Deferred tax

	Carrying amount	Tax base	Temporary differences	Deferred tax at 28% asset/ (liability)	
	R	R	R	R	
31 December 20.12					
Taxable temporary differences (given)	?	?	9 000	(2 520)	(1)
Unused tax loss	-	-	-	-	
Deferred tax liability				(2 520)	

(g) SUPER LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.10, 20.11 and 20.12

4. Income tax expense

	20.12	20.11	20.10	
	R	R	R	
Major components of tax expense				
SA normal tax				
Current tax	C7 1 960	-	-	(1)
Deferred tax	840	1 680	(2 240)	
- Movement in temporary differences	C8 -	C4 (560)	C1 840	(3)
- Recognition of unused tax loss	-	-	C2 (3 080)	(1)
- Recognition of unused tax loss not previously recognised	-	C5 (280)	-	(1)
- Unused tax loss utilised	C9 840	C6 2 520	-	(2)
	2 800	1 680	(2 240)	
Tax rate reconciliation				
Accounting profit/(loss)	10 000	7 000	(9 000)	(½)
Tax at 28%	2 800	1 960	(2 520)	(½)
Unused tax loss not recognised	-	-	C3 280	(1)
Unused tax loss utilised that was not previously recognised	-	C5 (280)	-	(1)
Income tax expense	2 800	1 680	(2 240)	
			Total	(11)

	Taxable temporary differences on 31 December 20.10	11 000	
C1	Taxable temporary differences on 31 December 20.9	8 000	(2 240 / 28%)
	Movement in temporary differences (taxable)	3 000	
	Increase in deferred tax liability (3 000 x 28%)	840	(credit deferred tax, debit P/L)

C2 11 000 x 28% = 3 080 (refer to (a))

C3 12 000 (unused tax loss) minus 11 000 (unused tax loss recognised) = 1 000 unrecognised unused tax loss x 28% = 280

C4 9 000 taxable temporary difference for 20.11 – 11 000 taxable temporary difference for 20.10 = 2 000 x 28% = 560 (Decrease in deferred tax liability, therefore, debit deferred tax and credit P/L)

C5 1 000 unrecognised unused tax loss [C3] x 28% = 280

C6 Unused tax loss on 31 December 20.11 of 3 000 (refer to (c)) minus the unused tax loss at 31 December 20.10 of 12 000 = 9 000 tax loss utilised x 28% = 2 520

C7 Refer to (e)

C8 9 000 taxable temporary difference for 20.12 – 9 000 taxable temporary difference for 20.11 = 0

C9 Unused tax loss on 31 December 20.12 of nil minus unused tax loss on 31 December 20.11 of 3 000 = 3 000 tax loss utilised x 28% = 840

LEARNING UNIT 6 – ACCOUNTING POLICY, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

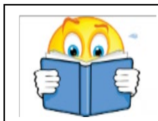
INTRODUCTION

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.

OBJECTIVES/OUTCOMES

After you have studied this learning unit, you should be able to do the following:

1. Identify the objective of IAS 8 and be able to apply IAS 8.
2. Provide guidance on the choice of an accounting policy relating to specific transactions.
3. Identify, account for and disclose a change in accounting policy.
4. Identify, account for and disclose changes in accounting estimates.
5. Identify, account for and disclose errors.



PRESCRIBED STUDY MATERIAL

The following **must** be studied before you attempt the questions in this learning unit:

1. IAS 8 *Accounting policies, changes in accounting estimates and errors.*

INDEX

1. Overview of IAS 8

	Accounting policies, Changes in Accounting Estimates and Errors	SAICA Level	Learning unit section
Definitions	**Definitions** Accounting policies Change in accounting estimate International Financial Reporting Standards (IFRS) Material omissions or misstatements of items Prior period errors Retrospective application Retrospective restatement Impracticable Prospective application	Level 3	6.2
Accounting policies	**Selecting accounting policies** When an IFRS specifically applies, then apply the policy relating to that IFRS. In the absence of an IFRS that specifically applies, management will use its judgement	Level 3	6.3
	Consistency of accounting policies An entity shall apply its accounting policies consistently	Level 3	6.3
	Changes in accounting policies An entity shall change an accounting policy only if the change is required by IFRS or if it provides reliable and more relevant information about the effects of transactions The following are not changes in accounting policy: - the application of an accounting policy to transactions that differs in substance from previous transactions - the application of a new accounting policy to transactions that did not occur previously or was immaterial Initial application of a policy to revalue assets (IAS 16 or IAS 38) is a change in accounting policy to be dealt with as a revaluation in accordance with IAS 16 or IAS 38 rather than in accordance with IAS 8.	Level 3	6.3

Accounting policies

Accounting policies, Changes in Accounting Estimates and Errors		SAICA Level	Learning unit section
Applying changes in accounting policies		Level 3	6.3
Compulsory change	**Voluntary change**	Level 3	6.3
Is required by an IFRS Apply specific transitional arrangements of IFRS if applicable Otherwise apply retrospectively	Results in more relevant and reliable information Apply changes retrospectively to extent practicable		
Impracticable		Level 3	6.3
Apply at the beginning of the earliest period for which retrospective application is practicable			
Disclosure		Level 3	6.3
If an entity has not applied a new IFRS that has been issued, but it is not yet effective then disclose: - This fact; and - Information relevant to assess the possible impact of the application of the new IFRS			
Compulsory change	**Voluntary change**	Level 3	6.3
Title of IFRS In accordance with transitional provisions plus description Nature of change Effect on future periods Amount of adjustment for current and each prior period presented Amount relating to periods before those presented if practicable If impracticable circumstances that led to that condition	Nature of change Reasons why the new policy is more reliable and relevant Amount of adjustment of current and each prior period presented Amount relating to periods before those presented if practicable If impracticable, the circumstances that led to that condition		

	Accounting policies, Changes in Accounting Estimates and Errors	SAICA Level	Learning unit section
Change in estimate	Many items cannot be measured with precision but can only be estimated, for example, bad debts, fair value of financial assets, useful lives of assets, etc.	Level 3	6.4
	Recognition Prospectively • In period of the change OR • In period of the change and future periods if change affects both • If change give rise to changes in assets and liabilities or an item of equity then it will be recognised by adjusting the carrying amount of assets, liabilities or equity in period of the change	Level 3	6.4
	Disclosure Nature and amount in current and future periods If impractical to estimate effect on future periods disclose the fact	Level 3	6.4
Prior period error	Can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements	Level 3	6.5
	Recognition Retrospective restatement, if practicable • Restating comparative amounts for prior period OR • Restating opening balances of assets, liabilities and equity if error occurred before the earliest prior period If impracticable to determine period specific effect • Restate opening balance of assets, liabilities and equity for earliest period that retrospective restatement is practicable	Level 3	6.5
	Disclosure • Nature of prior period error • Amount of correction for each prior period • Amount of correction at the beginning of earliest prior period • Description if impracticable and the circumstances that led to the existence of that condition	Level 3	6.5
Retrospective application and restatement	Impracticability in respect of retrospective application and retrospective restatement	Level 3	6.6

IAS 1: Statements of financial position

According to IAS 1.40A-B, an entity shall present three statements of financial position if an accounting policy is applied retrospectively, or if the entity makes retrospective restatements or reclassifications.

Examples when three statements of financial position are required:

- Retrospective change in accounting policy for valuation of inventory (e.g., weighted average to first-in-first-out);
- Errors in prior periods;
- Reclassification adjustments of amounts previously recognised in other comprehensive income to profit or loss;
- Reclassification adjustments on disposal of a foreign operation, derecognition of available-for- sale financial assets and when a hedged forecast transaction affects profit or loss (IAS 1.95); or
- Other retrospective changes in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

If financial statements are thus presented for the year ended 31 December 20.12 and the accounting policy for valuation of inventory was changed retrospectively, statements of financial position will have to be presented on 1 January 20.11, 31 December 20.11 and 31 December 20.12 (if the information is available).

Other than the disclosure required by IAS 1.41-44 and IAS 8, IAS 1.40C states that the entity need not present the related notes to the opening statement of financial position as at the beginning of the preceding period.

6.1 Scope (Level 1)

Refer to IAS 8.3 – 8.4.

6.2 Definitions (Level3)

Refer to IAS 8.5. – 8.6.

6.3 Accounting policies (Level 3)

Refer to IAS 8.7 – 8.31.

6.4 Change in accounting estimates (Level 3)

Refer to IAS 8.32 – 8.40.

Prospective application of change in estimate

IAS 8.38 – Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions **from the date of the change in estimate**.

IAS 16.51 The residual value and the useful life of an asset shall be reviewed **at least** at each financial year-end and, if expectations differ from previous estimates, the change(s) shall be accounted for as a **change in an accounting estimate** in accordance with IAS 8 *Accounting policies, Changes in Accounting Estimates and Errors*.

According to IAS8.38, a change in estimate is accounted for **from** the date of the change in estimate. However, since the residual value and the useful life of assets can be re-estimated during the year (refer to IAS16.51 above), a change in estimate with regard to the **residual value** or **useful life** of an asset will be accounted for from the **beginning** of the financial year in which the change in estimate occurred.

6.5 Errors (Level 3)

Refer to IAS 8.41 – 8.49.

6.6 Retrospective application and restatement (Level 3)

Refer to IAS 8.50 – 8.53

ADDITIONAL QUESTION

QUESTION 6.1 (50 marks)

The accounting profit before tax of Trueblue Ltd for the financial year ended 28 February 20.11 was R600 000 (R500 000 for the financial year ended 28 February 20.10).

The following information relating to Trueblue Ltd is presented to you for the year ended 28 February 20.11:

1. Inventory amounting to R95 000 was destroyed and written off due to a flood during the year. An amount of R60 000 was received from the insurance company as compensation for the inventory that was destroyed. The two amounts are included in the accounting profit before tax for the year ended 28 February 20.11. Assume that these amounts are material.

2. The directors of the company decided to change the accounting policy in respect of the valuation of inventory, since the new policy will ensure a more reliable value of inventory. Previously inventory was valued according to the weighted average method, but it should now be valued according to the first-in-first-out method. This change in accounting policy has not been accounted for as yet.

   The value of inventory at 28 February, based on the two methods of valuation, was as follows:

	20.11	**20.10**	**20.9**	**20.8**
	R	**R**	**R**	**R**
First-in-first-out method	460 000	420 000	395 000	380 000
Weighted average method	420 000	395 000	382 000	375 000

   The South African Revenue Service (SARS) will not re-open the previous years’ assessments but will accept the new policy in respect of the current year for tax poses.

3. During the current year, the bookkeeper established that a material error had been made in the published financial statements for the year ended 28 February 20.10. New manufacturing equipment amounting to R25 000 that was acquired on 1 September 20.9 was incorrectly recorded as administration expenses. The company depreciates such equipment at 20% per annum according to the straight-line method, apportioned for part of a year. This error has not been corrected.

   The accountant immediately informed the SARS of the error and the SARS **agreed to re-open the 20.10 assessment** in order to correct this error. In accordance with the Income Tax Act, the SARS grants a section 12C allowance on the equipment of 40% in the first year and 20% in the second, third and fourth years, which is not apportioned for part of a year.

4. Trueblue Ltd acquired a fleet of delivery vehicles on 1 March 20.9 for R500 000. The fleet has been depreciated over three years on the straight-line method, apportioned for part of a year. The fleet has a residual value of R140 000. The depreciation for the year ended 28 February 20.11 was correctly recorded.

   On 28 February 20.11 (after depreciation was recorded), management extended the maintenance contract of the fleet to 28 February 20.13 and estimated the remaining useful life of the fleet on 28 February 20.11 to be two years. This change has not been accounted for as yet.

   The SARS grants a section 11(e) wear-and-tear allowance on the cost of the fleet of delivery vehicles over four years, which is apportioned for part of a year.

5. The income tax rate is 28% and was not adjusted for the past five years. There are no temporary differences other than those that are apparent from the question. The deferred tax liability on 28 February 20.9 was R3 500. All the temporary differences included in the deferred tax balance of R3 500 are subject to a tax rate of 28% with no capital gains tax (CGT) implications.

6. The retained earnings balance on 1 March 20.9 was R800 000.

7. The company had 500 000 issued ordinary shares since incorporation.

REQUIRED	**Marks**
(a) Prepare an extract of the statement of profit or loss and other comprehensive income for Trueblue Ltd for the year ended 28 February 20.11 by starting with the profit before tax figure.	19
(b) Prepare an extract from the statement of changes in equity for Trueblue Ltd for the year ended 28 February 20.11 (only the retained earnings column is required).	3
(c) Disclose the following notes in the financial statements of Trueblue Ltd for the year ended 28 February 20.11:	
- Profit before Tax	8
- Change in accounting policy	12
- Prior period error	8
Please note:	
• The movement in temporary differences in the current tax calculation must be calculate using the statement of financial position method.	
• **Round off** all amounts to the nearest Rand.	
• Ignore any Value-Added Tax (VAT) implications.	
• Your answer must **comply** with International Financial Reporting Standards (IFRS).	

COMMENTS ON INFORMATION GIVEN IN THE QUESTION

- The **change in accounting policy** must be applied retrospectively which means that the information must be adjusted for:
  - the current year ended 28 February 20.11,
  - the previous year ended 28 February 20.10, and
  - the opening balance for the previous year (1 March 20.9).
- The valuations of inventories provided for 20.8 should not be used.
- The **error** regarding the equipment that was incorrectly expensed should be corrected in the financial year where the error occurred, being the previous financial year. The error will also affect the current year since depreciation on the equipment must still be recognised.
- The change in the useful life of the fleet is a **change in accounting estimate**. The change in accounting estimate must be applied prospectively to the current and future periods. The change in the accounting estimate in the current year must be done at the **beginning of the current year**, i.e. 1 March 20.10 (refer note 3).

EXAM TECHNIQUE

If comparative figures are not specifically excluded in the required question, comparative figures **are required**.

In this question, the statement of financial position is not required. If it were required, three statements of financial position would need to be prepared, as required by IAS 1.40A.

QUESTION 6.1 - Suggested solution

(a) TRUEBLUE LTD

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 28 FEBRUARY 20.11

	20.11 R	20.10 R	
Profit before tax [C4]	650 000	534 500	(6)
Income tax expense [C5]	(182 000)	(149 660)	(12½)
PROFIT FOR THE YEAR	468 000	384 840	(½)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	468 000	384 840	
		Total	(19)

(b) TRUEBLUE LTD

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 28 FEBRUARY 20.11

	Retained earnings R	
Balance as at 1 March 20.9	800 000	(½)
Change in accounting policy [C1]	9 360	(1)
Restated balance	809 360	
Total comprehensive income for the year		
- Profit for the year (restated)	384 840	(½)
Balance at 28 February 20.10	1 194 200	(½)
Total comprehensive income for the year		
- Profit for the year	468 000	(½)
Balance at 28 February 20.11	1 662 200	
Total		(3)

(c) TRUEBLUE LTD

NOTES FOR THE YEAR ENDED EBRUARY 20.11

1. Profit before tax

The following items are included in profit before tax:

	20.11 R	20.10 R	
Income			
Compensation received from insurance company for inventory damaged in flood (IAS 2.36 and IAS 1.98)	60 000	-	(1)
Expenses			
Write-off of inventory as a result of flood (IAS 2.36 and 1.98)	95 000	-	(1)
Depreciation on property, plant and equipment (IAS 1.104)			
- Equipment [C2]	5 000	2 500	(1)
- Fleet of delivery vehicles [C3.1]	80 000	120 000	(2½)

Included in depreciation for 20.11 is a change in estimate (decrease in depreciation) of R40 000 arising from the remaining useful life of the fleet of delivery vehicles that was changed from one year to two years on 28 February 20.11, with effect from 1 March 20.10. This change will result in an increase in depreciation in future periods amounting to R40 000 [C3.2]. (IAS 8.39).

Total (2½)
(8)

2. Change in accounting policy

The company changed its accounting policy during the year in respect of the valuation of inventory from the weighted average method to the first-in-first-out method. This change was effected to ensure fairer presentation of the valuation of inventory. The opening balance of retained earnings at the beginning of 20.10 was adjusted while the comparative amounts were restated accordingly. The effect of the change in accounting policy on the results for 20.10 and 20.11 is as follows: (2½)

	20.11 R	20.10 R	1 March 20.9 R	
Decrease in cost of sales [C1]	15 000	12 000		(1½)
Increase in income tax expense [C1]	(4 200)[2]	(3 360)[1]		(1½)
Increase in profit [C1]	10 800	8 640		
Increase in inventory [C1]	40 000	25 000	13 000	(2)
Increase in deferred tax liability [C1] [C6]	-	(7 000)	(3 640)	(1½)
Increase in tax payable [C1]	(11 200)	-		(1)
Increase in equity [C1]	28 800	18 000	9 360	
Adjustment against retained earnings on 1 March 20.9 (IAS 8.29(d))			9 360	(1)
Increase in earnings per share (IAS 8.29(c)) (10 800 / 500 000) (8 640 / 500 000)	0,02	0,02		(1)
			Total	(12)

INCREASE IN INCOME TAX EXPENSE AS A RESULT OF CHANGE IN ACCOUNTING POLICY

1. The R3 360 is a movement in the deferred tax balance relating to inventory from R3 640 to R7 000 [C6], since the SARS indicated that they will accept the new accounting policy only from the current year, even though the new policy has been applied retrospectively for accounting purposes.

2. The income tax expense line includes the current tax and movement in deferred tax relating to the change in accounting policy. The R4 200 (R15 000 x 28%) can also be proven as follows:

Current tax on change in accounting policy for the year ended 28 February 20.11

Increase in taxable profit	R15 000
Movement in temporary differences on inventory [C6] (reversal of taxable temporary difference)	R25 000
Taxable profit	R40 000
Income tax (current tax at 28%) (R40 000 x 28%) Income tax (deferred tax) (R7 000 - R0) [C6] (debit deferred tax liability and credit P/L) Income tax expense	R11 200 R 7 000) R 4 200

3. **Prior period error**

The error relates to a correction in respect of equipment that was incorrectly recorded as administrative expenses in the 20.10 financial year. The comparative amounts were restated. The effect of the correction of the error on the 20.10 results is as follows: (2)

	20.10 **R**	**1 March 20.9** **R**	
Decrease in other expenses [C3] (25 000 - 2 500)	22 500		(1)
Increase in income tax expense (22 500 x 28%)	(6 300)[1]		(½)
Increase in profit for the year	16 200		(½)
Increase in property, plant and equipment (25 000 - 2 500) [C2]	22 500		(1)
Increase in deferred tax liability	(2 100)		(½)
Increase in tax payable ((22 500 – 7 500) x 28%)	(4 200)		(1)
Increase in equity	16 200		(½)
Adjustment against retained earnings on 1 March 20.9 (IAS 8.49(c))		-	(1)
		Total	(8)

EFFECT OF ERROR IN CURRENT YEAR
Note that the effect of the error in the current year is **not** disclosed, since it is corrected in the current year **before** the financial statements are published.

INCREASE IN INCOME TAX EXPENSE AS A RESULT OF PRIOR PERIOD ERROR

The income tax expense line includes the current tax and movement in deferred tax relating to the prior period error. The R6 300 (R22 500 x 28%) can also be proven as follows:

Current tax on error for the year ended 28 February 20.10:

Increase in taxable profit	R22 500
Movement in temporary difference on equipment [C6] (R7 500 - 0) (taxable temporary difference)	(R7 500)
Taxable profit	R15 000
Income tax expense (current tax at 28%) (R15 000 x 28%) Income tax expense	R4 200
(deferred tax) (R2 100 - 0) [C6] (debit P/L and credit deferred tax liability)	R2 100
Income tax expense	R6 300

CALCULATIONS

C1. Change in accounting policy (inventory)

	20.9 R	P/L R	20.10 R	P/L R	20.11 R	
First-in-first-out (New)	395 000		420 000		460 000	
Weighted average (Old)	(382 000)		(395 000)		(420 000)	
	13 000[1]	12 000[3]	25 000[2]	15 000	40 000	[2½]
Tax at 28%	(3 640)	(3 360)	(7 000)	(4 200)	(11 200)	[2½]
	9 360	8 640	18 000	10 800	28 800	
						[5]

1 On 28 February 20.9, as a result of the change in accounting policy, the closing inventory increased by R13 000. Since closing inventory is deducted from cost of sales, the R13 000 decreases costs of sales, which will increase gross profit and profit before tax.

2 On 28 February 20.10, the closing inventory increased by R25 000 which also decreases cost of sales.

3 The P/L for the year ended 28 February 20.10 is affected by opening inventory that increased by R13 000 (which increases cost of sales) and closing inventory that increased by R25 000 (which decreases cost of sales). The net effect on P/L for the year ended 28 February 20.10 is a net decrease in cost of sales which is an increase in profit before tax of R12 000:

	Dr (Cr) R
Cost of sales	(12 000)
Opening inventory	13 000
Purchases	xx
Closing inventory	(25 000)

The same principle applies to the changes made to the inventory balance for the 20.11 financial year.

JOURNALS TO EXPLAIN CHANGE IN ACCOUNTING POLICY (not required)

The journals to account for the change in accounting policy are not required but are provided for **learning purposes only**.

	1 March 20.9	**Dr R**	**Cr R**
J1	Inventory (SFP)	13 000	
	Retained earnings (SCE)		9 360
	Deferred tax (SFP)		3 640
	Change in accounting policy in opening retained earnings of prior year		
	28 February 20.10		
J2	Inventory (SFP)	12 000	
	Cost of sales (P/L)		12 000
	Increase in closing inventory in prior year		
J3	Income tax expense (deferred tax) (P/L)	3 360	
	Deferred tax (SFP)		3 360
	Recognise deferred tax on increase in closing inventory		
	28 February 20.11		
J4	Inventory (SFP)	15 000	
	Cost of sales (P/L)		15 000
	Increase in closing inventory in current year		

The deferred tax and current tax consequences on the change in accounting policy for the **current year** are included in the tax journals that are provided in C6 for learning purposes.

C2. Prior period error

Equipment	**R**	
Acquisition on 1 September 20.9	25 000	
Depreciation for year ended 28 February 20.10 (25 000 x 20% x 6/12)	(2 500)	[1]
Carrying amount of equipment on 28 February 20.10	22 500	
Depreciation for year ended 28 February 20.11 (25 000 x 20%)	(5 000)	[1]
Carrying amount of equipment on 28 February 20.11	17 500	[2]

JOURNALS TO EXPLAIN PRIOR PERIOD ERROR (not required)

Even though the journals are not required in this question, if you are unsure of the effects of an error, it can be of great assistance to do the journals as part of your calculations.

	Correcting journals on 28 February 20.10	**Dr R**	**Cr R**
J1	Equipment (SFP)	25 000	
	Other expenses (P/L)		25 000
	Reclassification of equipment from other expenses		
J2	Depreciation (P/L)	2 500	
	Accumulated depreciation (SFP)		2 500
	Recognise depreciation on the equipment for prior year		

		Dr R	Cr R
J3	Income tax expense (current tax) (P/L)		
	(22 500 – 7 500 taxable temporary difference) x 28%) [C6]	4 200	
	Other payables: SARS (SFP)		4 200
	Current tax payable for operating costs incorrectly deducted		
J4	Income tax expense (deferred tax) (P/L) (7 500 x 28%) [C6]	2 100	
	Deferred tax (SFP)		2 100
	Recognise a deferred tax liability on the equipment		
	Correcting journal on 28 February 20.11		
J3	Depreciation (P/L)	5 000	
	Accumulated depreciation (SFP)		5 000
	Recognise depreciation on the equipment for current year		

The correction in the current year (J3) is corrected **before** the financial statements are published and therefore **not** disclosed in the note.

The deferred tax and current tax consequences for the current year are included in the tax journals that are provided in C6 for learning purposes.

C3.1 Change in accounting estimate

	After change in estimate R	Before change in estimate R	
Fleet of vehicles acquired on 1 March 20.9	500 000	500 000	
Depreciation for year ended 28 February 20.10 (500 000 - 140 000)/3	(120 000)	(120 000)	[1]
Carrying amount on 28 February 20.10 (1 March 20.10)	380 000	380 000	
Depreciation for year ended 28 February 20.11 (380 000 - 140 000)/3	(80 000)[1]	(120 000)	[1]
Carrying amount on 28 February 20.11	300 000	260 000	
Depreciation for year ended 28 February 20.12 (380 000 - 140 000)/3	(80 000)	(120 000)	
Carrying amount on 28 February 20.12	220 000	140 000	
Depreciation for year ended 28 February 20.12 (380 000 - 140 000)/3	(80 000)	-	
Carrying amount on 28 February 20.13	140 000	140 000	

[1] On 28 February 20.11, the new remaining useful life was two years. That means that on 1 March 20.10 three years remained.

C3.2 Effect of change in estimate on future depreciation

	R	
Future depreciation on 28 February 20.11 (after change in estimate) (80 000 for 20.12 + 80 000 for 20.13)	160 000	[½]
Future depreciation on 28 February 20.11 (before change in estimate)	120 000	[½]
Increase in future depreciation	40 000	
		[3]

C4. Profit before tax

	20.11 R	20.10 R	
Accounting profit (given)	600 000	500 000	[1]
Decrease in cost of sales as a result of the increase in closing inventory (change in accounting policy) [C1]	15 000	12 000	[1]
Prior period error: add back other expenses	-	25 000	[1]
Prior period error: deduct depreciation [C2]	(5 000)	(2 500)	[2]
Change in estimate: decrease in depreciation			
(R120 000 - R80 000) [C3.1]	40 000	-	[1]
	650 000	534 500	
			[6]

C5. Current tax

	20.11	20.10	
Profit before tax [C4]	650 000	534 500	[1]
Movement in temporary differences (taxable) [C6]	(20 000)	(12 000)	
Taxable profit	630 000	522 500	
Income tax expense (current tax) at 28% (debit P/L)	176 400	146 300	[1]
Income tax expense (deferred tax) (debit P/L) [C6]	5 600	3 360	[1]
Total income tax expense	182 000	149 660	
			[3]

C6. Deferred tax

	Carrying amount R	Tax base R	Temporary difference R	Deferred tax at 28% asset/ (liability) R	
28 February 20.9					
Balance (given)			12 500	(3 500)	[½]
Inventory [C1]	395 000	382 000	13 000	(3 640)	[1]
Deferred tax liability			25 500	(7 140)	
28 February 20.10					
Inventory [C1]	420 000	395 000	25 000	(7 000)	[1]
Equipment [C2]	22 500	15 000[1]	7 500	(2 100)	[1]
Fleet of delivery vehicles [C3.1]	380 000	375 000[2]	5 000	(1 400)	[1]
Deferred tax liability			37 500	(10 500)	
Movement in temporary differences (taxable)			12 000	(3 360)	[1]
28 February 20.11					
Inventory [C1]	460 000	460 000	-	-	[1]
Equipment [C2]	17 500	10 000[3]	7 500	(2 100)	[1]
Fleet of delivery vehicles [C3.1]	300 000	250 000[4]	50 000	(14 000)	[1]
Deferred tax liability			57 500	(16 100)	
Movement in temporary differences (taxable)			20 000	(5 600)	[1]
					[9½]
					[28]

1 25 000 - (25 000 x 40%) = 15 000
2 500 000 - (500 000/4) = 375 000
3 25 000 - (25 000 x 40%) - (25 000 x 20%) = 10 000
4 500 000 - (500 000/4) - (500 000/4) = 250 000

TAX JOURNALS (not required)

The tax journals for the financial year ended 28 February 20.11 are provided for **learning purposes only**.

		Dr R	Cr R
	28 February 20.11		
J1	Income tax expense (current tax) (P/L) [C5]	176 400	
	Other payables: SARS (SFP)		176 400
	Provide for current tax for the current year		
J2	Income tax expense (deferred tax) (P/L) [C6]	5 600	
	Deferred tax (SFP)		5 600
	Recognise increase in the deferred tax liability		

SELF ASSESSMENT QUESTIONS AND SUGGESTED SOLUTIONS

COMMENT

SAICA is advancing the assessment of students' ability to critically evaluate information provided in case study-format questions and combined with a sound knowledge of International Financial Reporting Standards (IFRS), requires of students to mostly supply their solution in a discussion format.

With reference to the above SAICA changes, students need to note that tests and examinations now require solutions mostly in a discussion format (theory). Therefore, tests and examinations will require 50% or more of the solution to be in a discussion format.

Question	Question name	Source	Marks	Topics covered	Page
1	Bulbine	FAC4861 Test 1/2023	40	Disclosure: • Income tax Discussion: • Conceptual framework	102
2	Duman Sunglass	FAC4861 Test 1/2022	40	Presentation: • Statement changes in equity Disclosure: • Income tax Measurement Measurement: • Inventory	110
3	Fitness Squad	FAC4861 Test 1/2021	40	Disclosure: • Income tax • Inventory Discussion • Inventory	118
4	Cool	FAC4861 Test 1/2020	40	Discussion: • Conceptual Framework Presentation: • Statement of profit and loss and other comprehensive income	128
5	Aluminium	FAC4861 Test 1/2019	40	Journals: • Income tax Disclosure: • Accounting policies and estimates Theory: • Inventory	136
6	Uber-Accountants	FAC4861 Test 1/2018	40	Disclosure: • Income tax • Inventory Discussion: • Presentation of financial statements	143

QUESTION 1 **40 marks**

YOU HAVE 15 MINUTES TO READ THIS QUESTION

IGNORE VALUE ADDED TAX

Bulbine Cosmetics Ltd (Bulbine) is a South African company with a 31 December financial year end. The company applies International Financial Reporting Standards (IFRS) with the preparation of its financial statements.

Bulbine uses the pulp of the Bulbinella plant (Bulbine frutescens) in the manufacturing of their unique cosmetic products. The Bulbinella plant, popular for its medicinal value, is indigenous to South Africa. It is an evergreen, frost, drought and heat tolerant plant with definitive seasonal yellow or orange flowers. The plant is also referred to as the “burn jelly plant” due to the relieve that the pulp brings when applied topically to burns, insect bite or abrasions.

You are an IFRS specialist, appointed to assist Bulbine with the finalisation of its financial statements for the year ended 31 December 2022.

Notes:

1. Inventory

Bulbine imports the base cream of its product from Crème Pour le Visage (Crème), a cosmetic company situated in France. Bulbine is also a shareholder of Crème and annually receives a profit share from the company.

Due to the fluctuation in the exchange rates, Bulbine decided to amend its accounting policy to account for inventory from the first-in-first-out (FIFO) method to the weighted average cost method.

The accountant of Bulbine was able to accurately calculate the following values and provided it to you as follows:

	2022 **R**	**2021** **R**	**2020** **R**
First-in-first-out method (old)	2 350 700	2 233 200	2 121 000
Weighted average method(new)	2 298 000	2 206 700	2 108 400

Assume that SARS will not re-open the previous years’ assessments for the change in the valuation method but would accept the new valuation for the financial year ended 31 December 2022.

2. **Taxation**

The following additional information, required to assist with the calculation of the taxation of Bulbine for the financial year ended 31 December 2022, was made available to you.

Accounting policy:

- Property, plant and equipment are accounted for at the cost model in terms of IAS 16 Property, Plant and Equipment and depreciated over its respective useful lives after consideration of any residual value, except for land which is not depreciated.

Information relating to 31 December 2021:

On 31 December 2021 the deferred tax balances were as follows:

	R Dr/(Cr)
1. **Taxable temporary differences** (excluding the capital loss in no. 2 below)	(134 400)
2. **Assessed capital loss:** Bulbine incurred a capital loss with the sale of shares that were accounted for at the fair value model through profit or loss. The South African Revenue Services (SARS) acknowledged this loss as a capital loss. According to the SARS, Bulbine may utilise this capital tax loss against any future capital taxable profit only. On 31 December 2021, Bulbine was certain that future capital profits would be probable.	42 120
3. **Assessed loss recognised:** Bulbine incurred an assessed loss amounting to R455 000 during the financial year ended 31 December 2021. It was the first year the company incurred a loss. According to the SARS, Bulbine may utilise the unused tax loss amounting to R455 000 against any future taxable income. On 31 December 2021, Bulbine was uncertain whether a profit would be realised in the following financial years.	?

Information relating to 31 December 2022:

- **Property:**

On 28 December 2022, Bulbine sold vacant land (accounted for at the cost model according to Bulbine's accounting policy) at a profit of R130 000.

The only other property which Bulbine owns, is as follows:

	Acquisition date	Amount
Administration building • Carrying amount on 31 December 2022 • Depreciation for the year ended 31 December 2022	23 May 2018	 R3 000 000 R125 000
Manufacturing building (Original cost: R2 200 000) • Carrying amount on 31 December 2022 • Depreciation for the year ended 31 December 2022	1 January 2019	 R1 848 000 R88 000

The South African Revenue Services (SARS) does not allow any deduction on land or administration buildings.

In terms of section 13(1), Bulbine can claim a tax allowance of 5% on the cost of the manufacturing building, which is not apportioned for part of the year.

- **Equipment:**

The following values were correctly determined at:

	Equipment R
Carrying amount on 31 December 2022	400 000
Depreciation for the year ended 31 December 2022	100 000
Tax base on 31 December 2022	140 000
Tax allowance for the year ended 31 December 2022	140 000

- Trade receivables amounted to R50 600 after an allowance for credit losses, amounting to R5 800, was taken into consideration. The South African Revenue Services (SARS) allows 25% of the accounts receivable balance as a provision for doubtful debts.

- On 30 December 2022, Bulbine paid rent amounting to R23 000, for the month of January 2023, in advance.

- Profit before tax correctly amounted to R1 450 000.

- Foreign income received from Crème amounted to R300 000, after R75 000 relating to foreign taxes has been deducted. The accountant correctly accounted for the foreign income as income received at the gross amount thereof.

- Bulbine received dividends amounting to R45 800. Tax (withholding tax) on these dividends was already paid for on behalf of Bulbine by the South African company from which the dividends was received.

- During the current financial year, Bulbine had to pay fines to the amount of R1 840 relating to its delivery vehicles that exceeded the required speed limit. These fines are not tax deductible.

- There are no other temporary differences, nor any non-taxable or non-deductible items, other than those evident from the information provided.

Additional information

- Assume that a normal tax rate of 27% and a capital gains inclusion rate of 80% are applicable for both the financial years ended 31 December 2022 and 31 December 2021.

REQUIRED

YOU NOW HAVE 60 MINUTES TO ANSWER THIS QUESTION

PART I		**Marks**
(a)	Prepare the income tax note to the annual financial statements of Bulbine Cosmetics Ltd for the year ended 31 December 2022. **Please note**: • Deferred taxation should be calculated by using the statement of financial position method. • Comparative figures are not required	30
	Communication skills: presentation and layout	1
(b)	In terms of the Conceptual Framework for Financial Reporting, briefly discuss whether the assessed capital loss was correctly recognised as an asset in the annual financial statements of Bulbine Cosmetics Ltd for the year ended 31 December 2021. You may assume that the recognition criteria have been complied with	8
	Communication skills: logical argument	1
Please note: • Round off all amounts to the nearest Rand. • Your answer must comply with International Financial Reporting Standards (IFRS).		

QUESTION 1 - Suggested solution

(a) Prepare the income tax note to the financial statements of Bulbine Cosmetics Ltd for the year ended 31 December 2022.

BULBINE COSMETICS LTD

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022

11. Income tax expense

	2022 R	
Major components of tax expenses		
SA normal taxation		
Current tax		
– Current year (Refer C1)	179 015	(18)
Deferred tax	88 371	
– Movement in temporary differences	(24 834)	(½)
– Movement in unused tax loss		
– Unused tax loss utilised (R455 000 x 27%)	122 850	(1)
– Unused tax loss not recognised before, utilised (R455 000 - R315 278) x 27%	(37 725)	(1)
– Capital loss utilised	28 080	(½)
	267 386	
Foreign tax (given)	75 000	(1)
	342 386	
Tax rate reconciliation		
Accounting profit	1 450 000	(½)
Taxation at 27%	391 500	(½)
Tax effect of non-deductible/non-taxable items:		
– Depreciation of administration building not deductible (R125 000 x 27%)	33 750	(1)
– Dividends received not taxable (R45 80 x 27%)	(12 366)	(1)
– Capital profit on the sale of land not taxable (R130 000 x (20% x 27%))	(7 020)	(1)
– Foreign income (R101 250 [R375 000 x 27%] - R75 000)	(26 250)	(1½)
– Fines payable (R1 840 x 27%)	497	(1)
– Unused tax loss not recognised before, utilised (R455 000 - R315 278) x 27%	(37 725)	(1½)
	342 386	
	Total	(30)
	Communication skills: presentation and layout	(1)

CALCULATIONS

C1. Prepare the current tax calculation of Bulbine Cosmetics Ltd for the financial year ended 31 December 2022 with the information provided.

Current tax calculation

	R	
Profit	1 450 000	(1)
Non-taxable/non-deductible items:		
– Depreciation of administration building not deductible	125 000	(½)
– Dividends received not taxable	(45 800)	(½)
– Accounting profit on land not taxable (R130 000 x 20%)	(26 000)	(1)
– Foreign income (R300 000 + R75 000)	(375 000)	(1)
– Fines payable	1 840	(½)
	1 130 040	
Movement in temporary differences (Refer C2)	91 978	(11½)
Movement in capital loss	(104 000)	
Taxable profit before tax loss	1 118 018	
Unused loss of prior year	(455 000)	(1)
	663 018	
Tax at 27%	179 015	(1)
		(18)

C2. Deferred tax

	Carrying amount	Tax base	Temporary difference at 100% or 80%	Deferred tax 27% asset/ (liability) Dr/(Cr)	[½]
	R	R	R	R	
31 December 2021					
Temporary differences	-	-	[2]497 778	(134 400)	[½]
Inventory adjustment	2 206 700	2 233 200	(26 500)	7 155	[1]
			471 278	(127 245)	
Capital loss		195 000	[3](156 000)	42 120	[1]
			315 278	(85 125)	
Unused tax loss	For limiting to temporary differences	[1]455 000	(315 278)	85 125	[1]
			-	-	
31 December 2022					
Administration building	[1]3 000 00	-	Exempt	-	[1]
Manufacturing building	[1]1 848 000	[4]1 760 000	88 000	(23 760)	[1½]
Equipment	[1]400 000	[1]140 000	260 000	(70 200)	[1]
Trade receivables	50 600	42 300			
Gross amount	[5]56 400	[5]56 400	-	-	[1]
Allowance for credit losses	[1](5 800)	[5](14 100)	8 300	(2 241)	[1]
Rent paid in advance	[1]23 000	-	23 000	(6 210)	[½]
			379 300	(102 411)	
Capital loss	-	[6]65 000	(52 000)	14 040	[1]
			327 300	(88 371)	
Unused tax loss	-	-	-	-	
			327 300	(88 371)	

Movement in temporary differences through P/L (R379 300 – R471 278)	(91 978)	24 834	[½]
Movement in capital loss ((R52 000) – (R156 000))	104 000	(28 080)	
Movement in unused tax loss (RNil – R315 278)	315 278	(85 125)	
	327 300	(88 371)	
		Total	[11½]

1	Given	
2	R134 400/ 27% = R497 778	[½]
3	R42 120/[27%/ 80%] = R156 000	[1]
4	R2 200 000 – [(R2 200 000 x 5%) x 4] = R1 760 000	[1]
5	R50 600 + R5 800 =R56 400 x25% = R14 100	[1]
6	R195 000 – R130 000 = R65 000 x 80% = R52 000	[1]

(b) In terms of the Conceptual Framework for Financial Reporting, briefly discuss whether the assessed capital loss was correctly recognised as an asset in the financial statements of Bulbine Cosmetics Ltd for the year ended 31 December 2021. You may assume that the recognition criteria have been complied with.

Bulbine could only recognise an asset for the capital loss incurred in the financial year 31 December 2021 if the capital loss:

- met the definition of an asset (Conceptual Framework 5.6) ; and (1)
- if recognition of the asset would have provided users of the financial statements with information that would be useful (Conceptual Framework 5.6 & 5.7).

Definition of an Asset

An asset is a present economic resource **controlled** by an entity as a result of past events (Conceptual Framework 4.3).
An economic resource is a **right** that has the **potential to produce economic benefits** (Conceptual Framework 4.4).

Right
According to the South African Revenue Service (SARS), Bulbine may utilise the assessed capital loss against any future taxable capital profit only. (1)
Bulbine therefore has a legal right to offset the unused assessed capital loss against any future taxable capital profits. (1)
(Conceptual Framework 4.7).

Potential to produce economic benefits
Bulbine has the right to offset future capital profits against the assessed capital loss, therefore the assessed capital loss has the potential to produce economic benefits, because it would lower tax payments in future. (1)
Bulbine is also certain that the company will obtain future capital profits. (1)
However, for the potential that economic benefits will be produced to exist, it does not need to be certain or likely that the right will produce economic benefits. (1)
(Conceptual Framework 4.14).

Controlled by the entity
Only Bulbine can utilise the assessed capital loss against its own future capital profits. Hence only Bulbine would **be able** to obtain the economic benefits associated with the capital loss. (1)

Bulbine therefore has the present ability to prevent other parties directing the use of this economic resource and obtaining the economic benefit that may flow from it, and therefore controls the economic resource (Conceptual Framework 4.20). (1)
Bulbine will obtain the future benefits from the unused assessed capital loss and the

benefits thereof will therefore not flow to any other party (Conceptual Framework 4.23). (1)

Past event
The past event is the capital loss which Bulbine incurred when the company sold certain of its shares at a loss during the financial year ended 31 December 2021. (1)

The assessed capital loss therefore adheres to the **definition** of an asset in terms of the Conceptual Framework for Financial Reporting. (1)
In order for the capital loss to be recognised in the financial statements of Bulbine, it also has to **comply with the recognition criteria**. (1)

The assessed capital loss complies with the recognition criteria according to the information provided, therefore, it can be concluded that the assessed capital loss was **correctly recognised** in the financial statements of Bulbine or the year ended 31 December 2021. (1)

Total	(13)
Maximum	(8)
Communication skills: Logical argument	(1)

QUESTION 2 **40 marks**

YOU HAVE 15 MINUTES TO READ THIS QUESTION

THIS QUESTION CONSISTS OF TWO SEPARATE PARTS THAT ARE NOT RELATED TO EACH OTHER.

PART I

ALL AMOUNTS EXCLUDE VALUE ADDED TAXATION (VAT) UNLESS OTHERWISE INDICATED.

Duman Ltd (Duman) is a company listed in the industrial sector of the Johannesburg Stock Exchange Ltd (JSE). You have been appointed to finalise the preparation of the financial statements of the company for the year ended 28 February 20.22.

The following information is available for the 20.22 financial year.

DRAFT SUMMARISED TRIAL BALANCE AS AT 28 FEBUARY 20.22

	Notes	Dr R	Cr R
Land at cost	1	3 500 000	
Office buildings at carrying amount	1	2 500 000	
Plant and machinery at carrying amount	1	945 000	
Inventory		831 500	
Cash and cash equivalents		2 044 000	
Prepaid insurance premium	2	90 900	
Trade and other receivables	3	2 405 600	
Deferred tax asset (1 March 20.21)	4	122 360	
Share capital (125 000 shares)	5		445 000
Retained income (1 March 20.21)			8 601 860
Profit before tax	6		1 702 500
Trade payables			1 690 000
		12 439 360	12 439 360

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 March 20.21, Duman purchased land for the future development of a new plant. Owing to the worldwide economic crisis and a decline in the property market during the second half of 20.21, the directors agreed to sell the land as soon as possible. The land was sold on 12 December 20.21 at a loss of R200 000.

Duman depreciates the office buildings at R205 500 per annum, while the South Africa Revenue Service (SARS) permits no deduction on the buildings.

On 28 February 20.22, the tax base of the plant and machinery amounted to R645 000.

2. Insurance contract

On the 15 February 20.22, the annual insurance premium amounting to R90 900 was paid in advance for the year ended 28 February 20.23. According to the SARS this prepaid insurance premium is deductible for income tax purposes in the year it was paid. There was no prepaid insurance premium for the year ended 28 February 20.21.

3. Trade and other receivables

Trade and other receivables consisted of the following on 28 February 20.22:

	R Dr/(Cr)
Trade receivables	2 495 300
Allowance account for credit losses	(410 600)
Other receivables	320 900
Balance at year end	2 405 600

The SARS grants only 40% of the allowance for credit losses as a deduction in terms of section 11(j) of the Income Tax Act.

4. Deferred tax asset

The net deferred tax asset of R122 360 at 28 February 20.21 consisted of the following:

	R Dr/(Cr)
Property, plant and equipment	(143 661)
Allowance account for credit losses	67 221
Unused tax loss	198 800
Net deferred tax asset	122 360

All the temporary differences that gave rise to the net deferred tax asset of R122 360 were taxed at 28%. The final tax assessment issued by the SARS for the financial year ended 28 February 20.21 reflected an assessed tax loss of R710 000 which was accepted by Duman.

On 28 February 20.21, the management of Duman 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 Duman. This opinion of management remained unchanged for the financial year ended 28 February 20.22.

5. Share capital

On 1 July 20.21 Duman issued 10 000 ordinary shares at the fair value of R10 each. On 31 December 20.21, Duman declared dividends of R0,20 per share to all registered shareholders on that date.

6. Profit before tax

You may assume that all transactions (excluding the accounting error in note 7) were correctly accounted for in profit before tax.

The following items are included in profit before tax:

6.1 Dividend income to the amount of R150 000 which is not taxable.

6.2 On 26 July 20.21 the Competition Tribunal fined Duman for retail price fixing. The Competition Tribunal imposed a penalty of R1 260 000 on Duman because of the existence of a vertical agreement between Duman and Arora Ltd for setting retail prices. The penalty was immediately payable. This penalty is not deductible for tax purposes.

6.3 Foreign revenue of R400 000 which is subject to foreign tax of 10% and is therefore not taxable in South Africa.

7. Accounting error

On 31 January 20.21 Duman received an amount of R345 000 (VAT inclusive) from a customer for services that were only rendered during June 20.22. The accountant recognised the R345 000 as revenue in January 2021 and did not allocate the VAT of 15% to the VAT output account. As a result, the R345 000 was included in revenue for the financial year ended 28 February 20.21. For tax purposes, the R345 000 was taxed in the financial year ended 28 February 20.21. The SARS indicated that they will re-open the 20.21 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 current tax expense for the year ended 28 February 20.21 was correctly calculated at R586 609 (after considering all the additional information contained within the notes above). Deferred tax for the year ended 28 February 20.21 has not yet been calculated or provided for.

- Assume the normal tax rate is 28%. The capital gains tax inclusion rate is 80%.

- The VAT rate is 15% for all periods.

PART II

Elizabeth Klopp recently joined Sunglass (Pty) Ltd (Sunglass) as a financial manager. Sunglass is a small sunglass wholesale business and has a 30 June year end. Elizabeth required you to assist with the preparation of the annual financial statements of Sunglass for the year ended 30 June 20.21.

The sales of Sunglass were affected by Covid-19 due to the lockdown during the financial year ended 30 June 20.21.

In a board meeting dated 21 July 20.20, Elizabeth suggested to the board to consider changing its current valuation method of inventory from the first-in, first-out method to the weighted average method.

The following transactions occurred during the current accounting period:

	Units	Unit price R
Inventory on 1 July 20.20:	1 300	130
Purchases:		
18 October 20.20	1 400	150
14 April 20.21	1 300	150
Sales:		
7 October 20.20	1 200	
18 March 20.21	1 200	

Purchases on the 14 April 20.21 relate to a special order of unique sunglasses entering the Southern Africa market that required a special delivery. Eyewear, a supplier of Sunglass, charged R5 per unit for delivery.

On 25 June 20.21, during the annual stock count, it was noted that 80 of the units bought on 14 April 20.21 were damaged. It was determined that the units would be repaired at a total cost of R30 and would be sold at 90% of their cost.

Additional information

- Sunglass measures its inventory using the first-in, first-out accounting method.

REQUIRED

YOU NOW HAVE 60 MINUTES TO ANSWER THIS QUESTION

PART I	**Marks**
(a) Prepare the statement of changes in equity of Duman Ltd for the year ended 28 February 20.22.	20
Please note: • The total column of the statement of changes in equity is not required. • Ignore comparative figures. • Calculate deferred tax by using the statement of financial position method.	
Communication skills: presentation and layout	1
(b) Prepare the income tax expense note to the financial statements of Duman Ltd for the year ended 28 February 20.22 in terms of IAS 12.81(c)(i).	7
Please note: • Comparative figures are not required.	
Communication skills: presentation and layout	1
Please note: • Round off all amounts to the nearest Rand. • Assume that all amounts are material, except were stated otherwise. • Your answer must comply with International Financial Reporting Standards (IFRS).	
PART II	
(a) Calculate the amount of inventory of Sunglass (Pty) Ltd to be disclosed in the annual financial statements for the year ended 30 June 20.21.	7
(b) Briefly advise Mrs Klopp on the advantages and disadvantages of the first-in, first-out valuation method to be considered before changing the inventory valuation method of Sunglass (Pty) Ltd to the weighted average method.	3
Communication skills: logical argument	1
Please note: • Your answer must comply with International Financial Reporting Standards (IFRS).	

QUESTION 2 – Suggested solution

PART I

(a) DUMAN LTD

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 28 FEBRUARY 20.22

	Ordinary share capital	Retained earnings	
	R	R	
Balance on 1 March 20.21	[1]345 000	8 601 860	(2)
Prior period error adjustment (345 000 x 72%)	-	(248 400)	(1)
Total comprehensive income for the year:			
Profit for the year [C1]	-	1 134 260	(16)
Issue of ordinary shares (10 000 x10)	100 000		(1)
Dividends paid	-	[2](25 000)	(1)
Balance on 28 February 20.22	445 000	9 462 720	

1 445 000 – 100 000 = 345 000
2 125 000 x 0,20 = 25 000

(20)
Communication skills: presentation and layout (1)

(b) DUMAN LTD

NOTES FOR THE YEAR ENDED 28 FEBRUARY 20.22

3. Income tax expense

Tax rate reconciliation	**R**	
Accounting profit (1 702 500 + (345 000 x 100/115)))	2 002 500	(1)
Tax at 28%	560 700	(1)
Tax effect of non-taxable /non-deductible items:		
Dividends not taxable (150 000 x 28%)	(42 000)	(1)
Capital loss on sale of land not deductible (200 000 x 20% x 28%)	11 200	(1)
Depreciation on office buildings not deductible (205 500 x 28%)	57 540	(1)
Penalties not deductible (1 260 000 x 28%)	352 800	(1)
Foreign tax (400 000 x 18%)	(72 000)	(1)
	868 240	
	Total	(7)

Communication skills: presentation and layout (1)

CALCULATIONS

C1. Profit for the year

Adjusted profit before tax	2 002 500	[1]
Current year (given)	(586 609)	[1]
Deferred tax [C2]	(241 631)	[13]
Foreign tax (400 000 x 10%)	(40 000)	[1]
	1 134 260	[16]

C2. Deferred tax

28 February 20.21	**Carrying amount**	**Tax base**	**Temporary difference at 100% or 80%**	**Deferred tax at 28% asset/ (liability)**	
Property plant and equipment (given)	?	?	[1]513 075	(143 661)	[1]
Allowance for credit losses (given)	?	?	[2](240 075)	67 221	[1]
Revenue received in advance (error)	[3](300 000)	-	(300 000)	84 000	[1]
			(27 000)	7 560	
Unused tax loss (given)	-	[4]755 000	(755 000)	211 400	[2]
Net deferred tax asset			(782 000)	218 960	

[1] 143 661/28% = 513 075
[2] 67 221/28% = 240 075
[3] 345 000 x 100/115 = 300 000
[4] 710 000 + 45 000 = 755 000

28 February 20.22					
Land	3 500 000	3 500 000	-	-	[1]
Office building	2 500 000	-	Exempt	-	[1]
Plant and machinery	945 000	645 000	300 000	(84 000)	[1]
Allowance for credit losses (given)	(410 600)	[1](164 240)	(246 360)	68 981	[1]
Prepaid insurance premium	90 900	-	90 900	(25 542)	[1]
			144 540	(40 471)	
Unused capital loss	-	200 000	[2](160 000)	44 800	[1]
			(15 460)	4 329	

[1] 410 600 x 40% = 164 240 or 410 600 – (410 600 x 60%) = 164 240
[2] 200 000 x 80% = 160 000

Movement in temporary differences (excluding unused tax loss and unused capital loss) (taxable) (144 540 – (27 000))	171 540	(48 031)	[1]
Movement in unused tax loss (reversal of deductible)	755 000	(211 400)	[½]
Movement in unused capital loss (deductible)	(160 000)	44 800	[½]
Total movement in temporary differences	766 540	(214 631)	[13]
OR 218 960 – 4 329 = 214 631			{2}

PART II

(a) Calculate the amount of inventory of Sunglass (Pty) Ltd for the year ended 30 June 20.21

Closing Inventory as at 30 June 20.21 [C1]	242 900	(7)

(b) Briefly advise Mrs Klopp on the advantages and disadvantages of the first-in, first-out valuation method to be considered before changing the inventory valuation method of Sunglass (Pty) Ltd to the weighted average cost method.

Mrs Klopp should consider the following benefits before changing the current valuation method of Sunglass (Pty) Ltd.

- If older inventory items were acquired in a period when the acquisition price thereof was higher, **FIFO would lead to a higher cost of goods sold and a lower net income.** (1)
  This will result in a decreased net profit, but also less tax payable. (1)

- However, due to inflation, prices tend to increase as time passes, which would allow the FIFO method to **produce a higher net income and tax liability over the long term**. (2)

Total	(4)
Maximum	(3)
Communication skills: logical argument	(1)

CALCULATIONS

C1. Closing inventory		**Units**	**Unit Cost R**	**Total Value R**	
01.07	Opening Balance	1 300	130	169 000	(1)
07.10	Sales	(1 200)	130	(156 000)	(1)
		100	130	13 000	
18.10	Purchase	1 400	150	210 000	(1)
		1 500		223 000	
18.03	Sales	(100)	(130)	(13 000)	(1)
		(1 100)	(150)	(165 000)	
		300	150	45 000	
14.04	Purchase	1 300	155	201 500	(1)
	Write down to NRV [C2]			(3 600)	(2)
				242 900	
				Total	(7)

C2. Write to net-realisable value:

Damaged items cost	80	155	12 400	[1]
NRV – fair value less Costs to Sell	80	[1]110	(8 800)	[1]
			3 600	

[1] 155 x 90% - R30 =110

QUESTION 3 **40 marks**

YOU HAVE 15 MINUTES TO READ THIS QUESTION

IGNORE VALUE ADDED TAX (VAT).

Fitness Squad Ltd (Fitness Squad) is a South African listed company that manufactures fitness equipment and sells its products across South Africa. You have been asked to assist with the preparation of the annual financial statements for the year ended 31 December 20.20 in your capacity as the junior accountant in the company's finance division.

The following extract from the audited statement of financial position of Fitness Squad as at 31 December 20.19 has been presented to you. All figures have been correctly calculated unless indicated otherwise.

Account description	Note	Dr R	Cr R
Land	1	1 600 000	
Plant and Machinery	2	3 472 500	
Inventory	3	5 370 000	
Trade receivables	4	1 325 000	
Deferred tax	5		778 400

Notes

1. Land

Fitness Squad acquired land in Johannesburg for the future development of a factory. The base cost of the land in terms of Paragraph 20 of the Eighth Schedule of the Income Tax Act is equal to the cost of the land. It is the policy of Fitness Squad to subsequently measure land by using the revaluation model in accordance with IAS 16 *Property, Plant and Equipment* (IAS 16). Land is revalued every two years. The fair value is determined using the market approach in accordance with IFRS13 *Fair Value Measurement.*

Further details relating to this land are provided below.

Date of purchase	1 January 2017
Cost	R1 200 000
Revalued carrying amount on 31 December 2018	R1 600 000
Fair value at 31 December 20.20	R1 100 000

2. Manufacturing plant and machinery

Manufacturing plant and machinery are accounted for in terms of the cost model according to IAS 16 and are depreciatedtheir useful lives on the straight-line method after consideration of any residual value. The manufacturing plant and machines were acquired on 15 September 2017 and were available for use on 1 October 2017. The manufacturing plant has a residual value of R200 000 whereas the residual value of machines was considered to be immaterial. Manufacturing plant and machinery are used in the production of fitness equipment. There has been no disposal or purchase of plant and machinery since acquisition.

The following is the extract disclosure note in the financial statements of Fitness Squad with regard to its manufacturing plant and machinery for the year ended 31 December 20.19:

	Plant R	Machinery R
Carrying amount at the beginning of the year	3 087 500	975 000
Cost	3 500 000	1 300 000
Accumulated depreciation	(412 500)	(325 000)
Depreciation	(330 000)	(260 000)
Carrying amount at the end of the year	2 757 500	715 000

During the beginning of the current year, management estimated that the total useful life of machinery should have been seven years.

3. Inventory

Inventory is measured using the weighted average cost formula.

The opening inventory on 1 January 20.20 consisted of the following:

- 1 150 units of finished goods, which had a weighted average cost of R4 200 each.
- Raw materials that are used in the assembly of equipment which had a value of R540 000.

On 5 January 20.20, Fitness Squad entered into a contract with a new supplier, Fit Designs Ltd, to provide Fitness Squad with raw materials to be used to assemble fitness equipment. The contract had the following terms:

- The agreement would be signed on 5 January 20.20. On this date, a deposit of 20% of the purchase price would be paid by Fitness Squad. The purchase price was R3 500 000.
- Fit Designs Ltd would deliver the raw material to Fitness Squad's manufacturing plant on 30 January 20.20.
- Transport costs and insurance costs of R12 000 and R25 000 respectively incurred by Fit Designs Ltd was payable by Fitness Squad on the date of delivery.
- The final payment will be due on 30 June 20.20.
- A trade discount 10% of the purchase price was given to Fitness Squad.
- Other administrative costs incurred by Fitness Squad amounted to R17 500 which were paid on 7 February 20.20.
- A normal credit term is 90 days.
- Both parties fulfilled all the terms of the agreement.

Inventory is assembled at the manufacturing plant which has a normal operating capacity of 64 000 direct labour hours per annum. The company allocates its fixed overheads to the manufactured equipment based on labour hours. During the current year, Fitness Squad lost 15 000 hours due to the national lockdown. The company incurred the following costs in the process of manufacturing equipment during the current year:

Details	**Total cost R**
Variable costs, excluding raw materials (3 650 units)	10 425 000
Fixed overhead costs	6 500 000

The cost of unused raw materials at the end of the year amounted to R945 000. The actual direct labour hours for the year were calculated to be 58 000 hours. A total of 4 050 equipment units were sold during the year across the country. During the year-end inventory count, it was established that the 105 units of the unsold equipment had minor defects and could be sold at a price of R4 500 each. The rest of the equipment remained in the condition to be sold at market prices.

4. Trade receivables

The trade receivable general ledger account shows the following.

Account	**20.20 R**	**20.19 R**
Gross trade receivable	560 000	1 395 000
Allowance account for credit losses	(108 000)	(70 000)
Net trade receivable	452 000	1 325 000

SARS allows 25% of the credit losses allowance on the trade receivables account as a deduction for income tax purposes.

5. Deferred tax

The 20.19 deferred tax note was as follows:

		R
Comprises temporary differences on:		
Land	(Liability)	(89 600)
Plant and machinery	(Liability)	(703 500)
Allowance for credit losses	(Asset)	14 700
	(Liability)	(778 400)

6. Revenue received in advance

On 30 November 20.20, Fitness Squad was awarded a contract to provide a new client with fitness equipment to the value of R3 million. Fitness Squad agreed to deliver the fitness equipment by 28 February 2021. Fitness Squad requires the client to pay 50% upfront in order to start with manufacturing. The deposit was received on 15 December 20.20.

7. Loss before tax

Due to its poor operations in 20.20, Fitness Squad made a net loss before tax of R2 336 500, which was correctly calculated after considering note 1 to 5.

The loss before tax also includes dividend income and foreign revenue of R150 000 and R1 200 000 respectively. Foreign income is subject to foreign tax of 10% and is therefore not taxable in South Africa, whereas dividends income is exempt from normal tax in terms of section 10(1)(k) of the Income Tax Act.

8. Taxation

On 30 April 20.20, Fitness Squad received their 20.19 tax assessment from the SARS. This assessment indicated that the taxable income for the year ended 31 December 20.19 amounted to R7 245 800. The current tax expense for the 20.19 financial year, as disclosed in the 20.19 financial statements, amounted to R2 390 760.

Additional information

- Manufacturing plant and machinery are granted wear and tear allowances by SARS at a rate of a 40:20:20:20 basis, which are not apportioned for part of a year.
- An assessed loss of R2 385 784 was correctly calculated after considering note 1 to 7.
- The directors indicated that the company was unlikely to return to profitability in the short-term.
- There are no non-taxable or non-deductible items included in the loss before tax, except those that are apparent from the information provided.
- The temporary differences arose solely as a result of the information above for tax purposes.
- The corporate income tax rate is 28% and the inclusion rate for capital gains tax is 80%.
- The appropriate discount rate is 9,5% per annum.
- You can assume that all amounts are material.

REQUIRED

YOU NOW HAVE 60 MINUTES TO ANSWER THIS QUESTION

		Marks
(a)	Prepare the income tax expense note to the financial statements of Fitness Squad Ltd for the financial year ended 31 December 20.20 in terms of IAS 12.79-80 only and provide an explanation of which items would be included in the tax rate reconciliation.	17
	Communication skills: presentation and layout	1
	Please note: • Comparative figures are not required. • You do not need to prepare the tax rate reconciliation. • The movement in temporary differences in the current tax calculation must be calculated using the statement of financial position method.	
(b)	Discuss, with reasons, the date and initial amount at which raw material bought from Fit Designs Ltd should be recognised as inventory by Fitness Squad Ltd.	10
	Communication skills: logical flow and argument	1
(c)	Prepare the inventory note to the financial statements of Fitness Squad Ltd for the year ended 31 December 20.20.	10
	Communication skills: presentation and layout	1
	Please note: • Comparative figures are not required. • The accounting policy note is not required.	
Please note: • Round off all amounts to the nearest Rand. • Your answer must comply with International Financial Reporting Standards (IFRS).		

QUESTION 3 – Suggested solution

(a) FITNESS SQUAD LTD

NOTES TO THE FINANCIAL STATEMENTS 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	(361 936)	
Current year	-	(½)
Overprovision in prior year [C1]	(361 936)	(1½)
Deferred tax	(688 800)	
Movement in temporary differences (deductible) [C2]	(316 127)	(8)
Unused tax loss utilised [C2]	(372 673)	(1)
SA Normal tax	(1 050 736)	
Foreign tax (1 200 000 x 10%)	120 000	(1)
	(930 736)	

Explanation of including items in the reconciliation:

[1] Dividends received is included in the tax rate reconciliation as the amount is included in the accounting loss however it is exempt from tax and therefore not included in the income tax expense or dividends income is a permanent difference and therefore a reconciling item. (1)

[2] The portion of the loss below the original cost (base cost) of land represents a capital loss of which 80% is deductible. 20% of the R100 000 included in accounting loss is not deductible and represents a reconciling item (or a permanent difference). (1)

[3] Foreign income is included in both the accounting loss and income tax expense; however it is taxed at a different rate (10%) than the corporate tax rate (28%) or the income tax expense in the statement of profit or loss and includes tax on foreign income taxed at a rate of 10%, not at 28%, and it is therefore a reconciling item. (1)

[4] Overprovision relates to prior year therefore adjusted to the current year's income tax expense, it is, however, not included in the current year's accounting loss. Or the income tax expense in the statement of profit or loss includes a overprovision of income tax for a prior period and not reflected

in current year's accounting loss. (1)

[5] The current year's tax saving was recognised in the loss for the year, whereas the income tax expense includes only a portion of the tax saving, therefore the unrecognised portion is a reconciling item. (1)

Total (17)

Communication skills: presentation and layout (1)

(b) Raw material

IAS 2 does not provide specific criteria for the recognition of inventory. In the absence of an IFRS that specifically applies to a transaction or event, management must use its judgement in developing an accounting policy and, in doing so, it must apply the following sources in descending order (IAS 8.10–11)

(a) the requirements of IFRS dealing with similar and related issues; and
(b) the definitions, recognition criteria and measurement concepts for the assets in the *Conceptual Framework for Financial Reporting (Conceptual Framework).* (2)

Therefore, the raw material purchased from Fit Designs Ltd will be recognised on the date that the asset definition and recognition criteria are met. (1)

An asset is defined as:

A present economic resource – An economic resource is a right that has a potential to produce economic benefits. Fitness Squad has a right to use the raw material purchased from Fit Designs Ltd in their manufacturing process and will benefit from the sale of the finished goods; (1)

Controlled by the entity – Fitness Squad controls the raw materials as it will direct how the raw material will be used in the manufacturing process and will be able to sell the finished goods to customers in order to earn an income; (1)

As a result of a past event – The signing of the contract with Fit Design is a past event. (1)

Fitness Squad can recognise the raw material as an asset only if information about the raw material will provide users of the financial statements with information that is useful. Information is useful if it provides relevant and faithfully represented information. (1)

Relevant information –

The raw material was delivered to Fitness Squad's manufacturing plant on 30 January 20.20, therefore there is no uncertainty that the raw material exists. (1)

The probability of the inflow of future economic benefits is not low as the inventory (finished product) will be sold to customers. (1)

Faithful representation –

The raw material was acquired by Fitness Squad at cost (that is known), therefore, there is no measurement uncertainty associated with the raw material. (1)

Inventory is measured at the lower of cost and net realisable value (NRV). The cost of inventory is comprised of all cost of purchase, costs of conversion and all other costs incurred in bringing the inventories to their present location and condition. (IAS 2.9-10), whereas the NRV is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. (IAS 2.6) (1)

Cost of purchase:

Fitness Squad will include the following costs as part of the cost of purchase as these costs are directly associated with the acquisition of the raw material:

The purchase price of R3 020 609 [C3] includes the 20% deposit of R700 000, the present value R2 670 609 and trade discount of R350 000. As the balance was deferred to 30 June 20.20, payment date was beyond the normal credit terms of 90 days, the present value was estimated using the appropriate discount rate of 9,5%. (3)

The insurance of R25 000 and transport costs of R12 000 are directly attributable and included in the cost of purchase. (1)

The administration expenses of R17 500 will not form part of the cost of purchase as these are not costs incurred in bringing inventory to their present location and condition. (1)

Therefore, the raw material bought from Fit Designs Ltd will be recognised as inventories on 30 January 20.20, and will initially be measured at R3 057 609. (1)

Total	(17)
Maximum	(10)
Communication skills: logical flow and argument	(1)

Inventory note

FITNESS SQUAD LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.20

5. Inventory

	20.20 R	
Inventories		
Raw materials and consumables	945 000	(½)
Finished products [C4]	3 734 910	(7½)
	4 679 910	

The cost of inventories recognised as an expense and included in cost of sales amounted to R21 152 865[a]. (1)

Inventories held at net realisable value amounted to R472 500[b]. The write-down of inventories amounted to R58 590. (1)

Total	(10)
Communication skills: presentation and layout	(1)

[a] (4 050 x R5 058) + R58 590 + (R6 500 000 – R5 890 625)
[b] 105 x R4 500

CALCULATIONS

C1. Overprovision

	R	
Taxable income per SARS assessment	7 245 800	[½]
Current tax at 28% (7 245 800 x 28%)	2 028 824	[½]
Current tax per 20.19 AFS	2 390 760	[½]
Overprovision	(361 936)	

C2. Deferred taxation

	CA	TB	TD (100%/80%)	DT (28%) Assets/ (liability)	
20.19	**R**	**R**	**R**	**R**	
Land	1 600 000	1 200 000	320 000	(89 600)	
Plant and machinery	3 472 500	[1]960 000	2 512 500	(703 500)	
Allowance for credit losses	(70 000)	[2](17 500)	(52 500)	14 700	
			2 780 000	**778 400**	[1]
20.20					
Land	1 100 000	1 200 000	(80 000)	22 400	[1]
Plant and machinery	[3]2 991 974	[5]-	2 991 974	(837 753)	[2]
Allowance for credit losses	(108 000)	[6](27 000)	(81 000)	22 680	[1]
Contract Liability	(1 500 000)	-	(1 500 000)	420 000	[1]
			1 330 974	(372 673)	
Unused tax loss utilised		(2 385 784)	(1 330 974)	372 673	[1]

[1] [3 500 000 + 1 300 000] x 20% = 960 000

[2] 70 000 x 25% = 17 500

[3] [2 757 500 – 330 000] + [715 000 – (715 000/4.75[4])] = 2 991 974

[4] 1 300 000/260 000 = 5 + 2 – 2.25 (period machine was used) = 4,75

[5] [3 500 000 + 1 300 000] x 40% = R1 920 000
[3 500 000 + 1 300 000] x 20% x 3 years = R2 880 000
Tax base – 31 Dec 20.20 = RNil

[6] 108 000 x 25% = 27 000

Movement in temporary differences (excluding unused tax loss) (taxable)			
P/L [2 460 000 – 1 330 974]	(1 129 026)	316 127	(1)
OCI [(320 000) – 0]	(320 000)	89 600	
Movement in unused tax loss (deductible)	(1 330 974)	372 673	
Total movement in temporary differences	2 780 000	778 400	

C3. Raw material purchase price

	R	
Deposit (3 500 000 x 20%)	700 000	[½]
Amount payable on 30 June 20.20	2 670 609	[1½]
Trade discount (3 500 000 x 10%)	(350 000)	[½]
	3 020 609	

n	=	6	[½]
i	=	9,5/12	[½]
FV	=	2 800 000	[½]
SOLVE PV	=	2 670 609	

C4. Inventory

	R	R	
Opening balance			
Raw materials		540 000	[½]
Finished goods (1 150 x R4 200)		4 830 000	[½]
OR Opening balance		5 370 000	[½]
Production			
Variable costs			
Raw materials purchased	3 057 609		[½]
Closing raw materials	(945 000)		[½]
Variable overheads	10 425 000	12 537 609	[½]
Fixed costs			
Depreciation	480 526		[½]
Fixed overheads (R6 500 000/64 000 x 58 000)	5 890 625	6 371 151	[1]
Total manufacturing costs		24 278 760	
Units available for sale (1 150 + 3 650)		4 800 units	[½]
Weighted average cost (R24 278 760/4 800)		R5 058	[1]
Closing balance			
Finished products			
(4 800 – 4 050) x R5 058		3 792 500	[1]
Minor defects			
105 x (R5 058 – R4 500)		(58 590)	[1]
		3 734 910	

QUESTION 4 **40 marks**

YOU HAVE 15 MINUTES TO READ THIS QUESTION

IGNORE VALUE ADDED TAX (VAT).

Cool Ltd (Cool) is a company listed on the Johannesburg Stock Exchange and has a 31 December financial year end. The company produces and supplies *cool stuff* products to the general public.

Cool incurred a loss before taxation amounting to R650 000 for the financial year ended **31 December 20.18**. Mr Hot, the chief financial officer, indicated that the loss was due to manufacturing difficulties that affected the production supply of the company negatively. On 31 December 20.18, management was not convinced that the company would be able to make a profit in the near future.

On 5 January 20.19, Cool decided to close down two production lines that were incurring severe losses. The two non-profitable production lines were closed on 30 November 20.19. These two production lines incurred a nett loss after tax amounting to R7 500 for the year ended 31 December 20.19.

During the first quarter of the financial year ended 31 December 20.19, the company acquired new machinery to address its production challenges relating to the continuing production lines. The new machinery was funded with a loan from Cool's private bank. Cool had to supply sufficient security (regarding their assets) for the loan to be granted to the company. Therefore, the services of Mrs Value (a qualified valuer) were acquired to confirm the value of the company's land and this is accounted for in the revaluation model. The land was acquired on 1 July 20.15 at R2 950 000 and had a carrying value of R3 000 000 on 31 December 20.18. On 1 February 20.19 Mrs Value determined the value of the land at R3 070 000.

For the financial year ended 31 December 20.19, the company has seen an increase in revenue. Cool did, however, also incur a loss before taxation for continuing operations amounting to R232 000 for the financial year ended **31 December 20.19**. Mr Hot attributed this loss to the production standstill due to the installation of the new machinery.

The following information relates to Cool's **continuing operations**:

Cool received the following amounts for the financial year ended 31 December 20.19:

- Revenue from the sale of products: R2 970 000.
- Net local dividends: R230 750.
- Gross foreign income amounting to R175 000 which was taxed at 25%.
- Repayment of trade receivable accounts: R170 340, of which R67 000 related to the trade receivable balance at 31 December 20.18. Interest earned on these accounts amounted to R15 800 for the financial year.

Cool made the following payments during the financial year ended 31 December 20.19:

Details	Amount R	Allocation: Administration	Allocation: Manufacturing
Salaries: All employees are permanently employed and were employed for all 12 months in the current financial year	1 890 000	30%	70%
Water and electricity (allocation based on actual usage)	80 900	20%	80%
Trade payables: Payments to suppliers of the raw materials utilised in the production of *cool stuff* products. There was no opening or closing balance for trade payables, since Cool utilises the 10% discount available on the early settlement of all outstanding accounts	1 225 680		
Finance charges (of which none was capitalised)	58 900		
Depreciation on property, plant and equipment	248 370	R83 370	R165 000
Transport costs to deliver products at retail stores	148 724	100%	
Other: Telephone	195 000		

Due to the operational difficulties experienced, Mr Hot downgraded all finished products (with a cost of R133 000) to *not-cool* products at the end of the financial year ended **31 December 20.18**. Even though these products could be sold at 80% of their cost price, they were earmarked to be donated to charity. However, during the financial year ended 31 December 20.19, these products were modified at no additional cost which increased the selling value thereof to R215 000 in total. On 31 December 20.19, 80% of these products had been sold, leaving 20% of them still on hand

On 1 January 20.19 there was no work-in-process.

The new machinery has the capacity to produce 100 000 *cool stuff* products per annum, which is regarded as its normal capacity. The installation of the new machinery was completed on 1 April 20.19 and production commenced immediately. The new machinery was the only machinery utilised for production during the financial year ended 31 December 20.19.

Cool produced 80 000 *cool stuff* products for the year ended 31 December 20.19. On

31 December 20.19:

- R130 000 of all the production cost was related to products that were not yet completed.
- Finished products on hand consisted of 6 000 products.
- There were no raw materials on hand.

On 1 December 20.19, Cool signed a contract with a local television network for the production and broadcast of an advertisement for the company. Cool paid R85 000 to produce the advertisement, which was completed by 30 December 20.19. Cool will determine the frequency and in which available timeslots the advertisement will be broadcast. The advertisement broadcast cost amounts to R5 000 per broadcast. On 31 December 20.19, Cool made an advance payment of R50 000 to the television network in order to secure prime slots for the broadcast of the advertisement in January 20.20. Cool may at any time request additional broadcast times. Cool anticipates that the advertisement will increase its market share and that the company will gain additional cash inflows by broadcasting it regularly. Based on the aforementioned, the financial manager of Cool recognised the R85 000 and R50 000 payments as an asset in the financial statements for the year ended 31 December 20.19. Management is confident that this advertising campaign will ensure the profitability of the company in the forthcoming financial year.

You may assume that the profit or loss presented in the statement of profit or loss and other comprehensive income for the year ended 31 December 20.19, equalled the taxable profit or loss before unused tax losses for the financial year.

The year-end temporary difference balances, before unused tax losses, were correctly calculated as follows:

	31 December 20.19	31 December 20.18
Taxable temporary difference		R110 000
Deductable temporary difference	R165 000	

Additional information:

- You may assume that all amounts are correct unless otherwise indicated.
- The financial statements for the year ended 31 December 20.18 were authorised on 15 January 20.19. You may assume that all amounts were correctly accounted for in the financial statements for the year ended 31 December 20.18.
- The normal income tax rate is 28% and capital gains are included at a rate of 80%.
- Cool presents its statement of profit and loss and other comprehensive income by function and in a single statement.

REQUIRED

YOU NOW HAVE 60 MINUTES TO ANSWER THIS QUESTION

		Marks
(a)	Discuss whether it was correct for the financial manager to recognise the R85 000 payment and the R50 000 payment, relating to the advertisement campaign, as an asset in the financial statements of Cool Ltd for the year ended 31 December 20.19 in terms of the *2018 Revised Conceptual Framework*	18
	Communication skills: logical flow and argument	1
(b)	Present the statement of profit or loss and other comprehensive income of Cool Ltd for the year ended 31 December 20.19.	19
	Communication skills: presentation and layout	2
	Please note: • Comparative figures are not required • Notes are not required	
Please note: • Round off all amounts to the nearest Rand. • Your answer must comply with International Financial Reporting Standards (IFRS).		

QUESTION 4 – Suggested solution

(a) Advertising cost accounted for as non-current asset.

In order for Cool Ltd to recognise the advertising costs (R85 000 and R50 000) as an asset, it has to adhere to the definition of an asset according to the *Conceptual Framework* (CF). (1)

In order for the advertisement costs to be an asset according to the Conceptual Framework, it has to be a present economic resource which is controlled by Cool as a result of a past event. (CF4.3) (1)

Cool Ltd signed a contract with the local television network on 1 December 20.19 and therefore has a contractual right for its advertisement to be broadcast by the television network in the predetermined timeslots. (1)

In order for the right to be an asset of Cool, this right must both have the potential to produce economic benefits (economic resource) (CF4.4) beyond the economic benefits available to all other parties and it has to be controlled by Cool. (CF4.9) (1)

Cool anticipates that the advertisement will increase its cash flows, therefore the advertisement has the potential to produce economic benefits to Cool. These benefits will also be available to Cool only, therefore no party other than Cool will benefit from the advertisement. (CF4.14) (2)

Cool decides on the timeslots in which the advertisement will be broadcast, and the frequency thereof. Cool therefore has the present ability to direct the use of the advertisement and any economic benefits that will result from the use of the advertisement, will be directly for the benefit of Cool, since the advertisement will increase the sales of their products. Cool therefore has control of the use of the advertisement. (CF4.20) (2)

On 31 December 20.19, Cool has the right to the advertisement which has the potential to produce economic benefits, due to the past event of signing a contract with the local television network. (2)

However, Cool can only recognise an asset for the advertisement should the advertisement asset provide users of the financial statements with information that is useful. To be useful, the advertisement asset should provide users of the financial statements with relevant information pertaining to the asset itself as well as the resulting income which is expected to flow to Cool from broadcasting the advertisement. To be useful, the advertisement asset should also be a faithful representation of the asset it is to the company as well as faithfully represent the resulting income which will be derived from the use of the asset. (CF5.7) (3)

The payment of the R85 000 relates to the *production* of the advertisement. This right grant Cool the potential of increased cash inflows, should it lead customers to purchase its merchandise. However, the probability of cash inflows is uncertain. To measure the future cash inflows at R85 000 will therefore not faithfully represent the asset and will also not provide relevant information to the users of the financial statements. (2)

Cool should therefore not recognise the R85 000 as a non-current asset, but expense it to profit and loss for the year ended 31 December 20.19. (2)

The payment of the R50 000 is an advance payment to secure prime timeslots for the broadcast of the advertisement in the following financial year. The economic benefit that will be obtained from this payment is the reduced future cash outflows. (2)

There is no uncertainty with the measurement of the future economic benefits that it will produce. This amount, therefore, faithfully represents the future economic benefits that Cool will obtain. (1)

It is also relevant information to users, since there is no uncertainty that the asset exists (the payment was made). Cool can therefore account the R50 000 payment as an asset in the financial statements for the year ended 31 December 20.19. (2)

Total	(22)
Maximum	(18)
Communication skills: logical flow and argument	(1)

(b) COOL LTD

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.19.

	20.19 **R**	
Revenue	2 970 000	(½)
Cost of sales [C1]	(2 554 376)	(7½)
Gross profit	415 624	(½)
Other income (R230 750 + R175 000 + R15 800)	421 550	(1½)
Distribution costs	(148 724)	(½)
Administrative expenses (R1 890 000 x 30%) + R195 000	(762 000)	(1)
Other expenses (R83 370 + (R80 900 x 20%))	(99 550)	(1)
Finance costs	(58 900)	(½)
Loss before tax	(232 000)	
Income tax expense [C2]	249 410	(3½)
Profit for the year from continuing operations	17 410	
Loss for the year from discontinued operations	(7 500)	(1)
PROFIT FOR THE YEAR	9 910	
Other comprehensive income:		
Items that will not be reclassified to profit or loss		
Gains on property revaluation (R3 070 000 – R3 000 000)	70 000	(1)
Income tax relating to items that will not be reclassified [R70 000 x (80% x 28%)]	(15 680)	(½)
Other comprehensive income for the year, net of tax	54 320	
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	64 230	
Total		(19)
Communication skills: presentation and layout		(2)

CALCULATIONS

C1. Cost of sales

	R	R	R	
Opening balance				
Finished products at NRV (R133 000 x 80%)			106 400	[½]
Production				
Variable costs				
Raw materials	1 225 680			[½]
Water and electricity (R80 900 x 80%)	64 720			[½]
		1 290 400		
Fixed costs				
Depreciation	165 000			[½]
Labour (R1 890 000 x 70% x 9/12)	992 250			[1]
	1 157 250			
R1 157 250 x 80 000units/75 000				[1]
(100 000units x 9/12months)		1 157 250		[½]
Hence no apportionment				
Total		2 447 650	2 447 650	
Closing balance				
Work in process (given)		(130 000)	(130 000)	[1]
		2 317 650		
Finished products				
R2 317 650/80 000units x 6 000units			(173 824)	[1]
Modified *uncool products* on hand (R133 000 x 20%)			(26 600)	[½]
Additional expense				
Labour (R1 890 000 x 70% x 3/12)			330 750	[½]
COST OF SALES			2 554 376	

C2. Income tax expense

	20.19	
	R	
Current tax	-	
Deferred tax	(293 160)	
Movement in temporary differences [C3]	(77 000)	[1]
Movement in unused tax loss [C3]	(216 160)	[1½]
Recognition of unused tax loss not previously recognised (R650 000 – R110 000) x 28%	(151 200)	
Recognition of unused tax loss (balancing)	(64 960)	
Foreign income (R175 000 x 25%)	43 750	[1]
	(249 410)	

C3. Deferred taxation

	CA	TB	TD	DT	
20.18	**R**	**R**	**R**	**R**	
Temporary differences			110 000	(30 800)	[½]
Assessed loss		650 000	(110 000)	30 800	[½]
			-	-	
20.19					
Temporary differences			(165 000)	46 200	[½]
Assessed loss		[1]882 000	(882 000)	246 960	[1]
				293 160	
Movement in temporary differences (R46 200 – (R30 800))				77 000	
Movement in unused tax loss (R246 000 – R30 800)				216 160	

1. 20.19: Assessed loss

	R	
Taxable profit/loss before unused tax loss	(232 000)	[½]
Unused tax loss of prior year	(650 000)	[½]
Cumulative tax loss as at 31 December 20.19	(882 000)	

QUESTION 5 40 marks

YOU HAVE 15 MINUTES TO READ THIS QUESTION

THE QUESTION CONSISTS OF TWO SEPARATE PARTS.

PART I **20 marks**

IGNORE VALUE ADDED TAX (VAT).

Aluminium Ltd (Aluminium) is a manufacturing company that operates in South Africa and is listed on the Johannesburg Stock Exchange. The company is a leading supplier of aluminium frames.

You are the financial accountant, and you are in the process of finalising the financial statements for the year ended 28 February 20.19 before they were authorised for issue on the 15 April 20.19.

The following information was presented to you:

1. **Aluminium frame order received**
   On 1 February 20.19, Aluminium entered into a contract with a customer to deliver 500 aluminium frames to the customer on 15 March 20.19. The contract requires the customer to pay a consideration of R500 000 in advance to Aluminium on 1 February 20.19. The customer paid the consideration and the accountant recognised the amount of R500 000 correctly as a contract liability in the statement of financial position for the year ended 28 February 20.19, in terms of IFRS 15 *Revenue from Contracts with Customers*.

2. **Land**
   Aluminium acquired land in Port Elizabeth for R1 100 000 on 1 March 20.18 (which is equal to the land's base cost for capital gains tax (CGT) purposes). Management was planning to construct a new factory building on this land and construction was due to start in 1 March 20.19. It is the policy of the company to subsequently measure land by using the revaluation model in accordance with IAS 16 *Property, Plant and Equipment*. On 28 February 20.19 the land was revalued to R1 500 000.

3. **Manufacturing plant and machinery**
   Manufacturing plant and machinery are accounted for in terms of the cost model according to IAS 16 *Property, Plant and Equipment* and are depreciated over their useful lives according to the straight-line method after consideration of any residual value. The manufacturing plant and 10 machines were acquired on 1 June 20.15 and were made available for use on 1 July 20.15. The manufacturing plant and the 10 machines have residual values of R500 000 and R400 000 respectively.

   The following is the disclosure note in the draft financial statements of Aluminium with regard to its manufacturing plant and machinery for the year ended 28 February 20.19:

	Plant R	**Machinery** R
Carrying amount at the beginning of the year	3 800 000	3 040 000
Cost	5 000 000	4 000 000
Accumulated depreciation	(1 200 000)	(960 000)
Depreciation	(450 000)	(360 000)
Disposal	-	(268 000)
Carrying amount at the end of the year	3 350 000	2 412 000

After the draft financial statements for the year ended 28 February 20.19 had been prepared, the directors of Aluminium re-estimated the residual value of manufacturing plant to be R460 000. The residual value of the machinery and the useful life of both plant and machinery remained unchanged. The financial accountant did not account for the change in the residual value since he was of opinion that it will only affect the financial statements for the year ended 28 February 20.20.

One machine was disposed of on 28 February 20.19 and has been correctly accounted for.

The South African Revenue Service (SARS) grants an allowance on plant and machinery in accordance with section 12C of the Income Tax Act on a 40:20:20:20 basis, which is not apportioned for part of a year.

4. Security

On 1 January 20.18 Aluminium entered into a contract with Yoga Security Company for security services. The contract fee is payable annually in advance and renews each year on 1 January. The payment on 1 January 20.19 amounted to R120 000 (1 January 20.18: R90 000). Both these amounts have been correctly accounted for in the 20.18 and 20.19 financial years. The SARS has indicated that these security service payments will be deductible for income tax purposes when actually incurred, in accordance with section 23H of the Income Tax Act.

5. SARS 20.18 assessment and 20.19 taxable income

The SARS assessment for 20.18 reflects an assessed tax loss of R1 810 550. During 20.18 Aluminium was of the opinion that future taxable profits will not be available against which the unused tax loss can be utilised. The financial accountant correctly calculated the taxable income for 20.19 at R33 844 641, before utilising the assessed loss.

6. Other information

The income tax rate is 28% and has remained unchanged for the past 10 years. The inclusion rate for capital gains tax is 80%.

PART II **20 marks**

IGNORE VAT.

You are the newly appointed financial manager of ABC Accountants. The senior partner approached you regarding the following outstanding matters.

Client 1: Print-Sure Ltd

Print-Sure Ltd (Print-Sure) supplies both printing services and stationery supplies. The company has a 31 December financial year end. The directors of Print-Sure services have also decided to change the accounting policy regarding the valuation of the company's inventory on 31 December 20.18. The previously used weighted average cost formula, will be replaced with the first-in-first-out cost formula, since it will result in more relevant and reliable presentation of the value of inventory.

On 31 December, the value of inventory, based on the two methods of valuation, was as follows:

	20.18	**20.17**	**20.16**	**20.15**
	R	**R**	**R**	**R**
First-in-first-out cost formula	345 000	310 000	265 000	240 000
Weighted average cost formula (old)	301 000	279	244 000	220 000

The South African Revenue Service (SARS) will not re-open the previous years' assessments but will accept the new policy in respect of the current year for tax purposes.

No adjustments have been performed to account for the above changes.

Client 2: Juice-House Ltd
Juice-House Ltd (JH) is listed on the Johannesburg Stock Exchange with a 31 December financial year end. The company imports two types of juices, Yum-Juice and Just-Refresh and sells these to customers in South Africa. The following information relates to the financial year ended on 31 December 20.18.

Yum-Juice
Yum-Juice is a popular brand and JH is the only company that supplies it to customers in South Africa. During December 20.18, a competitor commenced with the selling of Best-Juice, a famous juice brand imported from Italy. Best-Juice contains more vitamins and nutritional value and soon became a public favourite. This led to a decline in the market for Yum-Juice and, on 31 December 20.18, the selling price of Yum-Juice was estimated to be R41 per litre. The selling costs of Yum-Juice are negligible.

On 31 December 20.18 JH had 4 320 litres of Yum-Juice on hand, which was accounted for at its cost price amounting to R43 per litre.

During the year, JH entered into contract with Cool Ltd to supply 1 500 litres of Yum-Juice at R42 per litre on 5 March 20.19. At year end, Cool Ltd confirmed that the company is still committed to the contract, despite the decline in the market.

The financial director of JH was uncertain of the accounting of the inventory balance of Yum-Juice for the financial year ended 31 December 20.19 and approached ABC Accountants for advice.

REQUIRED

YOU NOW HAVE 60 MINUTES TO ANSWER THIS QUESTION

	Marks
PART I	
Prepare the journal entry to account for the movement in the deferred tax balance in the financial records of Aluminium Ltd for the year ended 28 February 20.19. **Please note:** • Journal narrations are not required. • The movement in temporary differences must be calculated by using the statement of financial position method.	20
PART II	
(a) Prepare the change in accounting policy note to the financial statements of Print-Sure Ltd for the financial year ended 31 December 20.18, according to IAS 8 *Accounting Policies, Changes in Accounting Estimate and Errors*.	12
Communication skills: presentation and layout	2
Please note: • Disclosure relating to the adjustments for basic and diluted earnings per share are not required	
(b) Write an email, addressed to the financial director of **Juice-House Ltd** to discuss, with reasons and supporting calculations, the correct inventory closing balance of Yum-Juice for the year ended 31 December 20.18 according to IAS 2 *Inventories*.	5
Communication skills: logical flow and argument	1
Please note: • Assume all amounts to be material except where stated otherwise. • Round off all amounts to the nearest Rand. • Your answer must comply with International Financial Reporting Standards (IFRS).	

QUESTION 5 – Suggested solution

PART I

Journals for the year ended 28 February 20.19

	Dr R	Cr R	
Tax expense - deferred (P/L)	574 576		(17)
Tax expense - deferred (OCI)	89 600		(1½)
Deferred Tax (SFP)		664 176	(1½)
Deferred tax movement for the current financial year			
		Total	(20)

CALCULATIONS

Deferred tax

	Carrying amount	Tax base	Temporary difference at 100% or 80%	Deferred tax asset at 28% Asset/ (liability)	
	R	R	R	R	
28 February 20.18					
Plant	3 800 000	[a]1 000 000	2 800 000	(784 000)	[1½]
Machinery	3 040 000	[b]800 000	2 240 000	(627 200)	[1½]
Prepaid expense	[c]75 000	-	75 000	(21 000)	[1½]
Unutilised tax loss	-	1 810 510	(1 810 510)	506 943	[1]
Deferred tax liability			3 304 490	(925 257)	
					[5½]

[a] 5 000 000 x 20% = 1 000 000
[b] 4 000 000 x 20% = 800 000
[c] 90 000 x 10/12 = 75 000

28 February 20.19					
Plant	[f]3 344 545	[d]-	3 344 545	(936 473)	[4½]
Machinery	2 412 000	[e]-	2 412 000	(675 360)	[1½]
Contract liability	(500 000)	-	(500 000)	140 000	[1½]
Prepaid expenses	[g]100 000	-	100 000	(28 000)	[1]
Utilised tax loss (1 810 550 - 1 810 550)	-	-	-	-	[½]
Land (at 80%)	1 500 000	1 100 000	320 000	(89 600)	[1½]
Deferred tax liability			5 676 545	(1 589 433)	
					[10½]

Movement in deferred tax

Total movement		
(1 589 433 – 925 257)	664 176	[1]
Movement through OCI	(89 600)	[1]
Movement through P/L	574 576	[½]

[d] 1 000 000 – (5 000 000 x 20%) = 0
[e] 800 000 – (4 000 000 x 20%) = 0
[f] (5 000 000 – 500 000)/450 000 = 10 years
(3 800 000 – 460 000)/88 (120 – 8 – 12 – 12)
x 12 = 455 455
3 800 000 – 455 455 = 3 344 545
[g] 120 000 x 10/12 = 100 000

PART II

(a) PRINT-SURE LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.18

1. Change in accounting policy

The company changed its accounting policy during the current financial year in respect of the valuation of inventory from the weighted average cost formula to the first-in-first-out cost formula.

This change was effected to ensure more relevant and reliable presentation.

The opening balance of retained earnings at the beginning of 20.17 was adjusted while the comparative figures were restated accordingly. (2)

The effect of the change in accounting policy is as follows:

	20.18 **R**	**20.17** **R**	**1 Jan 20.17** **R**	
Decrease in cost of sales [C1]	13 000	10 000		(4)
Increase in income tax expense	(3 640)	(2 800)		(1)
Increase in profit	9 360	7 200		(½)
Increase in inventory [C1]	44 000	31 000	21 000	(1½)
Increase in deferred tax liability	-	(8 680)	(5 880)	(1)
Increase in current tax payable	(12 320)	-		(½)
Increase in equity	31 680	22 320	15 120	(½)
Adjustment against retained earnings on 1 January 20.17 (IAS 8.29(d))			15 120	(1)
				(12)
		Communication skills: presentation and layout		(2)

CALCULATIONS

C1. Change in accounting policy (inventory)

	20.18	P/L	20.17	P/L	20.16	
First-in-first-out (New)	345 000		310 000		265 000	[1½]
Weighted average (Old)	(301 000)		(279 000)		(244 000)	[1½]
	44 000	13 000	31 000	10 000	21 000	[2½]
Tax at 28%	(12 320)	(3 640)	(8 680)	(2 800)	(5 880)	
	31 680	9 360	22 320	7 200	15 120	
						[5½]

(b) To: Financial Director (Juice-House Ltd)
From: Financial Manager
Date: 12 March 20.19
Subject: Inventory balance of Yum-Juice at 31 December 20.18

Dear Financial Director

Kindly refer below with regard to the accounting of the inventory closing balance of Yum-Juice for the year ended 31 December 20.18.

Inventory has to be valued at **the lower** of its cost (4 320 x R43 = R185 760) and its net realisable value, which is the amount that Juice-House Ltd expects to obtain from the sale of the Yum-Juice in the ordinary course of business (IAS 2.9). (1)

Since the selling price of Yum-Juice declined to below its cost price (due to the introduction of the Best-Juice brand in the market), the cost of the Yum-Juice inventory will not be fully recoverable (IAS 2.28). (1)

Inventory cannot be carried in excess of the amount expected to be realised from the sale or use thereof. Yum-Juice inventory should therefore be written down to its net realisable value (IAS 2.28). (1)

The net realisable value of Yum-Juice will be calculated as follows:

The contract with Cool Ltd satisfies a firm sales contract and therefore the net realisable value of 1 500 litres is based on the contract price of R42 (IAS 2.31). (1)

The remaining 2 820 (4 320 – 1 500) litres of juice will be measured by using the net realisable value of R41 (selling costs are negligible). (2)

The net realisable value of Yum-Juice inventory will therefore be calculated as follows:

1 500 x R42	=	R 63 000	(½)
2 820 x R41	=	R115 620	(½)
	=	R178 620	

Yours sincerely

Financial Manager

Total	(8)
Maximum	(5)
Communication skills: logical flow and argument	(1)

QUESTION 6 **40 marks**

YOU HAVE 15 MINUTES TO READ THIS QUESTION

IGNORE ANY VAT IMPLICATIONS

You are the audit clerk at Uber-Accountants and need to finalise the following queries with regard to the below three clients for the financial year ended 31 December 20.17.

Client 1: Catinho Ltd (Catinho) **19 marks**

Catinho is a company operating in the manufacturing and maintenance industry. Catinho is listed on the Johannesburg Stock Exchange and has a 31 December 20.17 financial year end.

You are the financial accountant of Catinho and the financial manager has presented you with an extract of the preliminary statement of profit or loss and other comprehensive income for the financial year ended 31 December 20.17.

CATINHO LTD

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.17

	20.17
	R
Revenue	9 180 000
Cost of sales	(2 570 400)
Gross profit	6 609 600
Other income	312 500
Operating expenses	(3 178 000)
Finance cost	(312 900)
Profit before tax	3 431 200
Income tax expense	???
PROFIT FOR THE YEAR	???

Additional information

1. Included in other income is a dividend received from a South African company, amounting to R62 500. This dividend is exempt from normal tax in terms of section 10(1)(k) of the Income Tax Act.

2. Catinho acquired land for future development at a purchase price of R1 700 000 on 31 March 20.16 (which is equal to the land's base cost for capital gains tax purposes). During the current financial year, Cathino sold the land for R1 870 000. Land is measured according to the cost model in terms of IAS 16 *Property, Plant and Equipment*. The accounting profit on the sale of land amounting to R170 000 is included in other income. The South African Revenue Services (SARS) confirmed that the sale of land will be subject to capital gains tax.

3. Catinho received foreign income amounting to R70 000 (after deduction of R10 000 foreign tax). This amount is included in other income and is not subject to income tax in South Africa.

4. Included in operating expenses is depreciation on plant and equipment amounting to R876 000. The tax allowance on the plant and equipment amounted to R900 000. The carrying amount of the plant and equipment on 31 December 20.17 amounted to R3 168 000 while the tax base was R2 500 000.

5. The SARS issued an additional 20.15 assessment on 15 August 20.17 to include an additional amount of R15 000 payable (which includes interest amounting to R4 500) which relates to an expense which Cathino claimed during the tax year ending 31 December 20.15 and that was not allowed as a deduction by SARS. The amount payable in terms of the additional assessment was not recorded in the financial statements for the year ended 31 December 20.17.

6. There are no temporary differences other than those that are apparent from the information in the question.

7. The only non-taxable and non-deductible items included in the accounting profit or loss are those that are apparent from the information provided.

8. The normal income tax rate is 28% and the capital gains tax inclusion rate is 80%.

9. You may assume that all amounts are material.

Client 2: D'Lux Ltd (D'Lux) **10 marks**

D'Lux is one of the largest paint manufacturers in South Africa. The company has a 31 December financial year end and is listed on the Johannesburg Stock Exchange.

The previous year's financial statements indicated a closing balance for raw materials of R4 200 000 (carried at cost) and for finished products of R5 251 000 (carried at cost). There are no work-in- progress at financial year end.

A normal spillage, amounting to R0,25 per litre of paint produced, occurs with the packaging of the paint.

Other information relating to the year ended 31 December 20.17:

	R
Raw material purchases for the current financial year (before any discount)	
5 766 134	
D'Lux received a 3% discount on the above purchases for settling their accounts in time.	
Delivery cost:	
350 000	
• Raw materials received	230 000
• Finished products delivered to customers	120 000
Depreciation	
900 000	
• Property, plant and equipment: Manufacturing	750 000
• Property, plant and equipment: Other	150 000

Normal capacity: 600 000 litres of paint per annum	
Actual production: 450 000 litres for the current financial year	
Other variable cost	R3,50 per litre
Actual spillage at the end of the production process	R0,30 per litre

The inventory count at the financial year end indicated the following:

- R700 000 worth of raw materials were identified as substandard and will be sold at R175 000;
- the closing balance for raw materials amounted to R6 498 150; and
- 40% of the finished products manufactured in the current financial year were the only finished products on hand at the financial year end.

Client 3: Manyonga Ltd (Manyonga) **11 marks**

The financial manager, Mr Samaai, prepared the statement of financial position of Manyonga as at 31 December 20.17 and sent you a copy for a final review. You have assisted Mr Samaai with the previous year's financial statements, and he awaits your feedback to finalise the financial statements for the year ended 31 December 20.17 before he sends it to the chief financial officer for approval. Mr Samaai provided you with notes regarding the matters that he is unsure of.

MANYONGA LTD

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.17

	Notes	**20.17 R'000**
ASSETS		
Non-current assets		
Property, plant and equipment		37 500
Intangible assets		3 500
Inventories	1	5 200
		46 200
Current assets		
Inventories		20 200
Trade receivables		20 500
Other current assets		500
Cash and cash equivalents		3 500
		44 700
Total assets		90 000
EQUITY AND LIABILITIES		
Equity attributable to the owners of the parents		
Share capital		15 200
Retained earnings		30 000
Other components of equity		1 500
Total equity		46 700
Non-current liabilities		
Long-term borrowings	2	24 600
Total non-current liabilities		24 600

	Notes	20.17 R'000
Current liabilities		
Trade and other liabilities		2 300
Allowance for credit losses	3	1 500
Short-term borrowings	4	2 500
Current tax payable		10 500
Deferred tax		2 800
Total current liabilities		19 600
Total liabilities		44 200
Total equity and liabilities		**90 900**

Notes

1. Manyonga has various types of inventories with different operating cycles. Manyonga acquired Inventory A amounting to R5 200 000 on 1 December 20.17. Inventory A has to undergo various processes before it will be ready to sell to a customer. Manyonga intends to sell Inventory A in February 20.19. The normal operating cycle of this type of inventory is 16 months.

2. Long-term borrowings of R24 600 000 represent a loan 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 20.18 consisted of R1 860 000 interest and a capital re-payment of R2 640 000.

3. Manyonga 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.

4. On 1 April 20.17 Manyonga obtained a short-term loan from Smart Bank amounting to R2 500 000. The loan and interest are repayable on 31 March 20.18, however the terms of the agreement stipulate that Manyonga has the discretion to extend the loan's due date to 31 December 20.19 at an additional fee of R50 000. The applicable interest rate for the extended period will be renegotiated. Mr Samaai 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 Manyonga intends to extend the loan.

REQUIRED

YOU NOW HAVE 60 MINUTES TO ANSWER THIS QUESTION

		Marks
(a)	Prepare the income tax note to the financial statements of Cathino Ltd for the year ended 31 December 20.17 as required by IAS 12.79, 80 and 81(c)(i) *Income Taxes* (refer to Client 1).	18
	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.	
	Communication skills: presentation and layout	1
(b)	Disclose the inventory in the inventory note to the financial statements of D'Lux Ltd for the year ended 31 December 20.17 (refer to Client 2).	9
	Please note:	
	• Comparative figures are **not** required.	
	• Narrative information is **not** required.	
	Communication skills: presentation and layout	1
(c)	Discuss the presentation and classification issues in terms of IAS 1 *Presentation of Financial Statements* relating to the statement of financial position of Manyonga Ltd as at 31 December 20.17 (refer to Client 3).	10
	Please note:	
	• Your feedback should include any incorrect presentation and classification and the suggested corrections of the errors noted	
	• Your answer should include calculations.	
	Communication skills: logical argument	1
	Please note:	
	• Round off all amounts to the nearest Rand.	
	• Your answer must comply with International Financial Reporting Standards (IFRS).	

QUESTION 6 - Suggested solution

(a) CATINHO LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.17

11. Income tax expense

Major components of tax expenses

	R	
SA normal tax		
Current tax	917 896	
- Current year	907 396	(7)
- Under provision for prior years (15 000 – 4 500)	10 500	(1)
Deferred tax		
- Movement in temporary differences	6 720	(4)
	924 616	
Foreign Tax	10 000	(1)
	934 616	
Tax rate reconciliation		
Accounting profit	3 436 700	(½)
Taxation at 28%	962 276	(½)
Tax effect of non-deductible/non-taxable items:		
- Dividends received (62 500 x 28%)	(17 500)	(½)
- Interest paid not deductible (R4 500 x 28%)	1 260	(½)
- Accounting profit on land not taxable (170 000 x 20% x 28%)	(9 520)	(1)
Difference in tax rate on foreign income (10 000 – (80 000 x 28%))	(12 400)	(1)
Under provision of current tax relating to prior periods (15 000 – 4 500)	10 500	(1)
	934 616	
	Total	(18)
	Communication skills: presentation and layout	(1)

CALCULATIONS

C1. Deferred tax

	Carrying amount	**Tax base**	**Temporary difference at 100% or 80%**	**Deferred tax 28% asset/ (liability)**	
	R	**R**	**R**	**R**	
31 December 20.16					
Land	1 700 000	1 700 000	-	-	[1]
Plant (3 168 000 + 876 000) (2 500 000 + 900 000)	4 044 000	3 400 000	644 000	(180 320)	[1]
			644 000	(180 320)	
31 December 20.17					
Land	-	-	-	-	
Plant	3 168 000	2 500 000	668 000	(187 040)	[1]
Movement in temporary differences through P/L (668 000 - 644 000)			24 000	(6 720)	[1]

C2. Profit before tax adjusted

	R	
Profit before tax	3 431 200	[½]
Foreign tax	10 000	[½]
Interest payable to SARS	(4 500)	[1]
	3 436 700	

C3. Current tax calculation

Profit before tax [C1]	3 436 700	[2]
Non-taxable/Non-deductible items:		
- Dividends received not taxable	(62 500)	[½]
- Interest paid not deductible	4 500	[½]
- Accounting profit on land not taxable (170 000 x 20%)	(34 000)	[1]
- Foreign income (70 000 + 10 000)	(80 000)	[1]
Movement in temporary differences	(24 000)	[½]
Taxable profit before tax loss	3 240 700	[1]
Tax at 28%	907 396	[½]
		[7]

(b) D'LUX LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.17

5. Inventory

	20.17 **R**	
Raw materials **[given]**	6 498 150	(½)
Finished products **[C1]**	2 046 000	(8½)
	8 544 150	
Total		(9)
Communication skills: presentation and layout		(1)

CALCULATIONS

C1. Finished products

	Raw materials R	**Work-in-process R**	**Finished products R**	
Opening balance	4 200 000	-	5 251 000	(1)
Transferred **from**		3 000 000	5 115 000	
Purchases	5 766 134			(½)
Less: Discount at 3%	(172 984)			(½)
Delivery costs (R350 000 – R120 000)	230 000			(½)
Depreciation (450'L/600'L x (R900 000 – R150 000))		562 500		(1½)
Abnormal spillage (450 000L x (R0,30 - R0,25))		(22 500)		(1½)
Write-down to nett realisable value (R700 000 – R175 000)	(525 000)			(1)
Variable cost (450 000L x R3,5)		1 575 000		(1)
Closing balance				
(Given)	(6 498 150)			(½)
(R5 115 000 x 40%)			(2 046 000)	(½)
Transferred **to**	3 000 000	5 115 000	8 320 000	

(c) Manyonga Ltd Comparative information

According to IAS 1.38, an entity shall present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements.

IAS 1.38A stipulates that a minimum of two statements of financial position shall be presented.

Manyonga Ltd needs to present comparative information in respect of the preceding financial period ended 31 December 2016. This will also ensure there are a minimum of two statements of financial position presented. (2)

Casting error
The total assets should equal the total equity and liabilities in the statement of financial position. There is a casting error, and the total assets should be R90 900 000. (1)

Inventory
In terms of IAS 1.66(a) an entity shall classify an asset as current when it expects to realise/sell the asset in its normal operating cycle.

According to IAS 1.68, an operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash.

The normal operating cycle of Inventory A is 16 months. The inventory was acquired on 1 December 20.17 and Manyonga intends to sell the inventory in February 20.19. The period between the acquisition and the realisation of the inventory into cash is within the normal operating cycle of this type of inventory. (2)

Therefore, the R5 200 000 must be classified as current assets. (1)

Long-term borrowings
IAS 1.61 stipulates that an entity shall disclose the amount expected to be settled after more than twelve months for each liability line item that combines amounts expected to be settled no more than twelve months after reporting period and more than twelve months after reporting period.

Therefore, the amount that is included in the R24 600 000 long-term borrowings that will be settled on or before 31 December 20.18 must be shown as the current portion of long-term borrowing and classified as current liabilities. (1)

The capital re-payment amount of R2 640 000 must be disclosed as current liabilities and the amount of R21 960 000 (R24 600 000 – R2 640 000) as non-current liabilities. (1)

Offsetting
In terms of IAS 1.32 and .33 an entity shall not offset assets and liabilities and should report both assets and liabilities separately.

According to IAS 1.33, measuring assets net of valuation allowance is not offsetting.

Therefore, the classification of the allowance for credit losses under current liabilities is not correct and should be offset against the trade receivables of R20 500 000. (1)

The final trade receivables presented in the statement of financial position should be R19 000 000 (R20 500 000 – R1 500 000). (1)

Short-term borrowings
In terms of IAS 1.73, if an entity expects and has the discretion to roll over an obligation for at least 12 months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period.

According to the terms of the loan agreement, Manyonga Ltd has the discretion to roll over the loan from Smart Bank and Manyonga Ltd expects that the entity will roll over the loan as they have already started negotiating with Smart Bank. (1)

The loan of R2 500 000 should be classified as non-current liabilities since the rollover of the loan to 31 December 20.19 is more than 12 months after the reporting period of 31 December 20.17. (1)

Deferred tax
According to IAS 1.56, when an entity presents current and non-current liabilities as separate classifications in its statement of financial position, deferred tax liabilities shall not be classified as current liabilities.

Therefore, the deferred tax balance of R2 800 000 is incorrectly classified as current liabilities and should be classified as part of non-current liabilities. (1)

Total (13)
Maximum (10)
Communication skills: logical argument (1)