

Tutorial letter 106/0/2023

APPLIED FINANCIAL ACCOUNTING II

FAC4864/NFA4864/ZFA4864

Year Module

Department of Financial Governance

IMPORTANT INFORMATION:

This tutorial letter contains important information
about your module.

CASE STUDIES

Case study	Question number and name	Marks	Topics covered	Page
1	1. Check1 Ltd	100	<ul style="list-style-type: none"> • Proforma consolidation journal entries • Disclosure of disposal of investment in subsidiary note (IFRS 12) • Presentation of non-current assets in the consolidated statement of financial position • Discussion of recognition and measurement of customer contract (IFRS 15) • Discussion of key strategic risks (Integration with MAC4862) • Recommendation of Key Performance Indicators (Integration with MAC4862) 	4
2	1. Airtrain Ltd	45	<ul style="list-style-type: none"> • Discussion of revenue contract (IFRS 15) • Presenting of journal entries of revenue (IFRS 15) • Discussion of the identification of performance obligations (IFRS 15) • Calculation of deductions in terms of income tax purposes (Integration with TAX4862) • Discussion of deductible amounts (Integration with TAX4862) • Discussion of VAT consequences (Integration with TAX4862) 	21
	2. Swarroo Ltd	55	<ul style="list-style-type: none"> • Presentation of consolidated statement of cash flows (operating activities) • Critically discussion of statement of cash flows (investing activities) 	23
3	1. Cooldrink Ltd	50	<ul style="list-style-type: none"> • Presentation of consolidated statement of profit or loss • Disclosure of investment in subsidiary note (IFRS 12) 	41
	2. Mzansi Drones Ltd	50	<ul style="list-style-type: none"> • Discussion of corporate governance, in terms of King IV Report • Discussion of IFRS 3, IFRS 10 and IFRS 11 • Proforma consolidation journal entries 	45
4	1. TukIn Ltd	50	<ul style="list-style-type: none"> • Discussion of consolidated statement of cash flows • Calculation of dividends received and additions of PPE in the consolidated statement of cash flow • Discussion of tax consequences of granting ordinary shares to managers 	66
	2. Book-It-Pro Ltd	50	<ul style="list-style-type: none"> • Discussion on revenue – Performance obligations discussions, critique of revenue journal, loyalty points journals 	71

Case study	Question number and name	Marks	Topics covered	Page
5	1. Nuts Ltd	45	• Presentation of a consolidated statement of changes in equity	88
	2. Haughty Pastas Ltd	25	• Journal entries for an investment in associate (foreign and local)	92
	3. RAF Industries Ltd	23	• Discussion on control (IFRS 10) • Discussion of classification and measurement of a joint arrangement (IFRS 11)	95
	Agrio Ltd	7	• Discussion on identification of related parties (IAS 24)	97
6	1. Lockdown Health Ltd	26	• Discussion on revenue – Performance obligations discussions, critique of revenue journal, loyalty points journals	117
	Telecon Ltd	14	• Journal entries for revenue recognition	
	2. Amarok Raceway Ltd	60	• Disclosure of investment in subsidiary note (IFRS 12) Calculation of amounts presented in the statement of cashflow and notes	119
7	1. Just One Energy Ltd	100	• Presentation of non-current asset section of consolidated statement of financial position, including subsidiaries and foreign operation • Presentation of consolidated statement of changes in equity, including change in degree of control of foreign operation • Presentation of unconsolidated structured entity note • Discussion on control, in accordance with IFRS 10	143
8	1. Busco Ltd	60	• Presentation of consolidated statement of cash flows (operating activities) • Discussion of statement of cash flows (investing and financing activities) Discussion on classification and recognition of joint arrangement (IFRS 16)	164
	2. Green Ltd Bulawayo Ltd	20 20	• Discussion on revenue (step 3) • Journal entries for revenue recognition • Consolidation journal entries for an investment in associate	169 169
9	1. Mumbai Ltd	75	• Presentation of consolidated statement of equity • Disclosure of investment in associate note to consolidated financial statements (IFRS 12)	184
	2. Planet Active Ltd	25	• Discussion on related parties • Discussion on revenue (step 1 to step 6)	188
10	1. Lowveld Honey Ltd	35	• Consolidation journal entries for a step acquisition	205
	2. Mageu King Ltd	40	• Presentation of consolidated statement of cash flows	208
	3. AHW Plumbing Ltd	25	• Discussion on control (IFRS 10) • Discussion on non-controlling interests (IFRS 3)	212

CASE STUDY 1**100 marks**

YOU HAVE 30 MINUTES' READING TIME. SPEND 30 MINUTES READING THE CASE STUDY BEFORE YOU CONTINUE TO THE REQUIRED SECTION.

QUESTION 1**100 marks**

Check1 Ltd ("Check1") is a South African company listed on the JSE Limited. The functional and presentation currency of Check1 is the South African rand. The Check1 group is involved in diverse activities in the retail industry. In order to enhance shareholders' wealth, Check1 has attempted to improve its growth through an expansion strategy of acquiring equity interests in other companies. All the companies in the group have a 31 August year end.

Check1 plans to evaluate the success of their expansion strategy using the following Key Performance Areas (KPA's):

1. Operating performance,
2. Value growth, and
3. Synergy benefits

The following was extracted from the trial balances of Check1 Ltd, Small & Tiny Ltd, Sport Shoe Ltd and Pikolina Zapatos S.A for the year ended 31 August 20.22 (you can assume that it is correct):

	Check1 Ltd	Pikolina Zapatos S.A	Small & Tiny Ltd	Sport Shoe Ltd
	R	EUR	R	R
Debits				
Property Plant and Equipment	12 865 000	561 000	1 360 800	1 632 500
Debtors	104 500	31 600	358 200	98 000
Credits				
Ordinary share capital				
- 500 000 shares	500 000			
- 70 000 shares				200 000
- 50 000 shares		10 000		
- 50 000 shares			200 000	
Retained earnings	16 081 250	420 000	3 620 100	3 350 100
Revaluation surplus	325 400	31 250	702 522	-
Deferred tax	514 500	13 000	132 000	-

Investment in Pikolina Zapatos S.A ("Pikolina")

Pikolina is a shoe manufacturer and distributor, based in Alicante, Spain. On 29 October 20.21, Check1 acquired 60% of the shares of Pikolina for a cash consideration of R1 800 000. From this date, Check1 had control of Pikolina in accordance with IFRS 10 *Consolidated Financial Statements*. Pikolina is incorporated in Spain and has a functional currency of Euro (EUR). Pikolina is the only foreign subsidiary of Check1.

On 29 October 20.21, Check1 also granted a loan to Pikolina for an amount of R1 000 000. The loan bears interest at 9% per annum, payable annually on 31 October. The repayment of the loan is however not expected or planned in the foreseeable future. Check1 regarded the capital amount of the loan as part of the net investment in Pikolina.

The net assets of Pikolina were deemed to be fairly valued on 29 October 20.21, with the exception of the following:

- The carrying amount and fair value of the industrial equipment was EUR100 000 and EUR110 000 respectively. In the individual accounting records of Pikolina, the equipment is measured according to the revaluation model in terms of IAS 16 Property Plant and Equipment (PPE). Industrial equipment is revalued every year. At acquisition date the remaining useful life of the industrial equipment was estimated at four years with no residual value. Pikolina revalued this equipment at year-end with EUR5000 in its individual financial statements. The revaluation surplus relates to movements in the PPE revaluation.

No additional assets, liabilities or contingent liabilities were identified on the acquisition date.

The equity of Pikolina consisted of the following at the respective dates:

	29/10/20.21
	EUR
Share capital (50 000 ordinary shares)	10 000
Retained earnings	135 600
Revaluation surplus	20 000
	<u>165 600</u>

Pikolina sold inventories to Check1 during the current financial year. On 31 August 20.22, Check1 still had inventories bought from Pikolina to the value of R140 000 on hand. Total sales from Pikolina to Check1 for the current reporting period amounted to R560 000. Total profit made by Pikolina on these sales to Check1 amounted to EUR5 000 for the current period.

Pikolina declared and paid a dividend of EUR15 000 on 30 June 20.22 to all shareholders registered on 30 May 20.22.

Total net asset value (including goodwill) and total foreign currency translation reserve before allocation to the parent and non-controlling interest (including the adjustment to goodwill and fair value adjustments at acquisition) for the year ended 31 August 20.22 amounted to EUR461 842 and R214 294 debit respectively. You can assume these figures to be correct.

The following exchange rates were applicable at the respective dates:

	EUR1 = R
29 October 20.21	16,26
Average for the period 29 October 20.21 to 31 August 20.22.	17,37
30 June 20.22	16,70
31 August 20.22	16,50

Investment in Small & Tiny Ltd (Small & Tiny)

Check1 acquired 80% of the shares and voting rights of Small & Tiny Ltd (Small & Tiny), a leading children clothes supplier, on 1 March 20.20, for a cash consideration of R2 200 000. Included in the cash consideration was R28 744 attorney fees for drawing up the purchase agreement. From this date, Check1 had control of Small & Tiny as per the definition of control in accordance with IFRS 10 *Consolidated Financial Statements*.

The equity of Small & Tiny consisted of the following at the respective dates:

	01/03/20.20	31/08/20.21
	R	R
Share capital (50 000 ordinary shares)	200 000	200 000
Retained earnings	1 550 000	2 520 100
Revaluation surplus	<u>552 522</u>	<u>552 522</u>
	<u>2 302 522</u>	<u>3 272 622</u>

All the assets and liabilities were deemed to be fairly valued on 1 March 20.20, except for the following:

- On 1 March 20.20 Small & Tiny was leasing a T-shirt printing machine from Printers Ltd at an annual rental (in arrears) of R375 000, while the market related rental amounted to R410 000. The lease agreement was originally entered into on 1 March 20.16 and covers a period of 6 years. It was not possible to calculate the interest rate implicit in the lease. Small & Tiny's incremental borrowing rate amounted to 9,25% and 8,75% on 1 March 20.16 and 1 March 20.20 respectively. Ownership of the machinery will not pass to Small & Tiny at the end of the lease period and leased assets are depreciated on the straight-line basis. The carrying value of the lease liability and right of use asset in the separate financial statements of Small & Tiny was R657 437 and R556 586 respectively on 1 March 20.20.
- Since the management of Small & Tiny decided to lease T-shirt printing machines going forward, they classified the previous three year old T-shirt printing machine as held for sale on 1 September 20.19 when the carrying amount of the machine amounted to R340 000 and the fair value less costs to sell amounted to R350 033. Their intention is to sell this machine within the next 18 months, from date of classification as held for sale and management are actively involved in processes to sell this machine. Marketing and general costs to sell this machinery amounted to R40 000, on 1 September 20.19. There is an active market for second-hand T-shirt printing machines and the management of Small & Tiny are of the opinion that this machine will sell within the eighteen months. The fair value of this printing machine increased slightly to R395 000 on 1 March 20.20.

At 31 August 20.20 the fair value of the T-shirt printing machine decreased to R290 000 due to the hard lockdown that was instituted worldwide. Management of Small & Tiny remains committed to sell the printing machine and have not changed their intention to sell this machine. The printing machine was sold on 30 January 20.21 for R275 000. A fair discount rate, compounded monthly, at 1 September 20.19 and 1 March 20.20 was 10% and 8,75% respectively. Eighteen months is considered a significant period. You can assume that all requirements were met to classify this machine as held for sale in accordance with IFRS 5 *Non- Current Assets Held for Sale*.

Small & Tiny had a garage sale and sold a boardroom table to Check1 on 27 January 20.21 for R200 000. The carrying value of this oak table was R220 000 at the date of sale. Boardroom tables are depreciated over 5 years on the straight-line basis.

Check1 bought inventory from Small & Tiny at a profit mark-up of 25% on cost. Total sales from Small & Tiny during the current reporting period amounted to Rnil (20.21: R330 000). Inventories on hand purchased from Small & Tiny were R120 000 for the 20.21 financial year. All inventory bought from Small & Tiny was sold during the current year.

The management of Check1 decided to sell its controlling interest in Small & Tiny. A decision was made on 15 April 20.22 to sell 70% of their interest in Small & Tiny on 31 August 20.22 for a cash consideration of R3 500 000, resulting in a remaining 10% equity investment. Check 1 did not exercise control nor significant influence over Small & Tiny from that date. The fair value of the shares on 31 August 20.22 was R120. Check1 lost control over Small & Tiny on 31 August 20.22.

Investment in Sport Shoe Ltd (Sport Shoe)

Check1 acquired a 10% equity interest in Sport Shoe on 31 December 20.18 for a cash consideration of R210 000. Check1 acquired a further 30% interest in Sport Shoe on 1 September 20.21, from which date Check1 exercised significant influence over the financial and operating policy decisions of Sport Shoe.

The consideration paid was as follows:

- Check1 issued 8 000 debentures with a face value of R100 each on 1 September 20.21. Interest of 7,25% is payable annually in arrears. The debentures will be settled at par, in cash on 31 August 2026. A pre-tax fair discount rate on similar debentures amounted to 9,5% per annum on 1 September 20.21.

All the assets and liabilities were fairly valued except for land that was undervalued by R231 959. It is the accounting policy of Sport Shoe to account for land at fair value in accordance with IAS 40 Investment Property. The fair value of the land did not change at year-end.

The equity of Sport Shoe consisted of the following at the respective dates:

	01/09/20.21
	R
Share capital (70 000 ordinary shares)	200 000
Retained earnings	2 650 600
	<u>2 850 600</u>

The fair value of Sport Shoe's shares is as follows:

	R
	Per share
31 December 20.18	30
31 August 20.21 and 1 September 20.21	54
31 August 20.22	60

Sport Shoe sold equipment with a carrying value of R80 000 to Check1 for R105 000 on 30 November 20.21. The remaining useful life of this equipment on date of sale is 2 years with a residual value of Rnil.

Check1 sold a delivery vehicle, with a carrying value of R340 000 to Sport Shoe on 5 January 20.22. Check1 made a profit of 25% on cost on this vehicle. Depreciation is provided at 20% per annum, on the straight-line method on the cost of the vehicle.

Investment in GymTech Ltd (GymTech)

On 1 August 20.22, the management of Check1 entered into negotiations to acquire the controlling interest in GymTech. GymTech has three distinct lines of business. They manufacture and sell gym equipment, import and sell electronic bicycle trip equipment and have a service department that maintains the gym equipment that they sell to their clients. The due diligence report revealed amongst others the following:

- GymTech has a contract with Global Gym Ltd to be its sole provider of gym equipment. GymTech has no contract for the maintenance of the equipment, nor do they have a contract to provide any electronic bicycle trip equipment to Global Gym. The contract with Global Gym will not be transferable and GymTech are not allowed to sell any information about Global Gym to third parties. Global Gym can cancel the contract at any time.

The CEO, of Check1, Mr. Muscle, has requested more information regarding the initial measurement and recognition of this customer contract.

Additional information

1. It is the accounting policy of all the companies in the Check1 Group to account for investments in subsidiaries and investments in associates at cost in its separate financial statements in accordance with IAS 27.10(a).
2. Check1 Group elected to measure non-controlling interests at the proportionate share of the acquiree's identifiable net assets at the acquisition date, for all acquisitions.
3. It is the accounting policy of Check1 to account for equity investments, other than investments in subsidiaries and associates, at fair value in accordance with IFRS 9 *Financial Instruments*. Check1 irrevocably elected to present subsequent changes in the fair value of its investments in other comprehensive income through a mark-to-market-reserve.
4. Depreciation and unrealised profit in inventory are translated at the closing rate by Check1 Ltd Group.
5. It is the accounting policy of the Check1 Group to account for property, plant and equipment according to the cost model in terms of IAS 16 *Property, Plant and Equipment*.
6. Property Plant and Equipment are depreciated on the straight-line basis over its estimated remaining useful life.
7. Profit after tax and other comprehensive income accrued evenly throughout the year unless otherwise specified.
8. The Group reclassifies items recognized in other comprehensive income to retained earnings on derecognition of the affected assets.
9. Assume a normal income tax rate of 25% and a capital gains tax inclusion rate of 100% in Spain.
10. Assume a normal income tax rate of 27% and a capital gains tax inclusion rate of 80% in South Africa.
11. Ignore Value Added Tax (VAT) and Dividend Tax.

CASE STUDY 1**REQUIRED**

YOU NOW HAVE 150 MINUTES TO COMPLETE THE CASE STUDY.

QUESTION 1

	Marks
<p>(a) Provide the pro forma consolidation journal entries to consolidate Pikolina Zapatos S.A into the consolidated financial statements of the Check1 Ltd Group for the year ended 31 August 20.22.</p> <p>Please note:</p> <ul style="list-style-type: none"> • The at acquisition journal is not required. 	32
<p>(b) Prepare the note relating to the disposal of Small & Tiny Ltd that will be part of the consolidated financial statements of Check1 Ltd Group for the financial year ended 31 August 20.22 in accordance with IFRS 12 Disclosure of Interest in Other Entities. Disclose only IFRS12.10(b) requirements.</p> <p style="text-align: right;">Communication skills: presentation and layout</p>	20 1
<p>(c) Prepare only the non-current assets sub heading in the Consolidated Statement of Financial Position for the Check1 Ltd Group as at 31 August 20.22. Comparative figures are not required.</p>	14
<p>(d) Explain, with reasons, the correct recognition and measurement of the customer contract between GymTech Ltd and Global Gym Ltd at the acquisition date in the consolidated financial statements of the Check1 Ltd Group.</p> <p style="text-align: right;">Communication skills: logical flow and presentation</p>	12 1
<p>(e) Discuss five key strategic risks (5 marks) that Check1 Ltd may face in the implementation of their expansion strategy and provide potential mitigations (8 marks) for each risk identified.</p>	13
<p>(f) Recommend two annual Key Performance Indicators (KPIs), for each of Check1 Ltd's three Key Performance Areas, which can be implemented to evaluate the success of Check1's expansion strategy. Motivate your recommendations.</p> <p style="text-align: right;">Communication skills: logical argument</p>	6 1
<p>Please note:</p> <ul style="list-style-type: none"> • Your answer must comply with International Financial Reporting Standards (IFRS). • Comparative figures are not required. • Show all your calculations. • Round off all amounts to the nearest rand. 	

CASE STUDY 1**QUESTION 1**

- (a) Provide the pro forma consolidation journal entries to consolidate Pikolina Zapatos S.A into the consolidated financial statements of the Check1 Ltd Group for the year ended 31 August 20.22.

	Dr R	Cr R	
J1	Depreciation (P/L) $(10\,000 \times 10/48) \times 16,50$	34 370	(2)
	Accumulated depreciation (SFP)		(1/2)
	Depreciation on equipment		
J2	Deferred tax (SFP) $(34\,370 \times 25\%)$	8 593	(1/2)
	Income tax (P/L)	8 593	(1/2)
	Tax effect of depreciation		
J3	Revenue (P/L)	560 000	(1/2)
	Cost of sales (P/L)		(1/2)
	Elimination of intragroup sales	560 000	
J4	Cost of sales (P/L)		
	$(140\,000/560\,000) \times \text{EUR}5\,000 \times \text{R}16,50$	20 625	(2)
	Inventory (SFP)		(1/2)
	Elimination of unrealised profit in inventory	20 625	
J5	Deferred tax (SFP) $(20\,625 \times 25\%)$	5 156	(1/2)
	Income tax (P/L)	5 156	(1/2)
	Deferred tax adjustment on unrealised profit		
J6	Revaluation surplus (OCI)	247 500	(1 1/2)
	Industrial equipment (SFP) $(15\,000 \times 16,50)$		(1/2)
	Eliminate revaluation due to policy at cost	247 500	
J7	Tax on revaluation surplus (OCI) $(247\,500 \times 25\%)$	61 875	(1/2)
	Deferred tax (SFP)		(1/2)
	Eliminate tax effect on revaluation	61 875	
J8	Interest received (P/L) $(1\,000\,000 \times 9\% \times 10/12)$	75 000	(1/2)
	Interest paid (P/L)		(1/2)
	Eliminate intragroup interest paid	75 000	
J9	Loan from Check1 (SFP)	1 000 000	(1/2)
	Loan to Pikolina (SFP)		(1/2)
	Elimination of intragroup loan	1 000 000	
J10	FCTR (P/L)		
	$(1\,000\,000/(16,50) - (1\,000\,000/16,26) \times 17,37)$	15 546	(2 1/2)
	FCTR (OCI)		(1)
	Reclassify the exchange difference on loan to OCI	15 546	
J11	Goodwill (SFP) $(6\,841 [\text{C}1] \times (16,50 - 16,26))$	1 642	(5 1/2)
	Equipment (SFP) $(10\,000 \times (16,50 - 16,26))$	2 400	(1 1/2)
	Deferred tax (SFP) $(2\,500 \times (16,50 - 16,26))$		(1/2)
	FCTR (OCI) (balance)		(1/2)
	Exchange differences on translation of IFRS 3 remeasurements	600	
		3 442	

	Dr R	Cr R	
J12 Non-controlling interests (P/L) [C2]	2 063 738		(3½)
Non-controlling interests (OCI)			
(-214 293 – 1 642 [J11]) x 40%		86 374	(1½)
Non-controlling interests (SFP) (balancing)		1 977 364	(½)
<u>Recognising NCI's portion of profit and FCTR</u>			
J13 Other income: Dividends received (P/L)	150 300		(1)
Non-controlling interests (SFP/(SCE) (250 500 x 40%)	100 200		(½)
Dividend paid (SCE)		250 500	(1)
<u>Elimination of intragroup dividend (15 000 x 16,70)</u>			
		Total	<u>(32½)</u>
		Maximum	<u>(32)</u>

- (b) Prepare the note relating to the disposal of Small & Tiny Ltd to the consolidated financial statements of Check1 Ltd Group for the financial year ended 31 August 20.22 in accordance with IFRS 12 Disclosure of Interest in Other Entities. Disclose only IFRS12.10(b) requirements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 AUGUST 20.22

18. Disposal of subsidiary

During the current year, Check1 Ltd sold 70% of its 80% interest in Small & Tiny Ltd and lost control over Small & Tiny Ltd. This resulted in a total amount of R256 902 being included in the line item "other income" in profit or loss. Included in this amount is an amount of R119 613 that relates to the remeasuring of the retained investment to its fair value. Check1 accounts for the retained investment as an equity investment as subsequently measured at fair value through other comprehensive income. (2)

	20.22 R	
Included in profit before tax		
Other income		
Consolidated profit or loss on disposal of interest in subsidiary [C3]	258 350	(14)
Portion of profit or loss attributable to fair value adjustment of remaining interest [C4]	(119 794)	<u>(3)</u>
	Total	<u>(19)</u>
Communication skills: presentation and layout		<u>(1)</u>

- (c) Prepare only the non-current assets sub heading in the Consolidated Statement of financial position for the Check1 Ltd Group for the financial year ended 31 August 20.22. Comparative figures are not required.

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION OF THE CHECK1 LTD GROUP
AS AT 31 AUGUST 20.22**

	R	
ASSETS		
Non-current assets		
Property, plant and equipment	22 009 130	(4)
Goodwill (6841 (C1) x 16,50)	112 877	(½)
Investment in equity instruments	600 000	(½)
Investment in associate (C8)	1 458 715	(11½)
	Total	<u>(16½)</u>
	Maximum	<u>(14)</u>

- (d) Explain, with reasons, the correct recognition and measurement of the customer contract with Global Gym at the acquisition date in the consolidated financial statements of the Check1 Ltd Group.
- The recognition principle in IFRS 3 requires the acquirer, in this case Check1 to recognize separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree, in this case GymTech.
 - To qualify for recognition the identifiable assets and liabilities acquired must meet the definition of assets and liabilities at the acquisition date.
 - In the application of the recognition principle, conditions may result in recognising some assets and liabilities that GymTech had **not previously recognised as assets and liabilities in its separate financial statements. In this instance we can refer to the customer relationship between GymTech and Global Gym. GymTech would not have recognised this customer relationship in its separate financial statements.** (1)
 - IFRS 3 requires that an intangible asset acquired in a business combination be separately recognised from goodwill. An intangible asset is identifiable if it meets either the separability criterion or the contract-legal criterion.
 - The separability criterion means that an acquired intangible asset is capable of being separated and sold. In this case of the **new legislation, prohibits GymTech of selling any details about its customers. This customer relationship thus does not meet the separability criteria.** (1)
 - GymTech established its relationship with Global Gym through a contract, consequently the relationship **arises from contractual rights**. Therefore, it meets the **contractual-legal requirement whether it is cancellable or not.** (1)
 - A contract that meets the **contract-legal criterion is identifiable** even if the asset is **not transferable or separable**, thus an intangible asset exists in the form of the customer relationship with Global Gym. (1)
 - Because GymTech has a relationship with Global Gym, the fair value of this intangible asset will incorporate **assumptions based not only on the relationship** towards the gym equipment but will **also incorporate assumptions on the maintenance** and the electronic bicycle trip equipment. (1)
 - Check1 must **assess whether the customer relationship for the maintenance and the electronic bicycle trip equipment meets the separability criterion**. In order to decide on the separability criterion, it should be established if **there is a market** where these **types of lists are either traded or licensed separately** and whether the **new legislation will allow such trades within the market.** (1)

- Should there not be such a market or it is **prohibited by legislation then these separate relationships will not** be identified as an intangible asset. (1)
 - The intangible asset will be **measured at fair value at the acquisition** date. (1)
- | | | |
|------------------------------------|---------|-------------|
| | Total | <u>(15)</u> |
| | Maximum | <u>(12)</u> |
| Communication skills: logical flow | | <u>(1)</u> |

CALCULATIONS

C1. Goodwill

Net asset value at acquisition	165 600	[½]
Industrial equipment (110 000 – 100 000) x 0,75	<u>7 500</u>	[1]
	173 100	
Exchange rate at acquisition	x <u>16,26</u>	[½]
Rand value at acquisition	<u>2 814 606</u>	
60% Interest	1 688 764	[½]
Less: Consideration (1 000 000 + 800 000)	<u>1 800 000</u>	[1]
	<u>111 236</u>	
Converted to EUR (111 236/16,26)	<u>6 841</u>	[½]
		<u>[4]</u>

C2. Non-controlling interest

Net asset value (given)	461 842	[½]
Less: goodwill [C1]	<u>6 841</u>	[½]
	455 001	
Exchange rate at year-end	<u>16,50</u>	[½]
Net asset value in rand	<u>7 507 516</u>	
40% NCI	3 003 006	[½]
Less: NCI at acquisition (2 814 606 x 0,4)	<u>1 125 842</u>	[½]
	1 877 164	
Plus: NCI dividends (250 500 x 40%)	100 200	[½]
Plus: FCTR (-214 293 – (J11) 1 642) x 40% [J12]	<u>86 374</u>	
NCI (P/L)	<u>2 063 738</u>	<u>[3]</u>

C3. Consolidated profit on disposal of subsidiary

Derecognise net assets [C5]	(4 522 622)	[1½]
Derecognise goodwill [C5]	(223 552)	[9½]
Derecognise non-controlling interests (4 522 622 x 20%)	904 524	[1]
Recognise fair value of consideration received (given)	3 500 000	[½]
Recognise fair value of retained investment (50 000 x 10% x R120)	<u>600 000</u>	[1½]
	<u>258 350</u>	<u>[14]</u>

C4. Portion of loss attributable to fair value adjustment of remaining interest

Remaining portion		
(10/80 x (-4 522 622 [C3] – 223 552 [C3] + 904 524 [C3]))	(480 206)	[2]
Fair value of remaining interest in investment subsidiary	600 000	[1]
	<u>119 794</u>	<u>[3]</u>

C5. Goodwill – Small & Tiny

Equity at acquisition (given)	2 302 522	[½]
Right-of-use asset (167 103 x 0,73) [C6]	121 985	[2½]
Lease liability (4 473 x 0,73) [C6]	(3 265)	[2]
Non-current asset held for sale [C7] (18 340 x 0,73)	13 388	[3]
Net asset value at acquisition	<u>2 434 630</u>	
80% interest	1 947 704	[½]
Consideration (2 200 000 – 28 744)	2 171 256	[1]
Goodwill	<u>223 552</u>	<u>[9½]</u>

Net asset value

Retained earnings (given)	3 620 100	[½]
Revaluation (given)	702 522	[½]
Share capital (given)	200 000	[½]
	<u>4 522 622</u>	<u>[1½]</u>

C6. Right-of-use asset

	Small & Tiny	Group	IFRS3 adj	
Finance lease 1 March 20.20	657 437	661 910	4 473	[1½]
Right-of-use asset	556 586	723 689	167 103	[2]

HP10BII		SHARP EL-733A		SHARP EL-738	
2 nd FC	(Clear all)	2 nd FC	(Clear all)	2 nd FC	(Clear all)
PMT	375 000	PMT	375 000	PMT	375 000
N	2	N	2	N	2
I	8,75%	I	8,75%	I	8,75%
FV	0	FV	0	FV	0
COMP PV:	R661 910	COMP PV:	R661 910	COMP PV:	R661 910

[1½]

HP10BII		SHARP EL-733A		SHARP EL-738	
2 nd FC	(Clear all)	2 nd FC	(Clear all)	2 nd FC	(Clear all)
PMT	(375 000 – 410 000)	PMT	(375 000 – 410 000)	PMT	(375 000 – 410 000)
N	2	N	2	N	2
I	8,75%	I	8,75%	I	8,75%
FV	0	FV	0	FV	0
COMP PV	723 689	COMP PV	723 689	COMP PV	723 689

[2]

C7. Non-current asset held for sale

	Small & Tiny	Group	Difference
Carrying value 1 March 20.20	340 000	395 000	[½]
Less cost to sell n = 12: i – 8,75/12; FV = 40 000		(36 660)	[1½]
	<u>340 000</u>	<u>358 340</u>	<u>18 340</u> [2]

C8. Carrying amount of investment – Sport Shoe

Consideration [C9]	1 108 885	[3]
Excess [C11]	104 097	[3]
Share of profit of associate [C10]	275 200	[3½]
Delivery vehicle (340 000 x 25% x 40%)	((34 000)	[1]
Realisation of profit (34 000/60 x 8)	4 533	[1]
	<u>1 458 715</u>	<u>[11½]</u>

C9. Consideration

Initial 10% investment (70 000 x 10% = 7 000 x R54)	378 000	[1]
Debentures [C9]	730 885	[2]
	<u>1 108 885</u>	<u>[3]</u>

Debentures issued

HP10BII		SHARP EL-733A		SHARP EL-738	
2 nd FC	(Clear all)	2 nd FC	(Clear all)	2 nd FC	(Clear all)
PMT	(8 000 x 100 x 7,25%)	PMT	(8 000 x 100 x 7,25%)	PMT	(8 000 x 100 x 7,25%)
=	58 000	=	58 000	=	58 000
N	= 5	N	= 5	N	= 5
I	= 9,5%	I	= 9,5%	I	= 9,5%
FV	== 800 000 (8 000 x 100)	FV	= 800 000 (8 000 x 100)	FV	= 800 000 (8 000 x 100)
PV	= ?	PV	= ?	PV	= ?
	R730 885		R730 885		R730 885

C10. Share of profit of associate

Profit for the year (3 350 100 – 2 650 600) x 40%	279 800	[1]
Equipment sold (105 000 – 80 000) x 0,73 x 40%	(7 300)	[1½]
Realisation of profit (18 000/2 x 9/12) x 40%	2 700	[1]
	<u>275 200</u>	<u>[3½]</u>

C11. Excess/Goodwill – Sport Shoe

Net asset value at acquisition (given)	2 850 600	[½]
Revaluation land (231 959 x 0,784) (IAS 12.51C)	181 856	[1]
	<u>3 032 456</u>	
40% Interest in Sport Shoe	1 212 982	[1]
Less: consideration (C9)	1 108 885	[½]
Excess	<u>104 097</u>	<u>[3]</u>

C12. Property, plant and equipment

Given – Check1	12 865 000	[½]
– Pikolina (561 000 x 16,50)	9 256 500	[½]
Pikolina – Industrial equipment (110 000 – 100 000) x 16,50	165 000	[1]
– Revaluation reversal (J7)	(247 500)	[½]
– Depreciation	(34 370)	[½]
Sport Shoe – Equipment sold (-7 200 + 2 700) [C10]	4 500	[1]
	<u>22 009 130</u>	<u>[4]</u>

C13. Analysis of owners' equity of Pikolina (for completeness)

	Total EUR	Rate	Total R	60%		40%
				At R	Since R	NCI R
29 October 20.21						
Share capital	10 000					
Retained earnings	135 600					
Revaluation	20 000					
Industrial equipment (110 000 – 100 000)	10 000					
Taxation at 25%	(2 500)					
	173 100	16,26	2 814 606	1 688 764		1 125 842
Goodwill	6 841		111 236	111 236		
Consideration				1 800 000		
						2 063 738
Current year						
Profit (420 000 – 135 600 + 15 000)	299 400	17,37	5 200 578		3 120 347	2 080 231
Depreciation (10 000 x 10/48)	(2 083)	16,50	(34 370)		(20 622)	(13 748)
Taxation (34 370 x 25%)	521	16,50	8 593		5 156	3 437
Inventory (140 000/560 000 x 5 000)	(1 250)	16,50	(20 625)		(12 375)	(8 250)
Taxation (20 625 x 25%)	312	16,50	5 156		3 094	2 062
Revaluation (31 250 – 20 000)	11 250	16,50	185 625		-	-
Revaluation reversal	(11 250)	16,50	(185 625)			
Dividends paid	(15 000)	16,70	(250 500)		(150 300)	(100 200)
FCTR – Goodwill (6 841 x (16,50 – 16,26))			1 642		1 642	-
FCTR – balancing			(215 936)		(129 562)	(86 374)
	<u>461 842</u>	16,50	<u>7 620 393</u>		<u>2 817 387</u>	<u>3 003 006</u>

C14. Small & Tiny Ltd (for completeness)

	Total R	80%		20%
		At R	Since R	NCI R
1 March 20.20				
Share capital	200 000			
Retained earnings	1 550 000			
Revaluation reserve	552 522			
Right-of-use asset	167 103			
Lease liability	(4 473)			
Deferred tax (167 103 – 4 473) x 27%	(43 910)			
Non-current asset held for sale	18 340			
Deferred tax	(4 952)			
	2 434 630	1 947 704		486 926
Goodwill		223 552		
Consideration (2 200 000 – 28 744)		2 171 256		
Since acquisition	862 376		689 901	172 475
Retained earnings (2 520 100 – 1 550 000)	970 100			
Depreciation (125 327 x 0,73)	(91 489)			
Finance cost (2 896 + 789) x 0,73	2 690			
Impairment loss (18 340 – 5 135)	(13 205)			
Office furniture (loss) (200 000 – 220 000) x 0,73	14 600			
Realisation (14 400 x 7/36)	(2 800)			
Inventory (120 000 x 25/125) x 0,73	(17 520)			
Current year	1 075 730		860 584	215 146
Profit (2 520 100 – 3 620 100)	1 100 000			
Depreciation (41 775 x 0,73)	(30 496)			
Finance cost (789 x 0,73)	576			
Office furniture realise (14 400 – 2 800)	(11 600)			
Inventory realized	17 280			
Revaluation (702 522 – 552 522)	150 000		120 000	30 000
	4 522 623		1 671 841	904 524
Derecognise	(4 522 623)		(1 671 841)	(904 524)

C15. Sport Shoe Ltd

	Total R	40%	
		At R	Since R
1 September 20.21			
Share capital	200 000		
Retained earnings	2 650 600		
Revaluation reserve – land (231 959 x 0,784%)	181 856		
	3 032 456	1 212 982	
Excess		(104 097)	
Consideration received		1 108 885	
Current year			
Profit (3 350 100 – 2 650 600)	699 500		279 800
Equipment (105 000 – 80 000) x 0,73)	(18 250)		(7 300)
Realisation of profit (18 000/2 x 9/12)	6 750		2 700
	3 720 456		275 200

- (e) Discuss five key strategic risks (5 marks) that Check1 may face in the implementation of their expansion strategy and provide potential mitigations (8 marks) for each risk identified.

Themes not required,	Risk	Mitigation
Integration issues	Lack of strategic fit of the acquired investments	(1) Develop a detailed investment strategy / plan to strategically align acquisitions to Check1's strategic goals. (1)
	Envisaged synergy and related benefits , may not be achieved.	(1) Conduct proper due diligence before investing and perform benefits tracking to verify if the initially expected investment returns are being achieved. (1)
	Inability to integrate acquired company's systems and standards into Check1: Check1 may not expediently standardise and integrate the acquired entities within the Check1 group to achieve efficiencies	(1) Speed up the standardisation process immediately after acquisition to ensure uniform systems and systems work towards achieving the same set of goals. (1)

Themes not required,	Risk	Mitigation	
	<p>Culture clashes resulting from difficulty to change and cultural differences may be counter-productive resulting in lower efficiency, increased turnover of key employees, and declining profitability.</p>	(1)	<p>Plan and deliver roadshows and information sessions to the acquired company after acquisition to inform and educate acquired company's management and personnel on the Check1 strategy, vision, mission, and values.</p> <p>Include compliance with Click1's values and contribution to strategic goals as part of acquired company's performance evaluation and rewards to encourage goal-congruent behaviours.</p>
Pricing vs. value	<p>Overpayment risk Risk of overpaying for acquisitions due to lack of proper due diligence, overstated forecasts used in valuations, or manipulation of financial records by acquired company'.</p>	(1)	<p>Perform independent valuation by qualified valuer prior to finalising the acquisition in order to ensure the price paid closely linked to value gained.</p> <p>Include contingent payments (part of consideration linked to future performance of the acquired company') to reduce the overpayment risk on acquisition.</p>
Investment Management	<p>Investment management risk Check1 may not have the competence or time and resources to properly manage the acquired investments and ensure they achieve the required investment returns and are operated efficiently and productively.</p>	(1)	<p>Appoint competent personnel to champion the change management, and manage the various investments.</p>
Difficult Exit	<p>Lack of flexibility in acquisitions disposal: Lack of agility as significant investments made in acquisition cannot be easily and quickly reversed / disposed at acceptable prices thus making it difficult and inefficient to dispose of acquired mistakes.</p>	(1)	<p>Consider a combination of diversification and organic growth strategies as part of their expansion strategy to best allocate capital to profitable investments.</p> <p>Consider partnering with strategic alliances on high-risk investments to reduce investment risk</p>

Themes not required,	Risk	Mitigation		
Financing Purchases	<p>Financing risk Check1 may not have sufficient cash / access to cash to fund the investments or may end up highly geared because of chasing acquisitions.</p>	(1)	<p>Consider alternative financing arrangements such as share exchange to reduce the risk of financing from internally generated cash and externally acquired debt.</p> <p>OR</p> <p>Optimise the acquired investments (sell non-core assets, right-size (downsize by retrenching non-essential staff) to generate cash for Check1 OR</p> <p>Increase acquired companies financial leverage (acquire debt in those companies) and transfer excess cash to Check1 through dividends or share buy-backs immediately after acquisition to generate cash inflow for Check1 after acquisition.</p>	(1)
Foreign Risks exposure	<p>Foreign investment risks exposure Acquiring foreign entities increases risk (currency, economic, political, etc) which can place Check1 at a disadvantage when these risks are not properly managed.</p>	(1)	<p>Develop risk management mechanisms including the use of derivative instruments to mitigate currency risk.</p>	(1)
Signalling Risk	<p>Negative signalling risk Acquisition strategy may signal that Check1 does not have the creativity, innovation, and competitive edge to grow internally leading to shareholders selling / short-selling Check1 shares which will result in the decline in share price / shareholder value.</p>	(1)	<p>Invest in investor relations / public relations programme to inform and educate Check1 investors of the expansion plans and the rationale for acquiring the targeted companies to reduce significant negative impact on announcement of new deals / acquisitions.</p> <p>OR</p> <p>Report on investments performance holistically in the annual reports to keep investors aware of the strategic nature of the investments made and the value added.</p>	(1)
	Available	(10)	Available	(13)
	Maximum	(5)	Maximum	(8)
			Total Maximum	(13)

CASE STUDY 2**100 marks****YOU HAVE 30 MINUTES' READING TIME. SPEND 30 MINUTES READING THE CASE STUDY BEFORE YOU CONTINUE TO THE REQUIRED SECTION.****QUESTION 1****55 marks**

Airtrain Ltd ("Airtrain") is a South African aerospace company. Airtrain designs manufactures and sells civil and military aerospace products worldwide. Airtrain has a 31 July year end and is listed on the JSE Limited.

EasyFlight (Pty) Ltd

On 1 July 20.22 Airtrain signed a contract with EasyFlight (Pty) Ltd ("EasyFlight") to manufacture a 2-seater helicopter to be used for training. The helicopter will be manufactured according to EasyFlight's specifications and has no other use except for training given by EasyFlight. The contract price was R5 million. EasyFlight paid a deposit of R1 million on 1 July 20.22 to secure the contract. The remainder of the contract price will be settled when delivery of the helicopter is taken on 30 June 20.23 and no progress payments are included in the contract. As part of the contract, the words "Proudly manufactured by Airtrain" will be prominently painted on the sides of the helicopter. The fair value of the advertisement is considered to be R120 000 in the market and Airtrain has estimated that the value of the advertisement for them would amount to R90 000.

On 31 July 20.22, the costs of fulfilling the contract to manufacture the helicopter amounted to R180 000 and the expected future costs to complete the helicopter are estimated to be a further R3 820 000.

The accountant of Airtrain is of the opinion that no revenue should be recognised for the 20.22 financial year as the performance obligation in accordance with IFRS 15 *Revenue from Contracts with Customers* will only be satisfied when the helicopter is delivered on 30 June 20.23.

At the inception of the contract between Airtrain and EasyFlight, the market related interest rate, without considering credit risk, was 8% and the market related interest rate considering Airtrain's credit risk was 10%. Airtrain's incremental borrowing rate was 12%. You may assume that the time value of money is significant.

UK Ministry of Defence

Airtrain developed a new generation uninterruptible power supply (UPS) named UP6. UP6 is a full-power, high-voltage DC adjustable-output field-grade isolated UPS used in military and aerospace applications.

The UK Ministry of Defence placed an order for 75 UP6 units at R41 000 per unit. According to the signed contract, the units will be delivered free on board (FOB) to the UK Ministry of Defence. The contract will be settled 30 days after delivery.

All Airtrain electronics come with a standard warranty. The standard terms and conditions published on Airtrain's website state: "The warranty is valid for 1 (one) year. The seller or manufacturer guarantees remedies for product defects for one year from the date of sale. During that time, the seller shall repair or replace the product if such defects are present. The warranty doesn't cover damage caused by accidents or unauthorised modifications, in which case out-of-warranty repair fees will apply."

On 8 July 20.22, the UP6 order was completed and shipped FOB to the UK Ministry of Defence. The delivery was arranged by Airtrain and executed by an independent third party.

The accountant of Airtrain has not yet accounted for the contract with the UK Ministry of Defence as he was waiting to receive the payment before determining the performance obligation and allocating the transaction price in terms of IFRS 15.

Employee wellness programme

Airtrain would like to promote awareness of a healthy lifestyle to its employees. During March 20.22 one of the company's employees (50 years old) went on a hiking tour in Wilderness, in the Western Cape. The company made all the arrangements for the hiking tour and paid the R7 000 (including VAT) to Silent Walks, a registered VAT vendor, the organiser of the hiking tour. This amount included meals and accommodation. The company also booked the domestic return flight and paid the R4 500 (including VAT) directly to Fly Safe Airways.

On the second day of the tour, the employee fell off the float while crossing a river. The employee was taken to the hospital where X-rays were taken, and other necessary medical services and medication were provided. The cost of the medical procedures amounted to R6 000 (including VAT) and the medication to R900 (including VAT). These expenses were also paid by Airtrain.

QUESTION 2**45 marks**

Swarroo Ltd is a company that is listed on the JSE Limited. Swarroo Ltd is located in the Western Cape and is one of the country's top wine producers. The Swarroo Ltd Group includes several local subsidiaries, as well as an investment in associates. The group has a 31 July 20.22 year end.

You can assume that the amounts provided in the extract of the consolidated statement of profit or loss and other comprehensive income as well as the extract to the consolidated statement of financial position are correct, except where stated otherwise in the information below.

1. Extract of the consolidated statement of profit or loss and other comprehensive income of the Swarroo Ltd Group for the year ended 31 July 20.22

	20.22
	Dr/(Cr)
	R
Revenue	(25 669 870)
Cost of sales	12 546 690
Other income	(559 863)
Other expenses	8 548 010
Finance costs	566 242
Income tax expense	1 725 791
Mark-to-market surplus	(665 846)
Total comprehensive income attributable to:	(5 228 646)
Owners of the parent	(3 406 638)
Non-controlling interests (assume correctly for all subsidiaries)	(1 842 023)

2. An extract to the consolidated statement of financial position of the Swarroo Ltd Group as at 31 July 20.22

	20.22	20.21
	R	R
Property, plant, and equipment	27 686 831	18 662 020
Investments in associates	7 793 315	-
Trade and other receivables	1 025 466	3 225 114
Inventory	5 048 850	2 684 680
Non-controlling interests	6 647 887	1 598 960
Deferred tax	2 979 497	1 608 631
Deferred consideration	1 073 176	-
Trade and other payables	2 813 453	3 742 771
Shareholders for dividends	2 698 750	3 115 880
Current tax payable	3 362 030	2 445 580

3. Pinotache Ltd

Pinotache Ltd is a company that specialises in the manufacturing and delivery of glass wine bottles. On 31 October 20.17, Swarroo Ltd acquired a 16% interest (16 000 ordinary shares) in Pinotache Ltd for a cash consideration of R698 450. The fair value of these shares amounted to R958 336 on 1 February 20.22. Swarroo Ltd correctly classified this investment as a financial asset in accordance with IFRS 9 *Financial Instruments* at 31 October 20.17.

The executive board of directors of Swarroo Ltd met on 1 November 20.21 to discuss Pinotache Ltd's lucrative market opportunities and whether to increase its shareholding. On 1 February 20.22, Swarroo Ltd acquired an additional 54 000 ordinary shares cash, in Pinotache Ltd at a discounted R57,78 per share. Swarroo Ltd obtained control over Pinotache Ltd in accordance with IFRS 10 *Consolidated Financial Statements* from that date.

All the assets and liabilities of Pinotache Ltd were deemed to be fairly valued on 1 February 20.22, except for land, which had a fair value of R360 000 higher than its carrying amount. Pinotache Ltd subsequently recognised the land at its fair value on 31 July 20.22. The revaluation surplus of Pinotache Ltd only relates to this piece of land. No additional assets, liabilities, or contingent liabilities were identified on 1 February 20.22. Land is not included in the property, plant and equipment balance, as it is disclosed separately.

The fair value of the net assets of Pinotache Ltd consisted of the following on 1 February 20.22:

	Dr/(Cr) R
Property, plant, and equipment	2 500 858
Land	3 000 000
Inventory	1 084 620
Trade and other receivables	958 002
Trade and other payables	(1 015 005)
Cash and cash equivalents	(556 682)
	<u>5 971 793</u>

The equity of Pinotache Ltd consisted of the following on 31 July 20.22:

	Dr/(Cr) R
Ordinary share capital (100 000 shares)	500 000
Retained earnings	7 256 880
Revaluation surplus	279 360
	<u>8 036 240</u>

4. Tinta Barocca Ltd

Tinta Barocca Ltd is listed on the JSE Limited and the company's main business is to purchase grapes from various farms to produce wines. Swarroo Ltd acquired a 60% interest (120 000 ordinary shares) in Tinta Barocca Ltd on 1 August 20.21 and exercised control over Tinta Barocca Ltd in accordance with IFRS 10 *Consolidated Financial Statements* from that date.

The purchase price for the transaction was settled as follows:

- A cash payment of R2 400 000 on 1 August 20.21;
- A further cash payment of R1 600 000 that will only be paid on 1 August 20.26;
- 15 000 Swarroo Ltd ordinary shares that will be issued to the seller of the Tinta Barocca Ltd shares on the acquisition date. These shares were registered in the seller's name on 1 September 20.21. The fair value of the shares was R68,25 on 1 August 20.21 and R69,45 on 1 September 20.21; and
- An office building with a carrying amount of R2 066 554 in Swarroo Ltd's separate financial statements and a fair value of R2 465 400 on 1 August 20.21. The fair value of the building increased to R2 566 800 by the time the building had been registered in the seller's name on 15 October 20.21. The office building was transferred to the previous shareholders of Tinta Barocca Ltd.

All the assets and liabilities of Tinta Barocca Ltd were deemed to be fairly valued at the acquisition date, except for the following:

- Inventory which had a carrying amount of R358 665 and a fair value of R455 822 on 1 August 20.21.

No additional assets, liabilities, or contingent liabilities were identified at the acquisition date. No gain on bargain purchase arose from this acquisition.

On 1 May 20.22, Swarroo Ltd purchase an additional 40 000 shares in Tinta Barocca Ltd at a control premium of R65 per share. Swarroo Ltd still had control over Tinta Barocca Ltd in accordance with IFRS 10 *Consolidated Financial Statements*.

The fair value of the net assets of Tinta Barocca Ltd consisted of the following on the respective dates:

	1 Aug 20.21	1 May 20.22
	Dr/(Cr)	Dr/(Cr)
	R	R
Property, plant, and equipment	8 225 566	9 664 580
Inventory	1 155 884	1 455 866
Trade and other receivables	1 655 811	1 801 944
Cash and cash equivalents	465 588	593 215
Trade and other payables	(1 046 849)	(615 803)
	<u>10 456 000</u>	<u>12 899 802</u>

The inventory that was fairly valued in accordance with IFRS 3 at the acquisition date, was still on hand at 31 July 20.22.

The total comprehensive income attributable to non-controlling interest in the consolidated statement of profit and loss and other comprehensive income correctly takes Tinta Barocca Ltd's non-controlling interests profit into account at the different ownership percentages during the year.

5. Shirazz Ltd

On 1 December 20.16 Swarroo Ltd acquired an 83% interest in the ordinary shares of Shirazz Ltd for a cash consideration of R5 000 000. Swarroo Ltd exercised control over Shirazz Ltd in accordance with IFRS 10 *Consolidated Financial Statements* from that date.

Details of the equity value of Shirazz Ltd at the relevant dates were as follows:

	1 Dec 20.16	1 Aug 20.21	31 Jul 20.22
	R	R	R
Share capital	500 000	500 000	500 000
Retained earnings	4 455 880	8 650 211	9 556 880
Mark-to-market reserve	124 500	255 433	325 560
	<u>5 080 380</u>	<u>9 405 644</u>	<u>10 382 440</u>

Goodwill of R783 285 was recognised at the acquisition date for this acquisition. All the assets and liabilities of Shirazz Ltd were deemed to be fairly valued and no additional assets, liabilities, or contingent liabilities were identified on 1 December 20.16.

Shirazz Ltd did not declare any dividends during the 20.22 financial year.

6. Hanepoot Ltd

Hanepoot Ltd is widely known for the manufacturing of oak barrels in which wine is aged.

On 1 April 20.22 Swarroo Ltd acquired 37% of the ordinary share capital of Hanepoot Ltd for R6 220 000, consequently exercising significant influence over the financial and operating policies of Hanepoot Ltd from that date.

Hanepoot Ltd's net asset value was considered to be fairly valued on 1 April 20.22, while the equity of Hanepoot Ltd consisted of ordinary share capital, retained earnings, and mark-to-market reserve amounting to R750 000, R15 585 500, and R550 444 respectively.

On 1 April 20.22 Hanepoot Ltd also sold oak barrels of wine to Swarroo Ltd at a profit of 50% on cost. The selling price for these barrels of wine to Swarroo Ltd amounted to R1 250 000.

The accountant of Swarroo Ltd was unsure whether the barrels of wine should be recorded as inventory or property, plant and equipment, and therefore had recorded, the share of profit for eliminating the unrealised profit, into other expenses. After discussions with the auditors, it was confirmed that these barrels of wine should be recorded as property, plant, and equipment. These barrels of wine have a useful life of 10 years from the date of sale.

Hanepoot Ltd's profit for the period 1 April 20.22 to 31 July 20.22 amounted to R4 235 000, while the mark-to-market movement in other comprehensive income amounted to R392 070.

Hanepoot Ltd declared a dividend of R450 000 on 30 June 20.22.

7. Extract of the cash flows from investing activities of the consolidated statement of cash flows for the Swarroo Ltd for the year ended 31 July 20.22

	R
Cash flows from investing activities	
Additions to property, plant and equipment (27 686 831 – 18 662 020)	(9 024 811)
Proceeds from disposal of property, plant and equipment	100 409
Acquisition of subsidiary (Pinotache Ltd)	(3 120 120)
Acquisition of subsidiary (Tinta Barocca Ltd) (2 400 000 + (40 000 x 65))	(5 000 000)
Acquisition of investment in associate (Hanepoot Ltd)	6 220 000
Dividends paid (2 698 750 – 3 115 880 – 634 580)	(1 051 710)
Acquisition of partial acquisition of subsidiary	(2 600 000)
Interest paid (566 242 – 101 976)	(464 266)
Net cash from investing activities	<u>(14 879 511)</u>

8. Additional information

- It is the accounting policy of Swarroo Ltd to measure investments in subsidiaries and associates at cost in the separate financial statements in accordance with IAS 27.10(a).
- Swarroo Ltd elected to measure non-controlling interests of Tinta Barocca Ltd and Shirazz Ltd at the proportionate share of the acquiree's net identifiable assets at the acquisition date in accordance with IFRS 3.19(b).
- Swarroo Ltd elected to measure non-controlling interests of Pinotache Ltd at fair value at the acquisition date in accordance with IFRS 3.19(b).

- It is the accounting policy of Swarroo Ltd to account for investments in equity instruments, other than investments in subsidiaries and associates, in accordance with IFRS 9 *Financial Instruments*. Swarroo Ltd irrevocably elected to present any subsequent changes in the fair value of the investments in equity instruments in other comprehensive income in a mark-to-market reserve.
- Swarroo Ltd elected to transfer any cumulative gains or losses within equity in terms of IFRS 9.B5.7.1.
- Swarroo Ltd recognises any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received (attributable to the owners of the parent in an equity transaction) directly in a change in ownership reserve in equity.
- Owner-occupied land is accounted for on the revaluation model and all other property, plant, and equipment items on the cost model in accordance with IAS 16.
- Cash flows from interest and dividends received are classified as operating activities and cash flows from interest and dividends paid are classified as financing activities.
- Pinotache Ltd and Tinta Barocca Ltd both declared dividends on 31 July 20.22. Swarroo Ltd declared a dividend amounted to R634 580 on 31 May 20.22.
- Hanepoot Ltd was the only investment in associates for the year ended 31 July 20.22.
- Assume a market related post-tax discount rate of 7,56% per annum, compounded annually.
- Included in other expenses in the consolidated statement of profit or loss and other comprehensive income for the year ended 31 July 20.22 is depreciation and amortisation amounting to R1 558 620 and R352 440 respectively.
- During the year Swarroo Ltd sold fixed assets with a carrying amount of R954 602. Swarroo Ltd made a profit of R100 409.
- The annual goodwill impairment test was performed on the draft consolidated financial statements for the year ended 31 July 20.22. There were indications of impairment of the goodwill relating to the investment in Shirazz Ltd at 31 July 20.22. It was subsequently determined that the carrying amount of Shirazz Ltd at 31 July 20.22 exceeded the recoverable amount of Shirazz Ltd by R431 478. This is the first and only goodwill impairment for the 20.22 financial year.
- Other income, as presented in the consolidated statement of profit or loss and other comprehensive income, consists only of two items; a cash dividend of R433 283 that Swarroo Ltd received from an investment in equity instruments and interest received from financial institutions.
- None of the entities in the Swarroo Ltd Group are investment entities.
- There were no changes in the issued ordinary share capital of any of the companies during the respective financial years.
- Assume a normal income tax rate of 27% and a capital gains tax inclusion rate of 80%. Ignore the effect of value added tax (VAT) and dividend tax.

CASE STUDY 2**REQUIRED**

YOU NOW HAVE 150 MINUTES TO COMPLETE THE CASE STUDY.

QUESTION 1

	Marks
For parts (a) to (d) ignore any income tax and value added tax (VAT) implications.	
(a) Discuss the accuracy of the statement made by the accountant in relation to the contract between Airtrain Ltd and EasyFlight (Pty) Ltd for the year ended 31 July 20.22, in accordance with IFRS 15 <i>Revenue from Contracts with Customers</i> .	10
(b) Discuss how the contract clause "Proudly manufactured by Airtrain" painted on the helicopter included in the contract between Airtrain Ltd and EasyFlight (Pty) Ltd should be accounted for in the accounting records of Airtrain Ltd.	6
(c) Assume the accountant of Airtrain Ltd was correct. Prepare the journal entries in the accounting records of Airtrain Ltd to account for the contract with EasyFlight (Pty) Ltd for the year ended 31 July 20.22.	7
(d) Draft an email to the accountant of Airtrain Ltd where you discuss the identification of the performance obligations in accordance with IFRS 15 <i>Revenue from Contracts with Customers</i> with regard to the contract with the UK Ministry of Defence.	11
Communication skills: presentation and format	1
For parts (e) to (g) assume that Airtrain Ltd is registered as a category C-VAT vendor and that the company only dealt with VAT vendors, except for the transaction with the UK Ministry of Defence. Further, assume that all amounts exclude VAT unless indicated otherwise.	
(e) Calculate, with reference to relevant legislation, the deductions that Airtrain Ltd could claim for income tax purposes relating to the transaction with EasyFlight (Pty) Ltd for the company's 20.22 year of assessment.	5
(f) Discuss, with reference to relevant legislation, if Airtrain Ltd will be able to deduct any amount for the company's 20.22 year of assessment regarding the warranties issued to the UK Ministry of Defence.	4
(g) Discuss the VAT consequences for Airtrain Ltd relating to all amounts paid by the company before, during and after the hiking tour of the company's employee.	10
Communication skills: logical argument	1
Please note:	
<ul style="list-style-type: none"> • Show all your calculations. • Round off all amounts to the nearest rand. • Journal narrations are not required. • Your answer must comply with International Financial Reporting Standards (IFRS). 	

QUESTION 2

	Marks
<p>(a) Prepare only the following section of the consolidated statement of cash flows of the Swarroo Ltd Group for the year ended 31 July 20.22 using the direct method.</p> <ul style="list-style-type: none"> • Cash flows from operating activities <p style="text-align: right;">Communication skills: presentation and layout</p> <p>Please note:</p> <ul style="list-style-type: none"> • Comparative figures are not required. • Clearly show and reference all your calculations. • Round off all amounts to the nearest rand. • Notes to the consolidated statements of cash flows are not required. • The amounts for cash receipts from customers and cash paid to suppliers and employees must be calculated. 	<p>27</p> <p>1</p>
<p>(b) Critically discuss any non-compliance with IAS 7 in the investing activities section of the consolidated statement of cash flows of the Swarroo Ltd Group for the year ended 31 July 20.22 as far as the information permits. Include calculations to support your discussion where applicable.</p> <p>Please note:</p> <ul style="list-style-type: none"> • Limit your discussion only to the issues for which there is evidence of inaccuracies, inconsistencies, errors in application and non-compliance with IFRSs in the information provided • You are, however, not required to calculate the cash flows from investing activities. <p style="text-align: right;">Communication skills: logical flow and format</p> <p>Please note:</p> <ul style="list-style-type: none"> • Comparative figures are not required. • Round off all amounts to the nearest rand. • Your answer must comply with International Financial Reporting Standards (IFRS). 	<p>16</p> <p>1</p>

CASE STUDY 2**QUESTION 1 - Suggested solution**

- (a) **Critically discuss if the accountant of Airtrain Ltd is correct or not in concluding that no revenue should be recognised for the contract with EasyFlight (Pty) Ltd for the year ended 31 July 20.22, in accordance with IFRS 15 *Revenue from Contracts with Customers*.**

In terms of IFRS 15, Airtrain must recognise revenue when the performance obligation is satisfied and that will be when control of the helicopter is transferred to EasyFlight. (1)

If a performance obligation is not satisfied over a period of time, Airtrain will satisfy the performance obligation at a point in time. The criteria for over a period of time (IFRS 15.35) should therefore be evaluated first. (1)

A performance obligation is satisfied over a period of time if anyone of the three criteria in IFRS 15.35 is satisfied:

- EasyFlight does not simultaneously receive and consume the benefits when the helicopter is manufactured by Airtrain. (1)
- EasyFlight does not control the machine while it is enhanced by Airtrain. (1)
- Although the machine has no alternative use, Airtrain does not have any right to progress payments relating to performance or enhancement completed to date. (2)

Therefore paragraph 35 does NOT apply and the performance obligation is not satisfied over a period of time, but at a point in time. (1)

The following control indicators also indicate that control will be transferred on 30 June 20.23:

- Right to final payment will be 30 June 20.23;
- EasyFlight obtains legal title on 30 June 20.23;
- EasyFlight will take physical possession of the helicopter on 30 June 20.23; and
- On 30 June 2023 all risks and rewards of ownership will be transferred to EasyFlight and EasyFlight will obtain the ability of direct use as from 30 June 20.23 (IFRS 15.38 (a) to (e)). (2)

Control is therefore transferred on 30 June 20.23 (at a point in time) when the performance obligation is satisfied (IFRS 15.38). (1)

The accountant of Airtrain is therefore correct and revenue should only be recognised by Airtrain on 30 June 20.23. (1)

	Total	<u>(1)</u>
	Maximum	<u>(10)</u>

**COMMENT**

Many students discussed the performance obligations, instead of realising it is step 5 that needs to be discussed.

Students also came to the incorrect conclusion that the performance obligation is satisfied over a period of time. Remember that you have your IFRS handbooks with you, please refer back to paragraph 35.

- (b) Discuss how the contract clause “Proudly manufactured by Airtrain” painted on the helicopter that is included in the contract between Airtrain Ltd and EasyFlight (Pty) Ltd should be accounted for in the accounting records of Airtrain Ltd.

According to IFRS 15.47, the transaction price is the amount of consideration to which Airtrain expects to be entitled in exchange for transferring the promised helicopter to EasyFlight. (1)

Airtrain expects to be entitled to R5 000 000 cash and the advertising intangible asset of having the word painted “proudly manufactured by Airtrain”. (1)

Any non-cash consideration will be measured at fair value (IFRS 15.66) and fair value will be determined in terms of IFRS 13. (2)

According to IFRS 13.27, the fair value of a non-financial asset (advertising intangible asset) takes into account the asset's highest and best use or by selling it to another market participant that would use the asset in its highest and best use. (1)

Therefore, the advertising intangible asset and revenue should be measured at R120 000 and not R90 000. (1)

The debit leg of the transaction: Advertising intangible assets will be recognised, measured and amortised in terms of IAS 38. (1)

The credit leg of the transaction: Revenue will be recognised in terms of IFRS 15 relating to the contract with EasyFlight. (1)

The transaction will be recorded on 30 June 20.23 when the performance obligation will be satisfied (refer section (a)). (1)

Total (9)
Maximum (6)



COMMENT

This was overall poorly answered. Students concluded that it is advertising costs and not an intangible asset. Also note that FAC4863 is just as important when you write FAC4864, as almost no student discussed IFRS 13's measurement principles, and therefore concluded that the amount is R90 000, instead of R120 000.

- (c) Assume the accountant of Airtrain Ltd was correct. Prepare the journal entries in the accounting records of Airtrain Ltd to account for the contract with EasyFlight (Pty) Ltd for the year ended 31 July 20.22.

	Dr R	Cr R	
1 July 20.22			
J1	Bank (SFP)	1 000 000	(1)
	Contract liability/ Payment received in advance (SFP)		1 000 000 (1)
	Deposit (advance payment) received from EasyFlight		
<hr/>			
31 July 20.22			
J2	Interest expense (P/L) (1 000 000 x 12% x 1/12)	10 000	(2)
	Contract liability/ Payment received in advance (SFP)		10 000 (1)
	Recognition of interest expense on advance payment		
<hr/>			
J3	Contract cost (asset) (SFP)	180 000	(1)
	Creditors/Bank (SFP)		180 000 (1)
	Recognition of contract cost up to year end		
			<u>(7)</u>

- (d) Draft an email to the accountant of Airtrain Ltd where you discuss the identification of the performance obligations in accordance with IFRS 15 *Revenue from Contracts with Customers* with regard to the contract with the UK Ministry of Defence.

To: Accountant – Airtrain
From: CTA student
Date: 15 October 20.22
Subject: Performance obligation in the contract with the UK Ministry of Defence

According to IFRS 15.22, the identification of the performance obligations should be done at the inception of the contract and not only when payment is received. Therefore, the accountant should have already identified the performance obligations relating to the contract. (1)

Airtrain should identify all goods and services promised in the contract that is distinct. (1)

Goods and services promised are distinct if both of the following criteria are met:

- The customer can benefit from the good or service either on its own or together with other resources that are readily available (i.e. the good or service is capable of being distinct); and
- The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the good or service is distinct within the context of the contract (IFRS 15.27)). (1)

The contract explicitly promises the UP6 units and the delivery of the units. The contract also includes an implied promise in the form of a 1-year warranty as it is a standard business practice to sell electronics with this warranty. (2)

UP6 units

The Ministry of Defence can benefit from the use of the UP6 unit on its own. (1)

The UP6 units are therefore distinct and a separate performance obligation. (1)

Delivery of UP6 units

The delivery is not a separate performance obligation because it is performed independently by a non-related third party. (1)

Warranty

The Ministry of Defence can benefit from the warranty together with the UP6 unit since the warranty will entitle the holder to a repair or replacement should the UP6 unit be faulty. Therefore, the warranty is capable of being distinct. (1)

However, the warranty is not available for sale without purchasing an electronic item from Airtrain. The warranty is also highly interdependent and highly interrelated to the UP6 unit. (2)

The warranty provides the Ministry of Defence with the assurance that the product will function as intended for one year and no other goods or services in addition to that assurance and, therefore, Airtrain will not account for it as a performance obligation (IFRS 15. IE228). (1)

Airtrain will account for the assurance-type warranty in accordance with the requirements in IAS 37. (1)

The 12-month warranty is therefore not distinct and should be combined with the promise of the UP6 unit. (1)

	Total	<u>(14)</u>
	Maximum	<u>(11)</u>
Communication skills: presentation and format		<u>(1)</u>

**COMMENT**

This was the part that students answered the best. There are many examples of identifying the performance obligations in TUT102 as well. If you are still struggling, please contact us.

- (e) Calculate, with reference to relevant legislation, the deductions that Airtrain Ltd could claim for income tax purposes relating to the transaction with EasyFlight (Pty) Ltd for the company's 20.22 year of assessment.

	R	
Section 24C is applicable		(1)
Deduction of expenses incurred (section 11(a)) (1)	(180 000)	(2)
Additional deduction in terms of section 24C		
R3 820 000/R5 000 000 (1) x R1 000 000 (1) = R764 000		(2)
R764 000 – R180 000 = R584 000 (s 24C allowance)	(584 000)	(1)
	Total	<u>(6)</u>
	Maximum	<u>(5)</u>

- (f) **Discuss, with reference to relevant legislation, if Airtrain Ltd will be able to deduct any amount for the company's 20.22 year of assessment regarding the warranties issued to the UK Ministry of Defence.**

In terms of **section 23(e) (1)**, no amount will be deductible when the warranty is provided for any anticipated or future losses (1) (1)

No loss or expense has actually been incurred as required by section 11(a), thus no deduction in 20.22 until (1)

the expenditure is actually incurred in terms of **section 11(a)** (repairs or replacements done during the 20.22 year of assessment), then **the cost of the repair and replacement will be deductible.** (1)

Total (1)
Maximum (4)

- (g) **Discuss the VAT consequences for Airtrain Ltd relating to all amounts paid by the company before, during and after the hiking tour of the company's employee.**

Airtrain incurred expenses of R7 000 on the booking of the hiking tour.

Input tax will be denied in terms of section 17(2) as this is the **provision of entertainment.** (1)

As this is a **fringe benefit included in gross income, par (i) and in terms of the Seventh Schedule** to the Income Tax Act section 18(3) of the VAT Act needs to be considered. (Gross income definition par (j) and paragraphs 2(c) and (d) of the Seventh Schedule). (1)

Section 18(3) **excludes a deemed output tax on the provision of entertainment**, therefore no output tax needs to be accounted for. (1)

Airtrain paid for the domestic flight of R4 500.

Input tax of $R4\ 500 \times 15/115 = R587$ can be claimed (1)

The purchase of the air ticket qualifies as a fringe benefit in terms of par 2(e) of the Seventh Schedule as **it is as a consequence of the employee's employment** (causal connection) and will be included in the gross income of the employee in terms of paragraph (j) of the gross income definition. (1)

The **cash equivalent of the benefit** is the **cost to Airtrain for the air ticket excluding VAT** as input tax could be claimed (section 10(13) of the VAT Act together with section 23C of the Income Tax Act), **therefore $R4\ 500 \times 100/115 = R3\ 913$.** (1)

The time of supply will be the same as for PAYE, **therefore the end of March 20.22.** (1)

Deemed **output tax** of R510 ($R3\ 913 \times 15/115 = R510$) must be accounted for in the tax period that March 20.22 falls into. (1)

Medical expenses

The **release of the debt of the employee** by paying the debt of the employee to a third party **qualifies as a financial service** in terms of section 2 of the VAT Act. (1)

Financial services qualify as exempt supplies in terms of section 12(a) of the VAT Act. (1)

Although the release of debt is a fringe benefit in terms of par 2(j) and 12B(1) of the Seventh Schedule to the Income Tax Act and is included in gross income in terms of par (i) of the gross income definition section 18(3) of the VAT Act specifically **excludes exempt supplies** from the application of section 18(3). **Therefore no deemed output tax must be accounted for** regarding the payment of the employee's medical bill and medication.

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

**EXAM TECHNIQUE**

There will always be integration with another module. Many students simply did not attempt this part, losing valuable marks.

Please refer back to your Taxation TUT letter for a discussion regarding VAT. Overall students did very poorly in this part of the integration.

QUESTION 2 - Suggested solution

- (a) Prepare only the following section of the consolidated statement of cash flows of the Swarroo Ltd Group for the year ended 31 July 20.22 using the direct method.

	R	
Cash flows from operating activities		
Cash receipts from customers [C1]	30 483 331	(2½)
Cash paid to suppliers and employees [C2]	<u>(22 612 355)</u>	(17)
Cash generated from operations	7 870 976	
Interest received (559 863 – 433 283)	126 580	(½)
Income tax refunded [C5]	314 323	(6)
Dividend received ((450 000 x 37%) + 433 283)	<u>599 783</u>	(1)
Net cash from operating activities	<u>8 911 662</u>	
		<u>(27)</u>
	Communication skills: presentation and layout	<u>(1)</u>

- (b) Critically discuss any non-compliance with IAS 7 in the investing activities section of the consolidated statement of cash flows of the Swarroo Ltd Group for the year ended 31 July 20.22. Where necessary include how the amount should have been calculated and/or disclosed.

Additions to property, plant and equipment

The additions to the property, plant and equipment were calculated incorrectly, as only the movement of the opening and closing balances was considered. (½)

The acquisition of PPE amount to be disclosed is therefore a cash outflow of R3 027 191 [C6]. (5)

Proceeds from disposal of property, plant and equipment

The profit of R100 409 has been disclosed instead of the proceeds from the disposal of the property, plant and equipment. The profit itself is a non-cash item, and therefore should be added back as a non-cash item in the cash paid to suppliers and employees. (1)

The proceeds of the disposal of PPE amount to be disclosed is a cash inflow of R1 055 011 (R100 409 + 954 602). (1½)

Acquisition of subsidiaries (Pinotache Ltd and Tinta Barocca Ltd)

Where a subsidiary is acquired or sold during the year and control is lost or acquired, it will be classified under investing activities (IAS 7.39).

In terms of IAS 7.42 the aggregate amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries is reported in the statement of cash flows and its notes, net of cash and cash equivalents acquired or disposed of.

The amount presented on the consolidated statement of cash flows as acquisition of subsidiary amount should be the consideration paid net of cash of the subsidiary acquired at initial acquisition. (½)

Pinotache Ltd – The cash amount paid was R3 120 120 (R57,78 x 54 000) and the overdraft of Pinotache Ltd was R556 682. Therefore, the net of cash outflow should be disclosed as R3 676 802. (1½)

Tinta Barocca Ltd – There are two errors evident in the amount for acquisition of subsidiary Tinta Barocca Ltd disclosed.

The amount presented under investing activities for this acquisition is incorrect. The cash amount paid was R2 400 000 and the bank balance of Tinta Barocca Ltd was R465 588. Therefore, the net cash outflow should be disclosed as R1 934 412. The additional acquisition amount should not be included.

(2½)

Acquisition of partial acquisition of subsidiary (Tinta Barroca Ltd)

The initial and addition purchase of shares are separate transactions in the same year and must be accounted for separately when taking into account IAS 7 disclosure requirements.

Changes in ownership interests in a subsidiary that do not result in a loss of control, such as the subsequent purchase or sale by a parent of a subsidiary's equity instruments, are accounted for as equity transactions (IAS 7.42B)

Therefore, the additional interest acquired on 1 May 20.22, would not be included in this initial acquisition consideration paid as in terms of IAS 7 that would represent an equity movement that should be reflected in the financing activities section of the cash flow.

(1½)

Acquisition of investment in associate (Hanepoot Ltd)

The amount is correct, as this is the amount paid for the acquisition of the investment in associate. The direction of the amount is incorrect and should be disclosed as a cash outflow of R6 220 000, and not a cash inflow.

(1)

Dividends paid

In the calculation provided, only the movement of the shareholders for dividends' opening and closing balances, as well as the dividends declared by Swarroo Ltd were considered.

(1)

Pinotache Ltd and Tinta Barocca Ltd also declared dividends, and therefore the dividends paid to non-controlling interests should also be considered. The dividends declared and paid to non-controlling interests amounted to R206 600 [C8].

(½)
(5½)

The total cash outflow for dividends paid should be disclosed as R1 258 310 [C7], but this should also be disclosed under financing activities, as this is the accounting policy of Swarroo Ltd Group.

(2)

Interest paid

The amount is correct, as well as the direction as an outflow. The amount of interest paid should however be disclosed under financing activities as this is the accounting policy of Swarroo Ltd Group.

(½)

Total (24½)Maximum (16)Communication skills: presentation and layout (1)

CALCULATIONS**C1. Cash receipts from customers**

Revenue	25 669 870	[½]
Movement in trade receivables (3 225 114 – 1 025 466)	2 199 648	[1]
Acquisition of Pinotache Ltd – Receivables	958 002	[½]
Acquisition of Tinta Barocca Ltd - Receivables	1 655 811	[½]
	<u>30 483 331</u>	<u>[2½]</u>

C2. Cash paid to suppliers and employees

Cost of sales	(12 546 690)	[½]
Operating expenses	(8 548 010)	[½]
Non-cash items:		
Depreciation	1 558 620	[½]
Amortisation	352 440	[½]
Fair value adjustment of PPE (2 465 400 – 2 066 554)	(398 846)	[1]
Profit on disposal of assets (100 409 (given))	(100 409)	[½]
Gain on bargain purchase (Pinotache) [C3]	(378 697)	[4½]
Unrealised profit eliminated [C4]	108 791	[3½]
Impairment loss on goodwill (431 478 x 83%)	358 127	[1]
Movement in working capital:		
Movement in inventory	(26 509)	
Increase in balances (5 048 850 – 2 684 680)	(2 364 170)	[½]
Acquisition of Pinotache Ltd – Inventory	1 084 620	[½]
Acquisition of Tinta Barocca Ltd – Inventory (1 155 884 + (455 822 – 358 665))	1 253 041	[1]
Movement in trade payables	(2 991 172)	
Decrease in balances (2 813 453 – 3 742 771)	(929 318)	[½]
Acquisition of Pinotache Ltd – Payables	(1 015 005)	[½]
Acquisition of Tinta Barocca Ltd – Payables	(1 046 849)	[½]
	<u>(22 612 355)</u>	<u>[17]</u>

C3. Gain on bargain purchase of subsidiary - Pinotache Ltd

Consideration transferred at acquisition date ((54 000 x 57,78) + 958 336)	4 078 456	[1½]
Non-controlling interests at acquisition date (958 336/16 000 x 30 000)	1 796 880	[1½]
	<u>5 875 336</u>	
Net asset value at acquisition date:		
- Net asset value (given)	5 971 793	[½]
- Land	360 000	[½]
- Deferred tax (360 000 x 27% x 80%)	(77 760)	[½]
	<u>6 254 033</u>	
Gain on bargain purchase	<u>(378 697)</u>	<u>[4½]</u>

C4. Unrealised profit eliminated between Hanepoot Ltd and Swarroo Ltd

	Dr R	Cr R	
Share of profit in associate (P/L) (1 250 000 x 50/150 x 37%)	154 167		[1½]
Property plant and equipment (SFP)		154 167	[½]
<u>Elimination of unrealised profit in the intragroup transaction</u>			
Deferred tax (SFP) (154 167 x 27%)	41 625		[½]
Share in profit in associate (P/L)		41 625	[½]
<u>Tax implication of elimination of intragroup transaction</u>			
Accumulated depreciation (SFP) (154 167/10 x 4/12)	5 139		[½]
Share of profit in associate (P/L)		5 139	[1]
<u>Realisation of unrealised profit</u>			
Share of profit in associate (P/L)	1 388		[½]
Deferred tax (SFP) (5 139 x 27%)		1 388	[½]
<u>Tax implication of the realisation of the unrealised profit</u>			
Share of profit of associate (154 167 – 41 625 + - 5 139 + – 1 388)		108 791	[3½]
Property, plant and equipment (154 167 – 5 139)		149 028	[1]
Deferred tax (41 625 – 1 388)		40 237	[1]

C5. Income taxes refunded

Increase in deferred taxation (2 979 497 – 1 608 631)		1 370 866	[½]
Deferred tax on fair value adjustment on assets and liabilities at acquisition of Pinotache Ltd (360 000 x 27% x 80%)		(77 760)	[½]
Deferred tax on fair value adjustment on assets and liabilities at acquisition of Tinta Barocca Ltd (97 157 x 27%)		(26 232)	[½]
Deferred tax on the movement of the mark-to-market reserve [(665 846/ (1 – (27% x 80%) = 849 293 – 665 846]		(183 447)	[1½]
Deferred tax on the unrealised profit [C5]		40 237	[1]
Movement of deferred tax included in profit or loss		1 123 664	
Income tax expense included in profit or loss (given)		(1 725 791)	[½]
		(602 127)	
Increase in South African Revenue Services (3 362 030 – 2 445 580)		916 450	[½]
		(314 323)	
		<u> </u>	<u>[5]</u>

C6. Additions to property, plant and equipment

Increase in PPE balance (27 686 831 – 18 662 020)		(9 024 811)	[½]
Depreciation		(1 558 620)	[½]
Consideration paid for Tinta Barocca Ltd		(2 066 554)	[½]
Disposal of PPE		(954 602)	[½]
Elimination of intragroup transactions [C4]		(149 028)	[1]
Acquisition of Pinotache Ltd		2 500 858	[½]
Acquisition of Tinta Barocca Ltd		8 225 566	[½]
		<u>(3 027 191)</u>	<u> </u>
			<u>[4]</u>

C7. Dividend paid to shareholders of the parent

Decrease in shareholders for dividends (2 698 750 – 3 115 880)	(417 130)	[½]
Dividends declared (given)	(634 580)	[½]
Dividends paid to shareholders of non-controlling interests (C8)	<u>(206 600)</u>	[5½]
	<u>(1 258 310)</u>	<u>[6½]</u>

C8. Dividends paid to shareholders of non-controlling interests

Increase in non-controlling interests (6 647 693 – 1 598 960)	5 048 733	[½]
Total comprehensive income for the period attributable to non-controlling interests (given)	(1 842 023)	[½]
Acquisition of Pinotache Ltd (958 336/16 000 x 30 000) at fair value	(1 796 880)	[1]
Acquisition of Tinta Barocca Ltd		
((10 456 000 + (455 822 – 358 665 = 97 157) – (97 157 x 27%) x 40%)	(4 210 770)	[2]
Partial acquisition of Tinta Barocca Ltd		
((12 899 802 + (97 157 x 73%) x 20%)	<u>2 594 146</u>	[1½]
	<u>206 600</u>	<u>[5½]</u>

CASE STUDY 3**100 marks**

YOU HAVE 30 MINUTES' READING TIME. SPEND 30 MINUTES READING THE CASE STUDY BEFORE YOU CONTINUE TO THE REQUIRED SECTION.

QUESTION 1**50 marks**

The Cooldrink Company Ltd ("Cooldrink") is a national beverage manufacturer trading with an international license. Cooldrink is listed on the Johannesburg Stock Exchange and have investments in other related industries. Cooldrink and all its investments have a 31 August year end.

The following trial balances are presented as at 31 August 20.21:

	Cooldrink Ltd R	PinkDrink PLC MZN	Bottles Ltd R	Slimwater Ltd R
Share capital (500 000 shares; 100 000 shares; 100 000 shares; 100 000 shares)	(500 000)	(100 000)	(100 000)	(2 500 000)
Retained earnings	(7 710 000)	(8 670 000)	(4 718 500)	(3 250 000)
Mark-to-market reserve	-	-	-	(58 200)
Deferred tax	(52 250)	-	(142 000)	(85 620)
Trade and other payables	(3 426 000)	(2 985 000)	(2 706 000)	(1 785 000)
Gross profit	(6 145 000)	(3 350 000)	(2 868 100)	(2 251 000)
Other income	(1 708 750)	-	(212 000)	-
Loan from Cooldrink Ltd	-	(4 250 000)	-	-
Investment property: Land	-	-	1 225 000	-
Plant and equipment	7 775 000	5 700 000	6 550 000	4 445 800
Investments:				
Bottles Ltd	2 200 000	-	-	-
Other equity investments	290 000	-	-	395 000
Inventory	660 000	2 400 000	986 000	422 000
Trade and other receivables	2 858 100	1 580 000	1 241 000	1 987 000
Sundry receivables	1 620 000	-	-	-
Cash and cash equivalents	613 650	6 840 000	(1 096 105)	962 000
Operating expenses	2 736 500	1 985 000	1 236 500	1 410 000
Income tax expense	538 750	450 000	474 205	208 020
Dividend declared and paid	250 000	400 000	130 000	100 000
	-	-	-	-

Bottles Ltd

Cooldrink purchased 80% of the shares and voting rights of Bottles Ltd ("Bottles") on 1 January 20.15 for a consideration of R2 200 000. On this date Cooldrink obtained control of Bottles in accordance with IFRS 10 *Consolidated Financial Statements*. Bottles operates a bottling plant and is responsible for the production of bottles and cans as well as the filling thereof. At the date of acquisition Bottles share capital and retained earnings amounted to R100 000 and R2 500 000 respectively.

All the assets and liabilities of Bottles were deemed to be fairly valued at 1 January 20.15 and no additional assets, liabilities or contingent liabilities were identified at that date.

In the previous financial year Bottles acquired valuable land to generate rental income. From the date of acquisition, the land was rented to Cooldrink for R11 000 per month. On 31 August 20.20 the fair value of the land amounted to R1 145 000.

On 1 March 20.21, Bottles sold computer equipment to Cooldrink. Bottles initially purchased this computer equipment on 1 September 20.20 for an amount of R165 000. Cooldrink paid an amount of R170 000 for this equipment and will depreciate it over the remaining useful life.

During the current financial year Bottles also paid a management fee of R211 000 to Cooldrink.

PinkDrink PLC

Cooldrink purchased a 60% controlling interest in PinkDrink PLC ("PinkDrink") on 1 July 20.21. PinkDrink is a Mozambican company and its functional currency commonly referred to as the Mozambique New Metical (MZN). PinkDrink also manufactures beverages and their flagship drink is a very popular carbonated strawberry drink. Cooldrink decided to invest in PinkDrink to gain access to PinkDrink's intellectual property. Cooldrink have been trying to perfect their own strawberry drink recipe for a number of years, but to no avail. The imported strawberry drink from PinkDrink has always been more popular in South Africa than the locally produced drink. The consideration paid was as follows:

- Cash consideration of R620 000 was paid on 1 July 20.21 into the lawyer's trust account. Included in the cash consideration paid are acquisition related costs in respect of valuations and lawyer's fees of R120 000.
- On 1 July 20.21 Cooldrink issued 3 200 of its own shares to the former owners at a market price of R140 per share. According to the purchase agreement Cooldrink will be liable to pay an additional amount of R150 000 if the market price of Cooldrink's shares declines below R120 per share during the first two years after acquisition. At 31 August 20.21 Cooldrink's share price declined by 5%. The fair value of the contingent consideration was estimated to be R60 000 and R85 000 on 1 July 20.21 and on 31 August 20.21 respectively.

At the acquisition date the manufacturing plant of PinkDrink was already very old and required urgent maintenance to ensure the production capacity can be maintained. This was noted in the purchase agreement and a factor in determining the consideration to be paid by Cooldrink for the investment. As part of the purchase agreement, Cooldrink also granted a loan to PinkDrink on 1 July 20.21 to the value of R1 000 000 to be used for plant maintenance. The loan bears interest, but settlement is neither planned nor likely to occur in the foreseeable future. Interest payments will be made annually and any tax consequences have already been included in the income tax expense for the year.

Cooldrink's accountant was uncertain how to account for the loan and the acquisition of a foreign subsidiary and therefore only recorded the cash outflow in the sundry receivables account.

The trial balance of PinkDrink as at 31 August 20.20 was as follows:

	MZN
Share capital (100 000 shares)	(100 000)
Retained earnings	(8 670 000)
Trade and other payables	(2 100 000)
Property, plant and equipment	5 800 000
Inventory	1 950 000
Trade and other receivables	1 260 000
Cash and cash equivalents	1 860 000
	<u>-</u>

All the assets and liabilities of PinkDrink were considered to be fairly valued on 1 July 20.21, with the exception of the intellectual property. The internally generated brand name had a fair value of MZN860 000 and was not recognised in the financial statements of PinkDrink. The brand name had an estimated remaining useful life of four years at the date of acquisition. No additional assets, liabilities or contingent liabilities were identified at the date of acquisition. The accountant prepared the following note for the investment in PinkDrink to the annual financial statements of the Cooldrink Group for the year ended 31 August 20.21:

10. Investment in PinkDrink PLC

Name and description of subsidiary:	PinkDrink PLC Mozambican beverage producer
Acquisition date:	1 July 20.21
Percentage of voting equity interests acquired:	60%

The acquisition was made to gain access to the subsidiary's brand name. Control was obtained over the subsidiary through acquisition of the majority of the voting rights.

The major classes of assets acquired and liabilities assumed as at 1 July 20.21 were as follows:

	R
Non-current assets Note 1	1 144 600
Current assets	1 083 000
Current liabilities	(446 100)
	<u>1 781 500</u>

Note 1: Non-current assets consist only of the property, plant and equipment of PinkDrink as presented in its separate trial balance.

Slimwater Ltd

Cooldrink purchased 25% of the shares and voting rights of Slimwater Ltd ("Slimwater") on 1 April 20.18 for a consideration of R1 100 000. From this date Cooldrink has been exercising significant influence over the financial and operating policy decisions of Slimwater. Slimwater bottles spring water at a fountain in the Maloti mountains.

Slimwater had the following equity and reserve balances at acquisition:

	1 April 20.18
	R
Share capital	2 500 000
Retained earnings	1 100 000
	<u>3 600 000</u>

All the assets and liabilities were fairly valued at 1 April 20.18.

From 20.20 onward Slimwater sold water to Cooldrink. Water is sold at a profit of 40% on cost. Included in Cooldrink's inventory in respect of these sales are R77 000 and R91 000 on 31 August 20.20 and 31 August 20.21 respectively.

During the current financial year Slimwater also paid a management fee of R120 000 to Cooldrink.

Slimwater acquired equity investments for the first time during September 20.20. The fair value movement on these investments are included in the mark-to-market reserve.

On 31 August 20.21, Cooldrink disposed of a 20% interest in Slimwater for R1 600 000. The remaining 5% interest had a fair value of R290 000 on 31 August 20.21. Cooldrink classified the remaining investment as a financial asset at fair value through other comprehensive income.

Additional information

1. The Cooldrink Ltd Group has elected to present the consolidated statement of profit or loss and other comprehensive income as a single statement by function in terms of IAS 1.99 and to present other comprehensive income net of tax in terms of IAS 1.91(a).
2. It is the accounting policy of Cooldrink to account for investments in subsidiaries and associates at cost in accordance with IAS 27.10(a) in its separate financial statements.
3. The accounting policy of the Cooldrink Group include the following provisions:
 - The group has elected to measure non-controlling interests at the proportionate share of the acquiree's identifiable net assets at the acquisition date for all subsidiaries.
 - The group considers loans and interest thereon to foreign subsidiaries as part of the net investment in the subsidiary.
 - The group accounts for plant and equipment according to the cost model and land according to the revaluation model in terms of IAS 16 *Property, Plant and Equipment*.
 - Computer equipment is depreciated over three years.
 - The group accounts for investment property according to the fair value model in terms of IAS 40 *Investment Property*.
4. Assume that all income and expenses were earned and incurred evenly throughout the financial year to which they relate, except for the income and expense items relating to the foreign loan in the accounting records of PinkDrink.
5. Assume a market related interest rate of 12% per annum.
6. All group dividends were declared and paid at year end, except for Slimwater which declared and paid its dividends on 31 July 20.21.
7. The following exchange rates were applicable at the respective dates:

	MZN1 = R
31 August 20.20	0,25
1 July 20.21	0,20
Average 1 July 20.21 – 31 August 20.21	0,22
31 August 20.21	0,24

8. Assume a normal income tax rate of 27% and a Capital Gains Tax inclusion rate of 80%. Ignore the effects of dividend tax and Value Added Tax (VAT).
9. Assume a normal income tax rate of 30% and no Capital Gains Tax in Mozambique.

QUESTION 2**50 marks**

Mzansi Drones Ltd ('Mzansi') is listed on the Johannesburg Stock Exchange and has a 30 June year end. The company manufactures and maintains a wide range of drones that are used in different industries for a variety of purposes.

Following the emigration of Mrs Mabaso (the previous group finance manager) to Qatar, you have been appointed as the group finance manager of Mzansi. The CEO (Mr Singh) has indicated to you that the previous group finance manager never had the time to get to the following matters that he needs clarity and advice on:

1. Governance structure and committees

Mzansi's governance structure consists of the Board of Directors ('Board'), assisted by four committees, namely the Audit, Remuneration, Risk and Governance and Nominations committees. Mzansi's Board consisted of the following individuals as at 30 June 20.21:

Director	Position
Ms S Docrat	Chairperson of the Board and Chairperson of the Audit Committee.
Mr K Singh	Chief Executive Officer (CEO) and member of the Audit committee.
Mr L Khumalo	Chief Financial Officer (CFO) and chairperson of the Nominations committee.
Mr F Steenkamp	Chief Operations Officer (COO), member of the Audit and the Remuneration committee.
Mr R Maleka	Director Human Resources and member of the Nominations committee.
Mr P Mostafa	Non-executive director and member of Risk and Governance committee.
Ms K Franks	Non-executive director and chairperson of Remuneration committee.
Mr A Abrams	Non-executive director, member of the Risk and Governance committee and the chairperson of the Nominations committee.

- Ms Docrat acquired 12% of the equity interest in Mzansi on 1 April 20.19 and has been serving on the audit committee for over six years.
- The Audit committee makes the final decision on all investments in shares by Mzansi in any company.
- The board meets four times annually and the other committees meet as and when required. There are no other members of the respective committees apart from those listed above.

2. Acquisition of Liquid Techs Ltd ('Liquid Techs')

The Board of Mzansi approved an expansion strategy in the prior financial year. The CFO, Mr Khumalo, was tasked with the responsibility of identifying a potential company that can be acquired as part of the expansion strategy approved by the Board. Following a detailed due-diligence process, Liquid Techs Ltd (Liquid Techs) was identified as a potential acquisition.

Liquid Techs offers drone training services and issues drone licenses upon the successful completion of the Drone training programme. The Board of Mzansi approved the acquisition of interests in Liquid Techs on 15 February 20.21 as it viewed the acquisition as the implementation of the expansion strategy. The Board of Liquid Techs accepted the proposed acquisition.

Mzansi acquired 75% of the issued ordinary shares of Liquid Techs on 30 March 20.21 and obtained control as per the definition of control in accordance with IFRS 10 *Consolidated Financial Statements*, over Liquid Techs from this date. The purchase met the definition of acquiring a business, as defined in IFRS 3 *Business Combinations*.

The following journal (J43) was processed by the group accountant as part of compiling the consolidated financial statements at year end:

	Notes	Dr R	Cr R
J43			
Share capital (SCE)		600 000	
Retained earnings (SCE)		3 200 000	
Mark-to-market reserve (SCE)		2 750 000	
Investment in Liquid Techs (SFP)			6 500 000
Land (SFP)	2.1	500 000	
Deferred tax (SFP)	2.1		108 000
Intangible asset: Brand (SFP)	2.2	850 000	
Deferred tax (SFP)	2.2		229 500
Non-current asset held for sale (SFP)	2.3	425 000	
Deferred tax (SFP)	2.3		91 800
Non-controlling interests (SCE/SFP)	2.4		1 973 925
Goodwill (SFP)		578 225	
<u>At acquisition elimination journal</u>			

- 2.1 The property, plant and equipment of Liquid Techs consisted of four buildings, several equipment and a piece of owner-occupied land. All of these assets were considered to be fairly valued in terms of IFRS 3 at the acquisition date, except for the owner-occupied land. The land was undervalued by R500 000.
- 2.2 The brand was internally generated by Liquid Techs and consists of a group of complementary assets with a similar useful life of 10 years remaining at the acquisition date. The fair value of the brand was R850 000 at the acquisition date.
- 2.3 The non-current assets held for sale consists of a training centre that was correctly classified as a non-current asset held for sale in terms of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* in the separate accounting records of Liquid Techs. The asset is correctly carried at the carrying amount of R1 000 000 in the separate accounting records of Liquid Techs at the acquisition date as the carrying amount was lower than the fair value less cost to sell of R1 425 000 in terms of IFRS 5.15-18.
- 2.4 Mzansi elected to measure non-controlling interests at the proportionate share of the acquiree's net identifiable assets at the acquisition date of Liquid Techs.

The CEO, Mr Singh, has requested a meeting with the CFO, Mr Khumalo, to explain the journal [J43] to him in detail. This is the only journal that the CEO does not understand. However, the CFO has indicated that he has a very busy schedule and tight deadlines. He has therefore asked the group finance manager to explain the journal in detail to the CEO.

3. Khan Solutions Ltd ('Khan')

Due to the current adverse market conditions, the Board of Mzansi decided to retrench the five staff members in the IT department and to outsource the IT services as this was the best economical option to reduce the staff costs. On 1 January 20.21, Mzansi entered into a joint arrangement with Nordine Holdings Ltd (Nordine), a tire manufacturing company that was facing similar challenges to Mzansi and also decided to retrench their IT staff. As a result, a separate company, Khan Solutions Ltd (Khan), was incorporated in accordance with the South African companies Act, 2008, with each party owning 50% of the shares and voting rights. The purpose of the arrangement is to provide IT services to both Mzansi and Nordine through the separate entity (Khan).

This arrangement meets the definition of a joint arrangement in terms of IFRS 11.4. The features of the agreement are as follows:

- Khan operates its own bank account and has rights to all its assets and is liable for all its liabilities;
- Either party to the arrangement can decide on the appointment of the management, as long as the appointment is in the best interest of the company;
- Khan maintains its own accounting records, separate to that of the parties to the joint arrangement;
- Khan can only provide IT services to outside clients with the approval of the parties to the joint arrangement;
- The parties have agreed to provide funds to honour the commitments made by Khan to financial institutions regarding its asset financing requirements; and
- All the financed assets are registered in Khan's name and the resulting obligations are incurred in Khan's name.

The CFO is of the view that the arrangement should be classified as a joint operation in the financial statements of Mzansi.

4. Magic Manufacturers Ltd

During the financial year ended 30 June 20.20, the Board of Mzansi approved a decision to expand their business by acquiring shares in Magic Manufacturers Ltd (Magic). Mzansi acquired 70% of the ordinary shares in Magic on 1 October 20.19 for a cash consideration of R14 500 000 and obtained control over Magic as per the definition of control in accordance with IFRS 10 *Consolidated Financial Statements*. Magic specialises in the manufacture of dsPIC30F microchips that are installed in a wide range of drones, including the types manufactured by Mzansi.

All the assets and liabilities of Magic were considered to be fairly valued at the date of acquisition, with the exception of land. The land had a carrying amount of R1 475 000 and was undervalued by R278 350. No additional assets, liabilities or contingent liabilities were identified at the date of acquisition.

The equity of Magic consisted of the following at the various dates:

	1 Oct 20.19 R	30 June 20.20 R	30 April 20.21 R	30 June 20.21 R
Share capital	3 250 000	3 250 000	3 250 000	4 750 000
Retained earnings	12 725 000	14 610 500	17 850 000	19 370 000
Mark-to-market reserve	105 000	122 000	122 000	166 500
	<u>16 080 000</u>	<u>17 982 500</u>	<u>21 222 000</u>	<u>24 286 500</u>

The following transactions occurred during the year ended 30 June 20.21:

On 30 April 20.21, Mzansi sold 30 000 ordinary shares in Magic for a cash consideration of R960 000. Mzansi still retained control over Magic as per the definition of control in accordance with IFRS 10 *Consolidated Financial Statements* after the transaction.

Magic sold inventory to Mzansi during the financial year ended 30 June 20.21. On 30 June 20.21, Mzansi had inventory purchased from Magic amounting to R145 500 still on hand. The inventory on hand relate to purchases for the period 1 May 20.21 to 30 June 20.21. Total sales from Magic to Mzansi for the financial year ended 30 June 20.21 amounted to R955 000. Magic sells inventory at a mark-up of 25% on cost.

Additional information

1. It is the accounting policy of Mzansi to account for investments in subsidiaries at cost in accordance with IAS 27.10(a) in its separate financial statements.
2. Mzansi elected to measure the non-controlling interests at the proportionate share of the acquiree's net assets at acquisition date for all acquisitions.
3. The Mzansi Group recognises any difference between the amount by which the non-controlling interests are adjusted, and the fair value of the consideration paid or received (attributable to the owners of the parent in an equity transaction) directly in a change in ownership reserve in equity.
4. No dividends were declared or paid by any of the companies in the group.
5. All the companies in the group have a 30 June year end.
6. The profit after tax for all the companies in the group accrued evenly throughout the year, unless otherwise indicated.
7. Assume a South African income tax rate of 27% and a Capital Gains Tax inclusion rate of 80%. Ignore the effects of dividend tax and Value Added Tax (VAT).

CASE STUDY 3**REQUIRED**

YOU NOW HAVE 150 MINUTES TO COMPLETE THE CASE STUDY.

QUESTION 1**REQUIRED**

	Marks
(a) Prepare the consolidated statement of profit or loss and other comprehensive income of the Cooldrink Ltd Group for the year ended 31 August 20.21. Your answer should start with “ PROFIT FOR THE YEAR ”.	40
Communication skills: presentation and layout	1
(b) Complete the investment in PinkDrink PLC note to the annual financial statements of the Cooldrink Ltd Group for the year ended 31 August 20.21 to meet the disclosure requirements of IFRS 3.59. You do not need to repeat the information already correctly included in the note by the accountant.	9
Please note:	
<ul style="list-style-type: none"> • Round off all amounts to the nearest rand or Mozambique New Metical. • Present your calculations per company for the consolidated statement of profit or loss and other comprehensive income. • Comparative figures and notes to the consolidated statement of profit or loss and other comprehensive income are not required. • Your answer must comply with International Financial Reporting Standards (IFRS). 	

QUESTION 2**REQUIRED**

	Marks
(a) Advise the CEO on any corporate governance concerns, in terms of the King IV Report, that you may have with regards to the information provided about Mzansi Drones Ltd in the Governance structure and committee's section.	10
(b) Draft a memo to the CEO with regards to the following:	
(i) Provide an explanation as to why journal J43 was required as part of compiling the consolidated financial statements of the Mzansi Drones Ltd Group for the year ended 30 June 20.21, in terms of IFRS 3 <i>Business Combinations</i> and IFRS 10 <i>Consolidated Financial Statements</i> .	10
(ii) Explain whether you agree with the view of the CFO on the classification of the joint arrangement between Mzansi Drones Ltd and Nordine Holdings Ltd in the consolidated financial statements of the Mzansi Drones Ltd Group for the year ended 30 June 20.21.	8
Communication skills: logical flow and argument	1
(c) Prepare the pro forma consolidation journal entries of the Mzansi Drones Ltd Group for the year ended 30 June 20.21. The at acquisition elimination journal is not required.	20
Communication skills: presentation and layout	1
Please note:	
• Journal narrations are required.	
• Journal entries relating to deferred taxation are required.	
• Round off all amounts to the nearest rand.	
• Round off all per centages to the nearest whole percentage.	
• Clearly show and reference all your calculations.	
• Your answer must comply with International Financial Reporting Standards (IFRS).	

CASE STUDY 3**QUESTION 1 – Suggested solution****(a) COOLDRINK LTD GROUP****EXTRACT FROM THE CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 AUGUST 20.21**

	R	
PROFIT FOR THE YEAR [C1]	5 099 985	(35)
Other comprehensive income:		
Items that will not be reclassified to profit or loss:		
Gain on property revaluation [(1 225 000 – 1 145 000) x 78,4%]	62 720	(1)
Share of other comprehensive income of associates (58 200 x 25%)	14 550	(1)
	<u>77 270</u>	
Items that may be reclassified subsequently to profit or loss		
Exchange differences on translating foreign operations (379 112 [C12] + 201 818 [C1])	<u>580 930</u>	(3)
Other comprehensive income for the year, net of tax	<u>658 200</u>	
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>5 758 185</u>	
Profit attributable to:		
Owners of the parent (balancing)	4 769 707	(½)
Non-controlling interests [C10]	<u>330 278</u>	(2)
	<u>5 099 985</u>	
Total comprehensive income attributable to:		
Owners of the parent (balancing)	5 263 718	(½)
Non-controlling interests [C11]	<u>494 467</u>	(2)
	<u>5 758 185</u>	
	Total	<u>(45)</u>
	Maximum	<u>(40)</u>
	Communication skills: presentation and layout	<u>(1)</u>

(b) COOLDRINK LTD GROUP**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 AUGUST 20.21****10. Investment in PinkDrink PLC**

Name and description of subsidiary (IFRS 3.B64(a)):	PinkDrink PLC Mozambican beverage producer
Acquisition date (IFRS 3.B64(b)):	1 July 20.21
Percentage of voting equity interests acquired (IFRS 3.B64(c)):	60%

The acquisition was made to gain access to the subsidiary's brand name. Control was obtained over the subsidiary through acquisition of the majority of the voting rights (IFRS 3.B64(d)).

The information above is included for completeness purposes only.

The fair value of the consideration paid was R1 008 000 (IFRS 3.B64(f)) and consisted of the following:

	R	
- Cash (620 000 – 120 000) (IFRS 3.B64(f)(i))	500 000	(1)
- Contingent consideration (IFRS 3.B64(f)(iii))	60 000	(½)
- Equity interests of Cooldrink Ltd (IFRS 3.B64(f)(iv)) (3 200 shares issued at fair value of R140 per share)	448 000	(1)
	<u>1 008 000</u>	

The contingent consideration is as a result of Cooldrink Ltd being liable to pay an additional amount of R150 000 if the market price of Cooldrink Ltd's shares declines below R120 per share during the first two years after acquisition (IFRS 3.B64(g)(ii); (iii)). (1)

The major classes of assets acquired and liabilities assumed as at 1 July 20.21 were as follows (IFRS 3.B64(i)):

Non-current assets [1 144 600 + 172 000 (860 000 x 0,20)]	1 316 600	(½)
Current assets	1 083 000	(½)
Non-current liabilities (860 000 x 30% x 0,20)	(51 600)	(½)
Current liabilities	(446 100)	(½)
	<u>1 901 900</u>	

Acquisition cost of R120 000 was incurred and this amount is included in administrative expenses (IFRS 3.B64(m)). (1)

The acquisition resulted in the recognition of a gain on bargain purchase of R133 140 and this amount is included in other income (IFRS 3.B64(n)(i)). The gain is due to the additional investment required from Cooldrink Ltd for production plant maintenance by the subsidiary (IFRS 3.B64(n)(ii)). (2)

Non-controlling interests amounted to R760 760 on the acquisition date and is measured at the proportionate share of the acquiree's identifiable net assets (IFRS 3.B64(o)(i)). (1)

Profit after tax since acquisition for the subsidiary of R187 868 [C1] is included in the group's profit after tax. The subsidiary's total profit after tax for the 20.21 financial year amounted R215 368 (187 868 + 27 500 [C12]) (IFRS 3.B64(q)(i) and(ii)). (2)

Total	<u>(12)</u>
Maximum	<u>(9)</u>

CALCULATIONS**C1. Profit after tax****Cooldrink**

Profit after tax	4 578 500	[1]
Gross profit	6 145 000	
Other income	1 708 750	
Operating expenses	(2 736 500)	
Income tax expense	(538 750)	

Intragroup dividends eliminations:

From PinkDrink (400 000 x 0,24 x 60%)	(57 600)	[1]
From Bottles (130 000 x 80%)	(104 000)	[1]
From Slimwater (100 000 x 25%)	(25 000)	[1]

Acquisition and subsequent measurement of PinkDrink

Acquisition related cost	(120 000)	[1]
Fair value adjustment on contingent consideration (85 000 – 60 000)	(25 000)	[1]
Interest received from foreign loan (1 000 000 x 12% x 2/12)	(20 000)	[1]

Slimwater

Share of profit of associate [C2]	157 515	[4]
Reverse profit on sale of interest in separate financial statements [C3]	(720 000)	[1]
Reverse fair value adjustment at acquisition of IFRS 9 investment [C4]	(70 000)	[1]
Consolidated profit on sale of interest [C5]	104 705	[4]

Bottles

Profit after tax	1 369 395	[1]
Gross profit	2 868 100	
Other income	212 000	
Operating expenses	(1 236 500)	
Taxation expense	(474 205)	
Reclassification of fair value adjustment on land [(1 225 000 – 1 145 000) x 78,4%]	(62 720)	[2]
Elimination of unrealised profit on intragroup transaction [C7]	(23 725)	[2]
Realisation of unrealised profit (23 725 x 6/30)	4 745	[1]
	<u>1 287 695</u>	

**COMMENT**

The unrealised profit is the additional depreciation that was calculated on the profit on sale of the computer equipment. The profit was not realised through use because the profit is reversed.

PinkDrink

Profit after tax	187 868	
Gross profit [C12]	122 833	[1]
Operating expenses [C12]	(100 283)	[1]
Interest expense [C12]	(20 000)	[1]
Forex gain [C12]	201 818	[1]
Taxation expense [C12]	(16 500)	[1]
Amortisation expense as a result of fair value adjustment at acquisition		

	FAC4864/106	
	NFA4864/106	
	ZFA4864/106	
(860 000 x 70% x 2/48 x 0,24)	<u>(6 020)</u>	[1]
	181 848	
Reclassification of forex gain to other comprehensive income (840 909 [C8] x 0,24)	(201 818)	[1]
Gain on bargain purchase [C9]	<u>133 140</u>	[5]
	<u>5 099 985</u>	<u>[35]</u>

**COMMENT**

Most of the students forget that the fair value of the contingent consideration must always be remeasured at year end and the movement be recorded in Profit or loss.

C2. Share of profit of associate - Slimwater

Profit after tax	632 980	[1]
Gross profit	2 251 000	
Operating expenses	(1 410 000)	
Taxation expense	(208 020)	
Share of profit of associate (632 980 x 25%)	158 245	[1]
Elimination of unrealised profit in opening inventory of Cooldrink (77 000 x 40/140 x 73% x 25%)	4 015	[1]
Elimination of unrealised profit in closing inventory of Cooldrink (91 000 x 40/140 x 73% x 25%)	<u>(4 745)</u>	[1]
	<u>157 515</u>	<u>[4]</u>

C3. Profit on sale of interest in separate financial statements – Slimwater

Proceeds on disposal of interest	1 600 000
Cost of interest disposed of (1 100 000 x 20/25)	<u>(880 000)</u>
	<u>720 000</u>

C4. Fair value adjustment at acquisition of IFRS 9 investment - Slimwater

Fair value of remaining interest	290 000
Cost of 5% remaining investment (1 100 000 x 5/25)	<u>(220 000)</u>
	70 000

C5. Consolidated profit on sale of interest - Slimwater

Proceeds on disposal of interest	1 600 000	[1]
Derecognise carrying amount of investment in associate on date of disposal of associate (6 341 180 [C6] x 25%)	(1 585 295)	[1]
Derecognise goodwill [1 100 000 - (3 600 000 x 25%)]	(200 000)	[1]
Recognise fair value of remaining interest	290 000	[1]
	<u>104 705</u>	<u>[4]</u>

C6. Consolidated net asset value - Slimwater

Plant and equipment	4 445 800
Other equity investments	395 000
Inventory	422 000
Trade and other receivables	1 987 000
Cash and cash equivalents	962 000
Deferred tax	(85 620)
Trade and other payables	<u>(1 785 000)</u>
	6 341 180
OR	
Share capital	2 500 000
Retained earnings	3 250 000
Mark-to-market reserve	58 200
Profit after tax [C2]	632 980
Dividends paid	<u>(100 000)</u>
	<u>6 341 180</u>

C7. Elimination of unrealised profit on intragroup transaction – Bottles

Computer equipment carrying value 1 March 20.21 [165 000 x (36 - 6)/36]	137 500	
Selling price to Cooldrink	<u>(170 000)</u>	
Unrealised profit on sale for Bottles	(32 500)	[1]
Deferred tax	8 775	[1]
	<u>(23 725)</u>	<u>[2]</u>

C8. Profit for the year allocation – PinkDrink

	Total MZN	10 Months MZN	2 Months MZN
Gross profit	(3 350 000)	(2 791 667)	(558 333)
Adjusted operating expenses	2 735 000	2 279 167	455 833
Operating expenses	1 985 000		
Add back: Interest expense (1 000 000 x 12% x 2/12/0,22)	(90 909)		
Add back: Forex gain - Restatement of foreign loan to spot rate at year end [4 250 000 – (1 000 000/0,20 + 90 909)]	840 909		
Interest expense	90 909	-	90 909
Forex gain	(840 909)	-	(840 909)
Income tax expense	450 000	375 000	75 000
	<u>(915 000)</u>	<u>(137 500)</u>	<u>(777 500)</u>

C9. Gain on bargain purchase – PinkDrink

Consideration transferred	1 008 000	
Cash consideration	620 000	[½]
Acquisition related cost	(120 000)	[½]
Transfer of shares (3 200 x 140)	448 000	[½]
Contingent consideration	60 000	[½]
Add: Non-controlling interests (1 901 900 x 40%)	760 760	[1]
Less: Net identifiable assets acquired	(1 901 900)	
Net asset value (given)	(1 781 500)	[1]
Intangible asset fair value adjustment (860 000 x 70% x 0,20)	(120 400)	[1]
	<u>(133 140)</u>	<u>—</u>
		<u>[5]</u>
OR Net identifiable assets acquired		
Share capital (100 000 x 0,20)	(20 000)	
Retained earnings opening balance (8 670 000 x 0,20)	(1 734 000)	
Profit for 10 months until acquisition (137 500 [C8] x 0,20)	(27 500)	
Intangible asset fair value adjustment (860 000 x 70% x 0,20)	(120 400)	
	<u>(1 901 900)</u>	

C10. Profit attributable to: Non-controlling interests

PinkDrink (181 848 [C1] x 40%)	72 739	[1]
Bottles (1 287 695 [C1] x 20%)	257 539	[1]
	<u>330 278</u>	<u>—</u>
		<u>[2]</u>

C11. Total comprehensive income attributable to: Non-controlling interests

PinkDrink [(379 112 [C12] x 40%) OR [C15] + 72 739 [C10]]	224 384	[1]
Bottles [(62 720 [C1] x 20%) + 257 539 [C10]]	270 083	[1]
	<u>494 467</u>	<u>—</u>
		<u>[2]</u>

C12. Conversion trial balance – PinkDrink

	MZN	Rate	Rand
Share capital	(100 000)	0,20	(20 000)
Retained earnings	(8 670 000)	0,20	(1 734 000)
Profit of the period before acquisition [C8]	(137 500)	0,20	(27 500)
Gross profit [C8]	(558 333)	0,22	(122 833)
Trade and other payables	(2 985 000)	0,24	(716 400)
Loan from Cooldrink Ltd	(4 250 000)	0,24	(1 020 000)
Property, plant and equipment	5 700 000	0,24	1 368 000
Inventory	2 400 000	0,24	576 000
Trade and other receivables	1 580 000	0,24	379 200
Cash and cash equivalents	6 840 000	0,24	1 641 600
Operating expenses [C8]	455 833	0,22	100 283
Interest expense [C8]	90 909	0,22	20 000
Forex gain [C8]	(840 909)	0,24	(201 818)
Income tax expense [C8]	75 000	0,22	16 500
Dividend declared and paid	400 000	0,24	96 000
FCTR (balancing)			(355 032)
	-		-

Intangible asset (net of tax)

At acquisition date	602 000	0,20	120 400
Amortisation	(25 083)	0,24	(6 020)
Exchange differences (balancing)			24 080
Year end	576 917	0,24	138 460

Total FCTR as at 31 August 20.21

From conversion trial balance			355 032	[1]
Intangible asset (net of tax)			24 080	[1]
			379 112	[2]

**COMMENT**

Management Fees – Most students showed the workings for management fees, but no mark was allowed because the net effect of the workings is nil on the disclosure .

C13. Analysis of owners' equity in Bottles (for completeness only)

	Total	Cooldrink (80%)		NCI
		At	Since	
At acquisition				
Share capital	100 000			
Retained earnings	2 500 000			
	2 600 000	2 080 000		520 000
Goodwill	120 000	120 000		-
Consideration and NCI	2 720 000	2 200 000		520 000
Since acquisition until beginning of current year				
Retained earnings (4 718 500 – 2 500 000)	2 218 500		1 774 800	443 700
Current year				
Profit for the year [C1]	1 369 395		1 095 516	273 879
Reclassification of investment Property	(62 720)		(50 176)	(12 544)
Intragroup transaction (23 725 – 4 745)	(18 980)		(15 184)	(3 796)
	1 287 695		1 030 156	257 539
Other comprehensive income for the year – revaluation of land	62 720		50 176	12 544
Dividend	(130 000)		(104 000)	(26 000)
	6 158 915	2 200 000	2 751 132	1 207 783

C14. Analysis of owners' equity in Slimwater (for completeness only)

	Total	Cooldrink (25%)	
		At	Since
At acquisition			
Share capital	2 500 000		
Retained earnings	1 100 000		
	3 600 000	900 000	
Goodwill	120 000	200 000	
Consideration	2 720 000	1 100 000	
Since acquisition until beginning of current year			
Retained earnings (3 250 000 – 1 100 000)	2 150 000		537 500
Current year			
Profit for the year [C2]	632 980		158 245
Intra transactions (-R4 745 + R4 015)	(R730)		(R183)
Other comprehensive income for the year	58 200		14 550
Dividend	(100 000)		(25 000)
	6 340 450	1 100 000	685 112

C15. Analysis of owners' equity in PinkDrink (for completeness only)

	Total MNZ	Rate	Total R	Cooldrink (60%)		NCI R
				At R	Since R	
At acquisition						
Share capital	100 000	0,20	20 000	12 000		8 000
Retained earnings	8 670 000	0,20	1 734 000	1 040 400		693 600
Profit for the period	137 500	0,20	27 500	16 500		11 000
Intangible asset	860 000	0,20	172 000	103 200		68 800
Deferred taxation	(258 000)	0,20	(51 600)	(30 960)		(20 640)
	9 509 500	0,20	1 901 900	1 141 140		760 760
Gain on bargain purchase				(133 140)		-
Consideration and NCI				1 008 000		760 760
Current year						
Loss for the period (excluding forex gain)	(63 409)	0,22	(13 950)		(8 370)	(5 580)
Forex gain [C8]	840 909	0,24	201 818		121 091	80 727
Amortisation	(25 083)	0,24	(6 020)		(3 612)	(2 408)
	752 417		181 848		109 109	72 739
Dividend FCTR	(400 000)	0,24	(96 000)		(57 600)	(38 400)
			379 112		227 467	151 645
	9 861 917	0,24	2 366 860	1 008 000	278 976	946 744

**EXAM TECHNIQUE**

It is very important to always remember that the workings will be marked only if they have been transferred to the disclosure. Once workings are completed, transfer them to the disclosure required.

QUESTION 2 – Suggested solution

- (a) **Advise the CEO on any corporate governance concerns, in terms of the King IV Report, that you may have with regards to the information provided about Mzansi Drones Ltd in the Governance structure and committees section.**

1. Board Composition

- 1.1 The Board should consist of a majority of non-executive directors of whom the majority should be independent:

Even though the majority of the non-executive directors appear to be independent, the Board does not consist of a majority of non-executive directors, as there are five executive and three non-executive directors. (1)

- 1.2 The chairperson of the board should be an independent non-executive director.

The chairperson of the board is not independent because she holds a 12% equity interest in Mzansi. (1)

- 1.3 The Board should promote diversity in its membership across a variety of attributes relevant for promoting better decision making and effective governance, including knowledge, skills, experience, age, race and gender.

There is no gender diversity as six of the eight members of the Board are males, it brings into doubt whether the Board seeks to have a variety of attributes and diversity. (1)

- 1.4 When determining the number of members of the Board, the need for a sufficient number of members that qualify to serve on board committees should be considered.

The company has five board committees, each requiring a sufficient number of non-executive directors to serve as members, and only three non-executive directors at present, it is questionable whether the size of the Board is sufficient. (1)

All the board members are also serving in one or two board committees, it is questionable whether they will have sufficient time to carry out their responsibilities as board members. (1)

2. Audit Committee

- 2.1 All members of an audit committee should be independent non-executive directors.

None of the members of the audit committee are independent non-executive directors. (1)

The chairperson of the audit committee is not independent because she holds 12% equity interest in Mzansi and other members are involved in the day-to-day running of the company. (1)

- 2.2 The chairperson of the Board should not be the chairperson or a member of the Audit committee.

Ms Docrat is the chairperson of the Board and chairperson of the Audit Committee, which is a concern. (1)

The audit committee cannot make decisions on the investment in shares in any company.

This is the responsibility of the Board (with the approval of shareholders). (1)

3. Remuneration and Risk and Governance Committee

3.1 The remuneration committee should comprise of at least three members.

The remuneration committee comprise of only two members. (1)

3.2 All the members of the remuneration committee should be non-executive directors, with the majority being independent non-executive directors.

Only one member of the remuneration committee is a non-executive director. (1)

3.3 The risk and governance committee should comprise of at least three members.

The risk and governance committee comprise of only two members. (1)

3.4 All the members of the Nomination committee should be non-executive directors, with the majority being independent non-executive directors.

Only one member of the nomination committee is a non-executive director. (1)

Total	<u>(13)</u>
Maximum	<u>(10)</u>

(b)(i) Draft a memo to the CEO explaining the journal [J43] in detail and why the journal was required as part of compiling the consolidated financial statements of Mzansi Drones Ltd in terms of IFRS 3 *Business Combinations* and IFRS 10 *Consolidated Financial Statements* as he requested.

Memo

To: Chief Executive Officer
From: Group Finance Manager
Date: 18 October 20.21

Below please find the explanations of the journal [J43] as requested. Should you have any questions, please let me know.

Mzansi obtained control over Liquid Techs on 30 March 20.21 and is therefore a parent of Liquid Techs in terms of IFRS 10 *Consolidated Financial Statements*. (1)

As Mzansi is the parent of Liquid Techs, it is required to prepare consolidated financial statements (IFRS 10.4). (1)

The first step in preparing consolidated financial statements is to combine the financial statements of the parent and the subsidiaries (i.e. 100% of the net of the subsidiary is added to the net of the parent) (IFRS 10.B86(a)). (1)

The second step is to offset (eliminate) the carrying amount of the parent's investment in Liquid Techs of R6 500 000 through the processing of journal 43 (IFRS 10.B86(b)). (1)

In addition, Liquid Techs share capital, retained earnings and mark-to-market reserve balances on the date of acquisition is also offset against the consideration paid for the investment in Liquid Techs in journal 43 with IFRS 3 explaining how to account for any related goodwill (IFRS 10.B86(b)). (1)

IFRS 3 requires Mzansi to recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in Liquid Techs (IFRS 3.10). (1)

The increase in land entry was processed to measure the land that was undervalued at its fair value (IFRS 3.18). (1)

The internally generated brand was recognised by Mzansi because it was identifiable (contractual-legal criterion) at the acquisition date (IFRS 3.IE20-21). (1)

The non-current asset held for sale should be recognised as its fair value less cost to sell of R1 425 000 at the acquisition date, which results in an increase of R425 000 to recognise at acquisition date. (1)

A deferred tax liability was recognised on the fair value adjustments on the land, intangible asset and the non-current asset held for sale as the carrying amounts of the assets increased but the respective tax bases remained unchanged. (1)

The deferred tax on the land and the non-current asset held for sale was calculated at the capital gains tax inclusion rate as the carrying amounts of the assets will be recovered through sale. (1)

The deferred tax on the intangible asset was calculated at 27% as the value will be recovered through use. (1)

The non-controlling interest in the Liquid Techs was measured in terms of their 25% proportionate interest in Liquid Techs' net identifiable assets at R1 973 925 (IFRS 3.10). (1)

Mzansi shall recognise goodwill of R578 225 calculated as of the acquisition date measured as the excess of its consideration paid of R6 500 000 and the non-controlling interests of R1 973 925 over the net acquisition date assets and liabilities of R7 895 700. (1)

Total (14)

Maximum (10)

Communication skills: Logical flow and format (1)

(b)(ii) Draft an email to the CEO where you explain whether you agree with the view of the CFO on the classification of the joint arrangement between Mzansi Drones Ltd and Nordine Holdings Ltd in the consolidated financial statements of the Mzansi Drones Ltd Group for the year ended 30 June 20.21.

Email

From: Group Finance Manager
To: CEO
Subject: Classification of the joint arrangement between Mzansi and Nordine.

The classification of the joint arrangement depends on Mzansi and Nordine's rights to the assets, and obligations for the liabilities, held in the separate entity (Khan). (IFRS 11.B20). (1)

Structure:

The structure of the joint arrangement is through a separate entity, Khan, formed in accordance with the South African Companies Act, 2008. (1)

Legal form:

The legal form causes Khan (the separate vehicle) to be considered in its own right (i.e. the assets and liabilities held in Khan are the assets and liabilities of Khan and not the assets and liabilities of Mzansi and Nordine. (1)

The terms of the agreement:

Khan operates its own bank account and keeps its own accounting records, separate to that of the parties and the terms of the agreement stipulates that Khan has rights to its assets and obligations for its liabilities. (1)

Other facts and circumstances:

The commitment by the parties to provide funding if Khan is not able to meet commitments made to financial institutions is not by itself a determinant that the parties have an obligation for the liabilities Khan. (1)

The fact that assets which are financed are registered and all the liabilities incurred are in Khan's name indicates that Mzansi and Nordine have no rights to the assets and no obligations to the liabilities of Khan. (1)

The contractual agreement should therefore be classified as a joint venture in the consolidated financial statements of the Mzansi Group. (1)

I therefore do not agree with the view of the CFO to classify the joint arrangement as a joint operation. (1)

(1)
(8)

(c) Prepare the pro forma journals of the Mzansi Ltd Group for the year ended 30 June 20.21.

Please note that the at acquisition elimination journal is not required.

	Dr R	Cr Rr	
J1	Retained earnings (SCE) ((14 610 500 – 12 725 000) x 30%)	565 650	(2)
	Mark-to-market reserve (SCE) ((122 000 – 105 000) x 30%)	5 100	(1)
	Non-controlling interests (SFP/SCE)		(1)
	Allocation of non-controlling interest of retained earnings	570 750	
J2	Non-Controlling interests (P/L) ((17 850 000 – 14 610 500) x 30%)	971 850	(1)
	Non-Controlling interests (SFP/SCE)		(1)
	Recognition of non-controlling interests' portion in current year's profit before the ownership transaction	971 850	
J3	Share capital (SCE)	1 500 000	(1)
	Non-controlling interests (SFP/ SCE) (balancing)		(1)
	Change in ownership reserve (SCE) [C1]	326 413	(4)
	Elimination of ownership transaction		
J4	Revenue (Magic) (P/L) (given)	955 000	(1)
	Cost of sales (Mzansi) (P/L)		(1)
	Elimination of intragroup sales	955 000	
J5	Cost of sales (Magic) (P/L) (145 500 x 25/125)	29 100	(1)
	Inventory (Mzansi) (SFP)		(1)
	Elimination of unrealised profit on inventory	29 100	
J6	Deferred tax (SFP) (29 100 x 27%)	7 857	
	Income tax expense (Magic) (P/L)		(1)
	Elimination of tax on unrealised profit	7 857	

	Dr R	Cr Rr	
J7 Non-controlling interests (P/L)			
((19 370 000 – 17 850 000 – 29 100[J5] + 7 857[J6]) x 36%)	539 553		(2)
Non-controlling interests (OCI) ((166 500 – 122 000) x 36%)	16 020		(2)
Non-controlling interests ((SFP/SCE)		555 573	(1)
Recognition of non-controlling interests' portion in current year's profit after ownership transaction			
		Total	<u>(22)</u>
		Maximum	<u>(20)</u>
		Communication skills: presentation and layout	<u>(1)</u>

CALCULATIONS

C1. Change in ownership (equity) (IFRS 10. B96)

Shareholding before transaction ((500 000 x 70%)/500 000) (given)	70%	
Shareholding after transaction ((500 000 x 70%) / 500 000 + (500 000/10))	64%	[2]
Fair value of consideration paid by NCI (given)	(960 000)	
Change in NCI	1 286 413	
NCI after transaction ((24 531 468 – 3 091 242 [C2]) x 36%)	7 718 481	[5]
NCI before transaction ((24 531 468 – 3 091 242 [C2]) x 30%)	(6 432 068)	[1]
Change of ownership	326 413	<u>[6]</u>

Or (from the perspective of the parent including goodwill)

Owner's equity after transaction	16 812 987	[5]
((24 531 468 – 3 091 242 [C2]) x 64%) + 3 091 242)		
Owner's equity before transaction	(18 099 400)	[1]
((24 531 468 - 3 091 242 [C2]) x 70%) + 3 091 242)		
Change of net assets	1 286 413	<u>[6]</u>

OR

Net asset value (given)	21 222 000	[1]
IFRS 3 adjustment (278 350 x 78,4%) [C2]	218 226	[1]
Net assets on disposal date	21 440 226	
Interest in current net assets (21 440 226 x (36% - 30%))	1 286 413	[2]
Amount with which NCI changes	1 286 413	<u>[4]</u>



COMMENT

Any share buy-backs and rights issues transaction are excluded from SAICA's examinable pronouncements. It is also important to note that the acquisition of an additional interest in an associate that leads to the retention of significant influence and the disposal of an interest in an associate, but with significant influence both before and after, is excluded.

Despite certain change in control transactions being at an awareness level or excluded from SAICA's examinable pronouncements, a chartered accountant will observe many different types of transactions in practice. As a result, the examples below include such transactions with the proficiency level required for CTA for each example indicated.

C2. Analysis of owners' equity of Magic

	Total	Mzansi Drones Ltd 70% - 64%		NCI 30% - 36%
		At	Since	
Share capital	3 250 000			
Retained earnings	12 725 000			
Mark-to-market reserve	105 000			
Land	278 350			
Deferred tax (278 350 x 80% x 27%)	(60 124)			
	16 298 226	11 408 758		4 889 468
Goodwill	3 091 242	3 091 242		-
Consideration and NCI	19 389 468	14 500 000		4 889 468
Since Acquisition up to the beginning of the year				
Retained earnings (14 610 500 – 12 725 000)	1 885 500		1 319 850	565 650
Mark-to-market reserve (122 000 – 105 000)	17 000		11 900	5 100
Current year before transaction 01/07/20.20 to 30/04/20.21				
Profit for the year (17 850 000 – 14 610 500)	3 239 500		2 267 650	971 850
Change in ownership	24 531 468		3 599 400	6 432 068
Share capital	1 500 000			1 500 000
Change in equity		(326 413)		326 413
	26 031 468	14 173 587	3 599 400	8 258 481
Current year after transaction 01/05/20.21 to 30/06/20.21				
Profit for the year (19 370 000 – 17 850 000)	1 520 000		972 800	547 200
Unrealised profit ((145 500 x 25/125) x 73%)	(21 243)		(13 596)	(7 647)
Mark-to-market reserve (166 500 – 122 000)	44 500		28 480	16 020
	27 574 725		4 587 084	8 814 054

CASE STUDY 4**100 marks**

YOU HAVE 30 MINUTES' READING TIME. SPEND 30 MINUTES READING THE CASE STUDY BEFORE YOU CONTINUE TO THE REQUIRED SECTION.

QUESTION 1**50 marks**

You are the Chief Financial Officer of the TukIn Heating Ltd ("TukIn") Group and you are responsible for the presentation of the consolidated financial statements of the TukIn Group. The TukIn Group of companies is based in South Africa and specialises in the wholesale and retail of heating equipment and appliances. TukIn has various investments in other companies. These investments include subsidiaries, which are not wholly owned as well as associates (significant influence).

All the companies in the group have a 30 June year end and have adopted International Financial Reporting Standards (IFRS) as their financial reporting framework.

The accounting clerk has already prepared the draft consolidated financial statements for the year ended 30 June 20.21.

During the review of the draft consolidated financial statements, the financial manager noted a few areas of concern. He has requested you to review the attached information to ensure that the principles of IAS 7 *Statement of Cash Flows* have been applied correctly. He is comfortable that other aspects not indicated in the attachments have been adjusted and accounted for correctly.

The attachments are as follows:

Attachment 1: Extract from the draft consolidated statement of cash flows of the TukIn Group for the year ended 30 June 20.21.

Attachment 2: Total non-current assets of the draft consolidated statement of financial position as at 30 June 20.21.

Attachment 3: The additional information supplied by the financial manager detailing decisions taken during the board meetings in the current year regarding significant matters.

Attachment 1**TUKIN HEATING LTD GROUP****EXTRACT FROM THE DRAFT CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 20.21**

	R
Cash flows from operating activities	
Cash receipts from customers	50 899 440
Cash paid to suppliers and employees ¹	(36 889 644)
Cash generated from operations	14 009 796
Dividends received	3 762 000
Interest received	1 221 000
Interest paid	(1 155 000)
Dividends paid	(5 500 000)
Income taxes paid	(6 089 028)
<i>Net cash inflow from operating activities</i>	6 248 768
Cash flows from investing activities (extract only)	
Proceeds from sale of property, plant and equipment (correct)	24 453 000
Cash flows from financing activities (extract only)	
Proceeds from partial disposal of subsidiary (21 587 000 – 169 176)	21 417 824
Proceeds from disposal of associate to simple investment	5 100 000
Repayment of long-term borrowings	(2 989 074)
Settlement of share-based payment liability relating to senior management incentive scheme	(5 000 000)

¹ Depreciation of R9 923 100 included in profit before tax has been correctly added back. This was the only non-cash adjustment against other expenses.

Attachment 2**TUKIN HEATING LTD GROUP****EXTRACT FROM THE DRAFT CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.21**

	20.21 R	20.20 R
ASSETS (EXTRACT ONLY)		
Non-current assets		
Property, plant and equipment	54 962 094	39 452 490
Financial assets	9 695 400	5 002 800
Goodwill	2 042 560	2 042 560
Investment in associate	-	6 723 750
	66 700 054	53 221 600

Attachment 3**Investment in HeatAuto Ltd (“HeatAuto”)**

On 30 November 20.19, TukIn acquired a 75% controlling interest in HeatAuto for a cash consideration of R20 000 000. All the assets and liabilities of HeatAuto were deemed to be fairly valued on 30 November 20.19. No additional assets, liabilities or contingent liabilities were identified on the acquisition date. On 30 November 20.19, the net assets of HeatAuto amounted to R24 793 920.

On 1 October 20.20, TukIn disposed of a portion of its investment in HeatAuto for a cash consideration of R21 587 000, resulting in a remaining interest of 30%. TukIn no longer exercised control over HeatAuto but retained the ability to exercise significant influence over the financial and operating policy decisions from that date.

The remaining interest in HeatAuto had a fair value of R10 080 000 on 1 October 20.20 and remained unchanged at year end (30 June 20.21).

The accounting clerk treated the disposal as a transaction between owners and continued to consolidate HeatAuto in the consolidated financial statements of the TukIn Group for the year ended 30 June 20.21. The accounting clerk accounted for the change in ownership reserve amounting to R7 733 273 as a result of this disposal transaction.

The profit on disposal of HeatAuto in the separate accounting records of TukIn is correctly recorded at R9 587 000, while the consolidated gain on disposal calculated by the financial manager correctly amounted to R7 172 895.

On 30 June 20.21, TukIn received a dividend of R2 310 000 from HeatAuto. HeatAuto did not declare or pay any other dividends during the year.

The trial balance for HeatAuto as at the relevant dates are as follows:

	30 June 20.21 Dr/(Cr) R	1 October 20.20 Dr/(Cr) R
Property, plant and equipment	53 034 084	50 101 704
Inventory	7 339 728	5 908 848
Trade receivables	6 399 030	5 810 640
Cost of sales	24 900 480	7 875 120
Other expenses	5 718 240 ¹	2 419 560
Income tax expense	1 127 280	474 870
Share capital	(1 000 000)	(1 000 000)
Retained earnings (30 June 20.20)	(25 552 160)	(25 552 160)
Long-term borrowings	(29 567 070)	(25 767 324)
Trade payables	(5 672 832)	(5 098 632)
Bank overdraft	(155 100)	(169 176)
Revenue	(36 571 680)	(15 003 450)
	<u>-</u>	<u>-</u>
Profit for the period	(4 825 680)	(4 233 900)

¹ Included in the other expenses amount is depreciation amounting to R618 750 for the period 1 October 20.20 to 30 June 20.21.

Investment in Stoves Ltd (“Stoves”)

On 30 June 20.19, TukIn purchased a 25% interest in Stoves. TukIn exercises significant influence over the financial and operating policy decisions of Stoves since that date. On 2 January 20.21, TukIn disposed of a 15% interest in Stoves at the fair value of R5 100 000 and consequently no longer exercised significant influence over the financial and operating policy decisions of Stoves after the disposal.

The carrying amount of the investment in Stoves on 30 June 20.20 amounted to R6 723 750. The investment in Stoves was the only investment in associate held in the group at that date.

The profit for the year ended 30 June 20.21 amounted to R3 000 000. The profit of Stoves accrued evenly throughout the year. TukIn received a dividend from Stoves during December 20.20.

The group’s profit on the disposal of Stoves as an associate is correctly calculated as R1 401 250.

Investment in Gas Heating Ltd (“Gas Heating”)

TukIn has an 80% controlling interest in Gas Heating for many years. All the assets and liabilities were deemed to be fairly valued at the date of acquisition. The goodwill related to this investment is R638 000 and the balance of the non-controlling interests was R6 340 500 at the beginning of the financial year.

The profit for the current year of Gas Heating amounted to R6 644 000. The company declared and paid a dividend of R200 000 during the current year.

Senior management incentive scheme

On 1 August 20.18, TukIn granted each of its five senior managers a cash payment equal to the fair value of 100 000 TukIn ordinary shares, provided that they remained in the employment of TukIn until 31 July 20.20. The IFRS expert consulted by the financial manager confirmed that this grant was correctly accounted for over the vesting period as a cash-settled share-based payment transaction. The share-based payment expense for the period 1 July 20.20 to 31 July 20.20 (correctly calculated) amounted to R5 million and was included in other expenses in the statement of profit or loss and other comprehensive income. The grant was fully settled by means of a cash payment of R28 million on 1 August 20.20.

Additional Information

- It is the accounting policy of TukIn to account for investments in subsidiaries and investments in associates at cost in its separate financial statements in accordance with IAS 27.10(a).
- It is the accounting policy of TukIn to account for investments in equity instruments other than investments in subsidiaries and associates, in accordance with IFRS 9 *Financial Instruments*. TukIn irrevocably elected to present subsequent changes in the fair value of the investments in other comprehensive income in a market-to-market reserve.
- The TukIn Group did not dispose of or acquire any other investments in associates during the current financial year, unless otherwise stated in the information provided.
- TukIn elected to measure non-controlling interests at the proportionate share of the acquiree’s identifiable net assets at the acquisition date.

- TukIn paid a dividend of R5 500 000 during the current financial year.
- Cash flows from interest and dividends received are classified as investing activities and cash flows from interest and dividends paid are classified as financing activities.
- Included in other income are profit on disposal of property plant and equipment amounting to R1 353 000, dividends received from financial assets of R3 762 000, and interest received of R1 221 000.
- Goodwill is tested for impairment on an annual basis and no impairment loss was required to be recognised in the financial statements during the current financial year.
- Assume a normal income tax rate of 27% and a capital gains tax inclusion rate of 80%. Ignore value added tax (VAT) and dividends tax unless specifically required.

QUESTION 2**50 marks**

Book-It-Pro Ltd ("Book-It") is a South African company that is listed under the support services sector of the Johannesburg Stock Exchange. Established in 20.01, the company offers unique and specialised services in the events, sport and transport industries within South Africa. The company has a 30 June year end.

Over the years the company has grown to be the biggest online ticketing platform where customers can purchase tickets for transportation (bus and airplane tickets), sporting and other entertainment events.

Book-It entered into agreements with various bus and airline operators and event organisers across the country. The agreements entail that customers book their bus trips and flights, sporting and other events using the Book-It online platform to purchase their tickets. Under the terms of the contracts with the operators and event organisers, when the customer places an order on the online platform, Book-It is entitled to a commission of 7,5% of the ticket selling price. Book-It is not responsible for the actual provision of transportation services or events as these are provided by the respective operators and event organisers.

Book-It have sold in excess of 100 million tickets in the last 20 years, for more than 12 500 events and worked with over 176 venues across South Africa.

Online sale of tickets**Bus and airline tickets**

The online platform has a built-in system that automatically calculates the commission fee and pays the remainder of the selling price to the bus and airline operators' bank account once the cancellation period has expired. The Book-It system interfaces with the systems used by operators and Book-It is able to access the operators' ticket master file. Book-It is able to access the operators' set ticket selling prices and to determine the ticket quantity levels to ensure that there is enough available ticket quantity before the ticket sale transaction can be processed. To conclude the transaction, the customer is required to pay the ticket price via credit card or EFT and upload the proof of payment.

Once the sale has been processed, customers have an option to receive their tickets via email or the physical ticket can be collected at any of the Book-It outlets across the country. Book-It has ticket printing facilities in every outlet. The tickets are printed directly from the operators' ticket master file. Book-It can only print the ticket when the customer comes to collect in person to minimise the risk of theft or damage. Every ticket has a unique number. Customers have up to 24 hours before the departure date to collect their tickets. Should the customer fail to collect the ticket before the said date, the trip is forfeited.

Book-It's policy allows customers to return their tickets, however they may not do so within 5 days before the departure date, should they change their minds. Customers will still be responsible for a handling and administration fee of 6% of the original selling price should they return the tickets. Only 94% of the original selling price can therefore be refunded to the customer by Book-It before the amount is transferred to the operators.

The total bus and airline tickets sales for the year ended 30 June 20.21 through the Book-It system amounted to R17 500 000.

Sale of tickets for the Joburg July 20.21

Joburg July is an annual and the greatest racing, fashion and entertainment extravaganza on the African continent. Due to the lockdown restrictions as a result of the COVID-19 pandemic, the 20.20 event was cancelled. However, with the easing of the restrictions, the preparation for the 20.21 event was back in full swing. This year's event took place on the 4th of July 20.21. Due to traffic congestion normally experienced during the Joburg July weekend, most attendees opted to use bus and airline transport services to attend the event.

In response to this, the following single trip tickets were booked via Book-It's website on 1 June 20.21:

Departure	Bus ticket		Flight ticket	
	Tickets	Price	Tickets	Price
Durban	150	R 450	20	R1 115
Cape Town	80	R1 250	15	R2 700
Northwest	25	R 315	5	R 550
Eastern Cape	11	R1 400	19	R3 200

Based on past experience, Book-It expects that for 5% of the bus and airline tickets sold during the 20.21 financial year, the customers would return the tickets for a refund within the prescribed time.

Sporting events tickets

Book-It concluded a deal with the Premier Athletic League (PAL), a South African national multi-coded sporting body responsible for the preparation, presentation and performance of teams to all multi-coded sporting events. Book-It will have the exclusive rights to sell all the PAL events tickets.

Costs already incurred on the PAL contract:

	Amount R	Date
Travel costs ¹	108 370	15 October 20.20
Legal and accounting fees ²	917 850	1 November 20.20
Commission fees and salary costs ^{1&3}	1 095 000	1 November 20.20 – 30 June 20.21
Printing costs ⁴	899 575	1 January 20.21

¹ To negotiate the deal, Book-It assembled and sent a team of five delegates to the PAL headquarters in Johannesburg, Gauteng. During the month of October 20.20, the team spent seven days in Johannesburg. The costs of travelling, accommodation and catering during their stay in Johannesburg amounted to R108 370.

² Book-It paid R917 850 to Race Attorneys & Accountants Ltd, a company that was responsible for conducting the due diligence (R750 000), assisted with the preparation of the legal documents (R95 000) and the provision of the accounting services (R72 850) for the proposed deal. The legal documents preparation fee will be recoverable against future revenues generated from the contract.

³ Book-It employed 10 more employees to capacitate their regions (two per region) in order to be able to successfully execute the PAL contract. The total cost of R895 000 was paid by Book-It as salaries to the additional employees.

On 30 November 20.20 when the contract between Book-It and PAL was concluded, Book-It paid the delegation team a commission fee of R200 000 as an incentive for securing this deal. The commission paid will be recoverable against future revenues generated from the contract.

- 4 Book-It's existing printing facilities do not support PAL ticket printing due to the special type of tickets that are used at PAL events. Book-It purchased 10 additional printing machines for R80 000 each. Book-It purchased printing software to the value of R99 575 to operate the printing machines.

Other events tickets

Book-It sold other events tickets at a stand-alone price of R5 250 000 (20.20: R7 120 500) during the financial year ended 30 June 20.21 (these were attributable to the period before the national lockdown). Book-It launched a new customer loyalty program on 1 July 20.19 which rewards customers with 1 customer loyalty point for every R100 spent on event tickets purchased through Book-It online platform. Each point can be redeemed on any future purchase of an event ticket at Book-It. All loyalty points will expire two years after it has been obtained.

Book-It estimated that 55 000 points will be redeemed for each financial year ended 30 June. Each point is estimated to have a stand-alone selling price of R1,10 per point. Customers redeemed 39 000 (20.20: 35 000) loyalty points during the year ended 30 June 20.21. At this date, Book-It continues to expect that 55 000 points will be redeemed for each financial year. 1 025 of the 39 000 loyalty points redeemed during 20.21 were in respect of the 20.20 loyalty points issued.

Additional information

- Ignore income tax, value added tax (VAT) and dividend tax.

CASE STUDY 4**REQUIRED**

YOU NOW HAVE 150 MINUTES TO COMPLETE THE CASE STUDY.

QUESTION 1

	Marks
<p>(a) Identify and explain the errors made by the accounting clerk in the preparation of the draft consolidated statement of cash flows of the TukIn Heating Ltd Group for year ended 30 June 20.21.</p> <p>Structure your discussion under the following headings:</p> <ul style="list-style-type: none"> • Sale of interest in HeatAuto Ltd; and • Other aspects. <p style="text-align: right;">Communication skills: logical argument, presentation and layout</p> <p>Please note:</p> <ul style="list-style-type: none"> • Your discussion should include reference to amounts, where applicable. • Your discussion should include the impact of the errors identified on the draft consolidated statement of cash flows. • Your discussion should not address any errors or omissions relating to headings, descriptions or the cash and cash equivalents balances. 	<p>18</p> <p>11</p> <p>2</p>
<p>(b) Assume that the correct Investment in associate balance as at 30 June 20.21 was R7 899 800. Calculate the dividends received from the Investment in associate, Stoves Ltd, during December 20.20.</p>	6
<p>(c) Calculate the correct additions to property, plant and equipment that should be disclosed in the consolidated statement of cash flows of the TukIn Heating Ltd Group for year ended 30 June 20.21.</p> <p style="text-align: right;">Communication skills: logical argument, presentation and layout</p>	<p>5</p> <p>2</p>
<p>(d) Briefly discuss the tax consequences for both TukIn Heating Ltd and the five senior managers of TukIn Heating Ltd for 20.19 to 20.21 years of assessments if TukIn Heating Ltd granted each of its five senior managers 100 000 TukIn Heating Ltd ordinary shares (using the retained earnings) on 1 August 20.18 instead of a cash payment, provided that they remained in the employment of TukIn Heating Ltd until 31 July 20.20. The shares had a value of R46 per share on 1 August 20.18 and R56 on 31 July 20.20. Provide reference to the correct legislation in your answer.</p> <p>Please note:</p> <ul style="list-style-type: none"> • Round off all amounts to the nearest rand. • Your answer must comply with International Financial Reporting Standards (IFRS). 	8

QUESTION 2

	Marks
<p>(a) Explain, with reference to the sale of bus and airline tickets, how Book-It-Pro Ltd should recognise and measure the revenue in its accounting records for the year ended 30 June 20.21. You may assume there were no returns nor any issues with the tickets during the financial year ended 30 June 20.21.</p> <p>Please note:</p> <ul style="list-style-type: none"> • You may assume that the contract for the sale of bus and airline tickets that is within the scope of IFRS 15 <i>Revenue from Contracts with Customers</i>, already exists between the respective parties (i.e. you do not have to discuss the criteria for identifying a contract with a customer). • Discussion on variable consideration and combination of contracts is not required. • Your answer should be limited to IFRS15 <i>Revenue from Contracts with Customers</i>. <p style="text-align: right;">Communication skills: logical argument and conclusion</p>	<p>14</p> <p>1</p>
<p>(b) Provide only the journal entry on 1 June 20.21 to account for the sale of bus and airline tickets to Joburg July attendees in the accounting records of Book-It-Pro Ltd for the year ended 30 June 20.21, in accordance with IFRS 15 <i>Revenue from Contracts with Customers</i>.</p>	10
<p>(c) Explain, with reasons and reference to amounts, whether the costs already incurred by Book-It-Pro Ltd during the year ended 30 June 20.21 on the contract with the Premier Athletic League should be capitalised. Your answer should be split between the:</p> <p>(i) incremental cost of obtaining the contract; and (ii) costs to fulfil the contract.</p>	10
<p>(d) Present only the revenue from other events tickets section in the statement of profit or loss and other comprehensive income of Book-It-Pro Ltd for the year ended 30 June 20.21. The presentation should be limited to the Revenue line item only.</p> <p style="text-align: right;">Communication skills: presentation and layout</p> <p>Please note:</p> <ul style="list-style-type: none"> • You may assume that the customer loyalty points are a single performance obligation and that it meets all of the requirements to be recognised as a contract within the scope of IFRS 15 <i>Revenue from Contracts with Customers</i>. • Comparative figures are not required. <p>Please note:</p> <ul style="list-style-type: none"> • Round off all amounts to the nearest rand. • Your answer must comply with International Financial Reporting Standards (IFRS). 	<p>14</p> <p>1</p>

CASE STUDY 4**QUESTION 1 – Suggested solution****TUKIN HEATING LTD GROUP****(a)****Sale of interest in HeatAuto Ltd ('HeatAuto')**

Error 1: It is evident from the change in ownership reserve created that the loss of control was not identified and consequently not treated correctly in the statement of cashflows. (1)

OR The accountant incorrectly treated this disposal as an equity transaction and recognised a change in ownership reserve. This is incorrect as control has been lost.

The current incorrect accounting treatment as an equity transaction between owners of the parent should be corrected and the transaction recorded as a loss of control over a subsidiary. (1)

Therefore, the cash from the proceeds of the disposal of the subsidiary was incorrectly classified under "financing activities" as 'partial disposal of subsidiary'. (1)

The aggregate cash flows arising from losing control of the subsidiary (HeatAuto) shall be presented separately and classified as "investing activities" [IAS 7.39]. (1)

Error 2: Based on the accountant's treatment of the transaction, the amount calculated for the proceeds from partial disposal is incorrect. Only the proceeds received should have been disclosed. The accountant therefore confused the principle based on the approach he was following. (1)

Furthermore, based on the correct classification of the sale as loss of control. The amount to be disclosed will be net of cash in the consolidated statement of cash flow. (1)

Theory: In terms of IAS 7.42 the aggregate amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries is reported in the statement of cash flows and its notes, net of cash and cash equivalents acquired or disposed of.

The amount of proceeds received of R21 587 000 should be calculated net of cash and cash equivalents of R169 176, however it is incorrectly calculated by the accounting clerk as the R169 176 was deducted from the proceeds received. (1)

Since HeatAuto's cash is an overdraft balance, the R169 176 should have been added to the proceeds received. (1)

Therefore, the amount to be disclosed under investing activities as 'Proceeds from disposal of subsidiary' should be R21 756 176 (21 587 000 + 169 176). (1)

Trade payables of the subsidiary: The trade payables balance of R5 098 632 of HeatAuto on the date of the sale of the subsidiary, was incorrectly omitted to calculate the cash paid to suppliers and employees in the statement of cash flow. (The balance of HeatAuto at date of disposal should be deducted from trade payables). This amount will decrease the cash paid to suppliers and employees. (1)

Property, plant and equipment of the subsidiary: The property, plant and equipment balance (of R50 101 704) of HeatAuto was also not taken into account on date of disposal of subsidiary. This would affect the calculation of acquisition of PPE line item under investing activities. (The balance of HeatAuto at date of disposal should be deducted from PPE). The amount will increase the amount paid for the acquisition of PPE or reduce the amount received as proceeds on disposal. (1)

Inventory of the subsidiary: The inventory balance (of R5 908 848) of HeatAuto on the date of the sale of the subsidiary, was incorrectly omitted from the calculation of the cash paid to suppliers and employees in the statement of cash flow. (The balance of HeatAuto at date of disposal should be deducted from inventory). The amount will reduce the amount paid to suppliers and employees. (1)

Trade receivables of the subsidiary: The trade receivables balance (of R5 810 640) of HeatAuto on the date of the sale of the subsidiary, was incorrectly omitted from the calculation of the cash received from customers in the statement of cash flow. (The balance of HeatAuto at date of disposal should be deducted from trade receivables). The amount will increase the amount received from customers. (1)

Long-term borrowings of the subsidiary: The long-term borrowings balance (of R25 767 324) of HeatAuto was also not taken into account on date of disposal of subsidiary. This would affect the calculation of repayment of long-term borrowings line item under financing activities. (The balance of HeatAuto at date of disposal should be deducted from long-term borrowings). The amount will increase the repayment of long-term borrowings. (1)

Error 3: The accounting clerk continued to consolidate the subsidiary up to year end even though control was lost. (1)

The profit or loss items (revenue, cost of sales, other expenses and income taxes) of HeatAuto for the period 1 October 20.20 to 30 June 20.21 must be eliminated from the consolidated statement of profit or loss and other comprehensive income. (1)

The assets and liabilities balances on 1 October 20.20 must be eliminated from the consolidated statement of financial position. (1)

The cost of sales of R17 025 360 (R24 900 480 – R7 875 120) incurred between date of loss of control and year end of the subsidiary must be removed from cost of sales. This will result in a decrease in the amount of cash paid to suppliers and employees (correcting both errors 1 and 3 simultaneously). (1)

The other expenses of R3 298 680 (R5 718 240 – R2 419 560) incurred between date of loss of control and year end of the subsidiary must be removed from other expenses. This will result in a decrease in the amount of cash paid to suppliers and employees (correcting both errors 1 and 3 simultaneously). (1)

[alternatively, adjust these amounts for the balances at date of loss of control, and remove amounts that were consolidated at year end. The net results is the removal of the movement between these dates.]

Similarly, the revenue received between date of loss of control and year end of the subsidiary of R15 003 450 (R36 571 680 – R21 568 230) should be removed and will decrease the amount of cash received from customers. (1)

The income tax expense movement from date of loss of control up to year end of R652 410 (R1 127 280 – R474 870) should be removed and will decrease the amount of income taxes paid presented under operating activities in the cashflow statement. (1)

Error 4: Resultant associate not identified and not accounted for in the consolidated financial statements of TukIn Heating Ltd Group.

OR: On the date that control was lost, TukIn still had significant influence over the financial and operating policy decisions of HeatAuto. (1)

Therefore, the profit of HeatAuto from date of loss of control to year end must be included in the consolidated profit before tax as 'profit from associate' and removed as a non-cash item when calculating the cash paid to suppliers and employees in the cashflow statement. (1)

The share of profit of associate amounts to $(R4\ 825\ 680 - R4\ 233\ 900) = R591\ 780 \times 30\% = R177\ 534$. (1)

The remaining 30% interest of the investment was not identified as an investment in associate on 1 October 20.20. The fair value of R10 080 000 is deemed to be the cost price of the new investment in associate and should be added to the investment in associate balance at year end. (1)

The non-cash acquisition of the associate of R10 080 000 will affect the calculation of dividends received from associates amount to be disclosed on the consolidated statement of cash flows. (1)

Error 5: The depreciation amount added back to profit before tax as a non-cash adjustment incorrectly includes depreciation attributable to assets of the subsidiary since date of loss of control of R618 750 (1)

To correct this, the R618 750 must be deducted from the non-cash adjustments, and will increase, the cash paid to suppliers and employees. (1)

	(1)
Total	<u>(28)</u>
Maximum	<u>(18)</u>

Other aspects

Error 6: The disposal of the associate was incorrectly accounted for under financing activities. This should be accounted for as a disposal of the associate under investing activities [IAS 7.16(d)]. (1)

Error 7: The group gain on disposal of associate Stove of R 1 401 250 should be accounted for as a non-cash adjustment in calculating cash generated from operations, which was not done. (1)

Theory: At date of loss of significant influence, the entity discontinues the use of the equity method (IAS 28.22). The entity shall recognise in profit or loss any difference between the fair value of the retained interest plus consideration received less the carrying amount of the investment on 2 January 20.21. [IAS 28.22(b)].

Error 8: Dividend paid by Gas Heating Ltd: It seems that the dividends paid by Gas Heating Ltd to the non-controlling interests were not included in the "dividends paid" in the consolidated statement of cash flow, as the amount only equals the amount paid by TukIn Heating Ltd of R5 500 000. (1)

The dividend paid to non-controlling interests amounts to (200 000 x 20%) is R40 000. This amount should be included in the dividends paid figure. (1)

The dividends paid is incorrectly disclosed under operating activities. It is the policy of TukIn Heating Ltd Group to account for dividends paid under financing activities. Therefore, dividends paid should be removed from operating activities and included under financing activities as a cash outflow. (1)

Error 9: Interest and dividends received are incorrectly accounted for under operating activities. It is the accounting policy of the TukIn Heating Ltd Group to classify interest and dividends received under investing activities. (1)

The cash dividend received from HeatAuto as an associate at year end was not taken into account in the cashflow statement. Therefore, the R2 310 000 must be added to dividends received at year end. (1)

This is evident from the amount shown as dividends received on the consolidated statement of cash flow is R3 762 000. This is only the dividend received from the other financial assets. (½)

The dividend received by TukIn Heating Ltd that is paid by Stoves Ltd as an associate during December 20.20, must be calculated and added to dividends received (part b). (1)

Error 10: The consolidated gain on sale of the interest in the subsidiary of R7 172 895 should be included in the profit before tax. Once this has been included in profit before tax, it will then need to be added back as a non-cash item when calculating cash paid to suppliers and employees using the direct method. (1)

Error 11: The settlement of the senior management incentive scheme was incorrectly classified as a financing activity. (1)

It should have been included in operating activities, as this is a payment to employees / working capital. This resulted in cash inflows from financing activities being understated and cash generated from operations being overstated/ cash paid to suppliers and employees being understated. (1)

Error 12: The amount at which the settlement of the senior management incentive scheme disclosed of R5 000 000 in the consolidated statement of cash flow is incorrect. The actual amount paid is R28 000 000 taken into account in operating activities as an outflow of cash. (1)

Total	<u>(12½)</u>
Maximum	<u>(11)</u>



COMMENT

A discussion type question for IAS 7 requires the same knowledge and skills compared to disclosing the consolidated statement of cash flows. You should therefore look forward to critically assess incorrect information provided! The exam technique used will be to read and assess the information provided and disclosed in the scenario to determine whether it is acceptable compared to the requirements of the standard(s). For example, from the information provided that the sale of shares in HeatAuto was a loss of control. However, the accountant treated the transaction as a normal transaction between owners.

For Error 4, the investment in HeatAuto changed from a subsidiary to an associate that is at Awareness level. However, when reviewing the impact of this change in ownership transaction, it is clear that it relates to the normal equity method procedures for an associate.

**COMMENT**

Your knowledge regarding loss of control should guide your answer:

- All the assets and liabilities should be derecognized (various non-cash adjustments)
- The derecognition of non-controlling interests (affects the dividends paid calculation)
- The cash effect is the proceeds on disposal less the cash balance of the subsidiary
- The transaction is recognized as an investing activity
- The gain or loss on disposal is a non-cash item
- The fair value of the remaining interest is a non-cash adjustment in investments in equity instruments
- The derecognition of goodwill is considered in the goodwill impairment calculation, if applicable

Contrasts this with the treatment of the transaction between owners in their capacity as owners:

- The transaction is a financing activity
- The cash effect is the proceeds on the sale
- The movement in non-controlling interests are considered when calculating the cash dividend paid, if applicable
- The movement in the Owners equity reserve is non-cash

(b) Calculate the dividends received from associate Stove Ltd during December 20.20

	R	
Increase in Investment in associate (6 723 750 – 7 899 800)	(1 176 050)	(1)
Share in profit of associate [(591 780 x 30%) (HeatAuto)]	177 534	(1)
Share in profit of associate [(3 000 000 x 6/12 x 25%) (Stoves)]	375 000	(1)
Loss of control, resulting in new associate (HeatAuto at FV)	10 080 000	(1)
Associate disposed (Stoves- becoming a simple investment) (6 723 750 + 375 000)	(7 098 750)	(1)
Dividends from HeatAuto	(2 310 000)	(1)
	<u>47 734</u>	<u>(6)</u>

**COMMENT**

To calculate the dividends received from a specific associate the “investment in associate” general ledger account needs to be reconciled. Include all other known (given) amounts for instance, the profit from associate as well as dividends received from other associates (HeatAuto). The balancing amount in this instance in the general ledger account will be the dividends received from the specific associate.

(c) Recalculate the correct additions to property, plant and equipment that should be disclosed in the cashflow statement

	R	
Increase in PPE balance (39 452 490 - 54 962 094)	(15 509 604)	(½)
Depreciation	(9 923 100)	(½)
Depreciation Heat Auto Ltd (loss of control)	618 750	(1)
Disposal of PPE (24 453 000 - 1 353 000)	(23 100 000)	(2)
Reversal of PPE of HeatAuto Ltd incorrectly consolidated	53 034 084	(1)
Disposal of subsidiary (HeatAuto Ltd)	(50 101 704)	(1)
	(44 981 574)	—
	Total	<u>(6)</u>
	Maximum	<u>(5)</u>
Communication skills: logical argument, presentation and layout		<u>(2)</u>

**COMMENT**

The proceeds from the sale of the property, plant and equipment already includes the profit from the sale of the PPE. The profit is deducted to get to the carrying amount of the PPE when reconciling the account to calculate correct amount of the additions to the PPE. The profit on sale of the PPE is a non-cash item and should be accounted for as a non-cash adjustment in calculating cash generated from operations

(d)

The ordinary shares allotted to its five senior managers are restricted shares in terms of section 8C as they need to remain in the employ of TukIn until 31 July 20.20. (1)

TukIn Heating Ltd

In the 20.19 year of assessment, the issue of the 100 000 ordinary **shares is capital in nature and no deduction** will be allowed in terms of *section 11(a)*. (1)

As the **retained earnings were used** to issue the shares, the **shares will be a dividend** when TukIn is **wounded up or liquidated** (s 1). (1)

Five senior managers

On the receipt of the 100 000 shares in the **20.19 year of assessment**, an amount of **R4 600 000** (100 000 x R46) accrues to each manager in terms the *gross income definition* (s 1) but as the shares have **not vested, it will be exempt** in terms of s 10(1)(nD). (1)

In the **20.21 year of assessment**, the restriction falls away and each manager will include the gain (in terms of s 8C), being the **market value of the shares on vesting date (R56)** less any consideration paid. (1)

As they did not pay any consideration for the shares, an amount of R56 x 100 000 = R5600 000 will be **included in their gross income**. (1)

When the managers eventually sell these shares, the **base cost of the shares** will be R5 600 000 for **capital gains tax purposes**. (1)

	Total	<u>(10)</u>
	Maximum	<u>(8)</u>
Reference to legislation (half marks in solution)		<u>(2)</u>

QUESTION 2 – Suggested solution

- (a) **Explain, with reference to the sale of bus and airline tickets, how Book-It-Pro Ltd should recognise and measure the revenue in its accounting records for the year ended 30 June 20.21. You may assume there were no returns nor any issues with the tickets during the financial year ended 30 June 20.21.**

When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (i.e. the entity is a principal) or to arrange for those goods or services to be provided by the other party (i.e. the entity is an agent) (IFRS 15.B34).

An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer (IFRS 15.B35).

Identifying performance obligations

At contract inception, Book-It shall assess the bus or airline transport services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer a good or service that is distinct [IFRS 15.22]. (1)

Promises in contracts with customers

The contract with a customer explicitly states the bus and or airline ticket that Book-It promises to transfer to a customer [IFRS 15.24 and IFRS 15.B34A(a)]. (1)

Distinct goods or services

Book-It has to determine whether the nature of its promise is to sell the tickets to customers itself or to arrange for the bus and airline tickets by assessing whether it controls the specified goods or service i.e. the bus and airline ticket sales before they are transferred to the customer. (1)

Book-It does not control the specified goods or service i.e. the provision of transportation service before they are transferred to the customer as: (1)

- It is not primarily responsible for fulfilling the promise to provide the transportation service as the responsibility rest with the bus and airline providers. Book-It is merely acting on behalf of the bus and airline providers. (1)
- Book-It does not have inventory risk before the specified good or service is transferred to the customer i.e.:
 - Book-It does not keep the tickets inventory (Book-It access the operators' system before a booking to determine availability and pricing) in their custody before the tickets are transferred to the customer. (1)
 - Tickets are printed or sent directly from the bus and airline operators' system when the customer collects the tickets. (1)
- Book-It does not have a discretion in establishing the prices for the bus and airline tickets as these are determined by the bus and airline operators themselves. (1)

Book-Its' performance obligation is therefore to arrange for the sale of tickets. The provision of the transportation services is a performance obligation by the bus and airline operators. (1)

Therefore Book-It is an agent as the single performance obligation is to arrange for the provision of the specified transport services by another party, the transport operators. (1)

Measurement

Book-It, as an agent, shall recognise the revenue from the sale of bus and airline tickets at a commission amount of 7,5% of the selling amount i.e. the amount it expects to be entitled to in exchange for arranging the sale of tickets and the provision of transportation services. (1)

This is the net amount of the consideration that Book-It retains after paying the bus and airline operators the consideration received in exchange for the sale of tickets. (1)

The total amount to be recognised as revenue by Book-It in exchange for arranging for the sale of tickets and the provision of transportation service for the year ended 30 June 20.21 is therefore:

Total amount received (bank) = R17 500 000		
Book-It's revenue (commission) = R1 312 500 (R17 500 000 x 7,5%)		
Paid to bus and airline operators as agent = R16 187 500 (R17 500 000 – R1 312 500).		(3)
	Total	(16)
	Maximum	(14)
Communication skills: logical argument and conclusion		(1)

- (b) Provide the journal entry to account for the sale of bus and airline tickets to the Joburg July attendees on 1 June 20.21 in the accounting records of Book-It-Ltd for the year ended 30 June 20.21, in accordance with IFRS15 *Revenue from Contract with Customers*.

	Dr R	Cr R	
1 June 20.21			
Bank (SFP) [C1]	317 125		(2)
Revenue – Commission (P/L) [C1]		22 595	(2)
Revenue – Handling fee (P/L) [C1]		951	(2)
Provision for refund liability (SFP) (15 856 [C1] – 951 [C1])		14 905	(2)
Trade payables (SFP) [C1]		278 674	(2)
<u>Recognition of revenue from the sale of bus and airline tickets</u>			<u>(10)</u>



COMMENT

Based on past experience, Book-It expects that 5% of the total sales for the Johannesburg July will be refunded. Therefore, Book-It's commission should only be calculated on 95% of the cash amount received. The operators will also only receive 92,5% of the 95% cash amount received. If customers refund their tickets a handling fee of 6% of the total sales price will be retained by Book-It. Book-It will therefore be entitled to the 6% and no amount will have to be paid over to the operators.

The refund amounts below are based on Book-It's best estimate and the actual amounts can be different. Therefore 5-days before departure (when customers cannot apply for a refund anymore) the estimated amounts will be adjusted to actual amounts. This will result in the provision for refund liability being reversed.

CALCULATIONS**C1. Total selling prices of tickets**

	Bus	Flight
Durban (150 x 450); (20 x 1 115)	67 500	22 300
Cape Town (80 x 1 250); (15 x 2 700)	100 000	40 500
Northwest (25 x 315); (5 x 550)	7 875	2 750
Eastern Cape (11 x 1 400); (19 x 3 200)	15 400	60 800
	<u>190 775</u>	<u>126 350</u>
Total sales (190 775 + 126 350)		317 125
Possible refunds (317 125 x 5%)		<u>(15 856)</u>
Not expected to require a refund		301 269
Commission (301 269 x 7,5%)		22 595
Payable to operators (301 269 x 92,5%)		<u>278 674</u>
		<u>301 269</u>
Possible refunds handling fee (15 856 x 6%)		951

(c) Explain, with reasons and reference to amounts, whether the costs already incurred by Book-It-Pro Ltd during the year ended 30 June 20.21 on the contract with the Premier Athletic League should be capitalised. Your answer should be split between the:

- (i) incremental cost of obtaining the contract; and
(ii) costs to fulfil the contract.

	Amount Capitalised (R)	Reasons	
(i) Incremental costs of obtaining the contract			
Travel costs	-	These would have been incurred regardless of whether the contract was obtained or not. Therefore, in accordance with IFRS 15.93, these costs are recognised as expenses when incurred, unless they are within the scope of another Standard, in which case, the relevant provisions of that Standard will apply.	(1)
Due diligence and accounting fees	-	These would have been incurred regardless of whether the contract was obtained or not. Therefore, in accordance with IFRS 15.93, those costs are recognised as expenses when incurred, unless they are within the scope of another Standard, in which case, the relevant provisions of that Standard will apply.	(1)
Preparation of a legal contract	95 000	In accordance with IFRS 15.91, this is incremental costs of obtaining the contract because the entity expects to recover these costs through future fees for the services to be provided.	(2)

	Amount Capitalised (R)	Reasons	
(i) Incremental costs of obtaining the contract			
Commission fees	200 000	In accordance with IFRS 15.91, the sales commission cost is an incremental cost of obtaining the contract as the entity expects to recover these costs through future fees for the services to be provided.	(2)
	295 000		
(ii) Costs to fulfil the contract			
Salaries for the additional ten employees	-	<p>Although the costs for these ten employees are incurred as part of providing the service to the customer, Book-It concludes that the cost does not generate or enhance resources of the entity (IFRS 15.95(b)).</p> <p>Therefore, the cost does not meet the criteria in IFRS 15.95 and cannot be recognised as an asset using IFRS 15.</p> <p>In accordance with IFRS 15.98, Book-It recognises the payroll expense for these ten employees when incurred.</p>	(1) (1) (1)
10 additional printing machines	800 000	<p>These are accounted for in accordance with IAS 16 <i>Property, Plant and Equipment</i>.</p> <p>Capitalised as it is expected that future economic benefits, the revenue from selling and printing the tickets, will flow to Book-It and the cost of R800 000 can be reliably measured.</p>	(1) (1)
1 specific printing software	99 575	<p>These are accounted for in accordance with IAS 38 <i>Intangible Assets</i>.</p> <p>Capitalised as the software is an identifiable non-monetary asset without physical substance as the software is bought separately. It is probable that future economic benefits, the revenue from selling and printing the tickets, will flow to Book-It as it is the software required for the system to print and issue the tickets. The cost of R99 575 can be reliably measured.</p>	(1) (1)
	899 575		
		Total Maximum	<u>(13)</u> <u>(10)</u>

**COMMENT**

The difference between the Incremental cost of obtaining the contract and cost to fulfil the contract is that the former is the cost incurred to obtaining the contract which is expected to be recovered through the future fees to be generated from the contract, the latter is the cost that is incurred after the contract has been obtained.

- (d) Present only the other events tickets section in the statement of profit or loss and other comprehensive income of Book-It-Pro Ltd for the year ended 30 June 20.21. The presentation should be limited to the Revenue line item only:

BOOK-IT-PRO LTD**STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.21**

R

Revenue

CY revenue excluding loyalty points R343 387 [C4.1]

Plus CY loyalty points redeemed R34 609 [C5.1]

Plus PY loyalty points redeemed R544 [C5.2]

378 540 [14]Communication skills: presentation and layout (1)**CALCULATIONS**

	20.21 R	20.20 R	
C1 Loyalty points earned			
5 250 000/100 x 1	52 500		[1]
7 120 500/100 x 1		71 205	[1]
C2 Stand alone selling price for the points			
52 500 x 1,1	57 750		[1]
71 205 x 1,1		78 326	[1]
C3 Commission earned			
5 250 000 x 7,5%	393 750		[1]
7 120 500 x 7,5%		534 038	[1]
C4 Allocation of transaction price			
Loyalty points			
393 750 x (57 750/(393 750 + 57 750))	50 363		[1]
534 038 x (78 326/(534 038 + 78 326))		68 307	[1]
Revenue on Tickets sold			
4.1 393 750 x (393 750/(393 750 + 57 750))	343 387		[1]
4.2 534 038 x (534 038/612 364)		467 730	

	20.21	20.20	
	R	R	
C5 Allocation of points			
Contract liability			
$((55\,000 - (39\,000 - 1\,205))/55\,000) \times 50\,363$	15 754		
$((55\,000 - 35\,000)/55\,000) \times 68\,307$		24 839	[1]
	<u>15 754</u>	<u>24 839</u>	
Revenue recognised on loyalty points redeemed			
5.1 $(37\,795/55\,000) \times 50\,363$	34 609		[2]
5.2 $(1\,205/55\,000) \times 24\,839$	544		[2]
	<u>35 153</u>		<u>[14]</u>

CASE STUDY 5**100 marks****YOU HAVE 30 MINUTES' READING TIME. SPEND 30 MINUTES READING THE CASE STUDY BEFORE YOU CONTINUE TO THE REQUIRED SECTION.****QUESTION 1****45 marks**

Nuts Ltd ("Nuts") is a South African company listed on the Johannesburg Stock Exchange. Nuts specialises in the sourcing and distributing of a variety of nuts in predominantly the South African market. To fast-track its growth, Nuts has adopted an expansion strategy of acquiring equity interests in other companies.

All the companies in the group have a 30 June year end. The 20.20 financial year audit is currently under way and you, the audit senior, have been provided with the following information:

Investment in TransTar Logistics Ltd ("TransTar")

Nuts acquired a 15% interest in TransTar on 1 January 20.17 for a cash consideration of R675 000. On this date Nuts classified the investment in accordance with IFRS 9 *Financial Instruments*.

On 1 December 20.19 Nuts bought another 60 000 shares in TransTar from existing shareholders for a cash consideration of R2 800 000. From this date Nuts exercised control over TransTar as per the definition of control in terms of IFRS 10 *Consolidated Financial Statements*.

The equity of TransTar consisted of the following on the respective dates:

	30 June 20.19	1 December 20.19	30 June 20.20
	R	R	R
Share capital (150 000 shares)	300 000	300 000	300 000
Retained earnings	2 650 000	?	4 900 000
Mark-to-market reserve	400 000	400 000	520 000
	3 350 000	?	5 720 000
TransTar's share price	38,00	40,00	42,00

The assets and liabilities of TransTar were deemed to be fairly valued on 1 December 20.19, except for the following:

- TransTar disclosed a contingent liability of R50 000 in its financial statements on 30 June 20.19 relating to a court case involving a client's goods that were stolen in transit. The value of the stolen goods was R650 000. The claim represents a present obligation, but at the acquisition date the attorneys of TransTar were of the opinion that it will not be successful, due to the standard indemnity clause in the transport contract which all clients have to sign. The fair value of the claim, taking into consideration all possible outcomes on 1 December 20.19, remained at R50 000. As part of the purchase agreement, the previous shareholders have agreed to reimburse Nuts with 80% of the value of the claim, should it be successful.

On 30 June 20.20 the court case progressed to such an extent that it became virtually certain that TransTar will have to pay the claim in full, as it was found that the client did not sign the indemnity clause in the contract. TransTar correctly recognised a provision of R650 000 in its financial statements at 30 June 20.20. The claim will be deductible for taxation purposes, should it be successful.

- TransTar had a specialised refrigeration trailer included in its property, plant and equipment at the acquisition date. This trailer was specifically built to distribute the products of one of its clients and was one of a kind. It was extremely difficult to determine the fair value of this trailer and the carrying value of R360 000 was used to approximate its fair value. The remaining useful life remained unchanged at four years at the acquisition date.

On 30 April 20.20 TransTar had a fallout with the client and the client decided to use another transport agency. As a result, the trailer was of no use to TransTar and the best price that they could get for the trailer was R150 000. On 31 May 20.20, the trailer was sold to an independent third party for R150 000.

- TransTar leases a truck washing machine from Big Wash Ltd at an annual rental of R500 000 (payable in arrears). The rental agreement was entered into on 1 December 20.13 and covered a period of 10 years with an option to extend the lease for another 2 years. It is reasonably certain that the option to extend the lease period will be exercised. Ownership will not pass to TransTar.

On 1 December 20.19 an annual market related rental amounted to R650 000. The interest rate implicit in the lease could not readily be determined. The incremental borrowing rate of TransTar as at 1 December 20.13 and 1 December 20.19 was 10,25% and 9,5% respectively. On 1 December 20.19, the value of the lease liability and corresponding asset in the statement of financial position of TransTar amounted to R2 161 769 and R1 682 761, respectively.

No additional assets, liabilities or contingent liabilities were identified at the acquisition date.

Included in Nuts's vehicles is a delivery vehicle purchased on 1 January 20.20 from TransTar. TransTar is not a manufacturer of motor vehicles. A profit of R50 000 was realised on the sale of the delivery vehicle. Vehicles are depreciated at 25% per annum on a straight-line method.

On 27 December 20.19 TransTar purchased a warehouse for a cash consideration of R920 000 for investment purposes. This warehouse is rented by Nuts at a rental of R25 000 per month and is used as a storage facility for its dry goods. TransTar fairly valued this property at R1 020 000 on 30 June 20.20. TransTar elected the fair value model to measure investment property in terms of IAS 40 *Investment Property*.

TransTar paid a dividend of R150 000 on 30 June 20.20 to all shareholders registered on 30 May 20.20.

For the period 1 July 20.19 to 1 December 20.19, the profit after tax of TransTar amounted to R987 500.

Investment in Freshly Grown Ltd ("Freshly")

On 1 March 20.19 Nuts acquired an 80% interest in the ordinary share capital of Freshly for a cash consideration of R1 850 000. Nuts exercised control over Freshly as per the definition of control in terms of IFRS 10 *Consolidated Financial Statements* from this date.

The equity of Freshly consisted of the following on the respective dates:

	1 March 20.19	30 June 20.19	30 June 20.20
	R	R	R
Share capital (200 000 shares)	200 000	200 000	140 000
Retained earnings	1 520 000	1 876 500	1 730 900
	<u>1 720 000</u>	<u>2 076 500</u>	<u>1 870 900</u>
10% cumulative preference share capital (20 000 shares)	100 000	100 000	100 000

The assets and liabilities of Freshly were deemed to be fairly valued on 1 March 20.19, except for the following:

- Included in Freshly's property, plant and equipment is a piece of owner-occupied land with a carrying value of R500 000 at the acquisition date. This land is currently held for industrial use as a site for one of Freshly's factories. Similar sites have recently been developed into office buildings to earn rental income. On the acquisition date there was no restriction to prevent the land from being developed into office buildings. The fair value of the land amounted to R850 000 (if the site was continued to be held for industrial use/developed into a factory building) and R1 050 000 (if the site was to be developed into office buildings).
- On 1 July 20.15, Freshly acquired a patent registered for 10 years. On 1 July 20.25, in terms of an agreement with Ground Ltd, this patent will be sold to Ground Ltd for R70 000. On 1 March 20.19, the fair value of this patent was R280 000 and the carrying value was R152 333. The agreement and registration period remained unchanged at the acquisition date.

The cumulative preference shareholders have a right to a preferential dividend compared to the payment of any dividend to the holders of the ordinary shares, and will receive the return on their investment upon liquidation of the acquiree. All preference dividends for previous years have been paid, up to and including 30 June 20.19. The fair value of the preference shares at acquisition date is R120 000.

On 30 June 20.20, Nuts sold 10 000 of the shares in Freshly for a consideration of R130 000. Nuts retained control over Freshly after the transaction.

Freshly paid an interim dividend of R80 000 on 10 January 20.20 to all shareholders registered on 30 December 20.19.

Nuts purchased all its pecan nut inventory from Freshly at cost plus 25%. Nuts's inventory still on hand at year end amounted to R250 000. On 30 June 20.20, before the share repurchase, Nuts wrote the inventory down to its net realisable value of R230 000.

Additional information

- It is the accounting policy of all the companies in the Nuts Group to account for investments in subsidiaries at cost in its separate financial statements, in accordance with IAS 27.10(a).

- It is the accounting policy of the Nuts Group to account for plant and equipment according to the cost model and land according to the revaluation model in terms of IAS 16 *Property, Plant and Equipment*. As land is not subject to significant and volatile changes, it is only necessary to revalue land every two years.
- It is the accounting policy of the group to carry intangible assets at cost less accumulated amortisation and accumulated impairment losses in terms of IAS 38 *Intangible Assets*.
- The Nuts Group elected to measure non-controlling interests at the proportionate share of the acquiree's identifiable net assets at the acquisition date for all its acquisitions.
- The profit after tax was earned evenly throughout the year for all companies in the group, except where otherwise indicated.
- Nuts elected to transfer any cumulative gains or losses within equity in terms of IFRS 9.B5.7.1.
- Nuts has various insignificant equity investments that are accounted for, in accordance with IFRS 9 *Financial Instruments*. Nuts irrevocably elected to present any subsequent changes in the fair value of the investments in equity instruments in other comprehensive income in a mark-to-market reserve.
- Assume a normal South African income tax rate of 27% and a capital gains tax inclusion rate of 80%. Ignore value added tax and dividend tax.
- There were no changes in the share capital of any of the entities during the year.
- Nuts recognises any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received (attributable to the owners of the parent in an equity transaction) directly in a changes in ownership reserve in equity.
- The opening balance of the mark-to-market reserve in the consolidated statement of changes in equity for the group was R750 000 as at 1 July 20.19.

QUESTION 2**25 marks**

Haughty Pastas Ltd (“HP”) operates in the restaurant industry and owns a chain of restaurants in South Africa. HP made various local investments over the past few years with the objective of gaining greater market share. Due to the recent COVID 19 pandemic, the market prices for restaurants worldwide have dropped. While health experts advise that the pandemic is slowly coming to an end, the directors of HP decided to take advantage of the lower cost of investments and to diversify their activities internationally.

The group annual financial statements of the HP Group for the year ended 31 July 20.20 are in the process of being finalised. Relevant information required for the completion of the group’s financial statements is provided hereunder. All companies in the group have a 31 July year end.

Flavour Favourites Plc (“FF”)

On 1 March 20.20 HP acquired a 30% equity interest in FF and exercised significant influence over the financial and operating policy decisions from that date. FF is a chain of restaurants based in the United States.

Details of the consideration transferred to the shareholders of FF were as follows:

- On 1 March 20.20 a cash consideration of US\$20 000 was paid.
- Not included in this cash payment of US\$20 000 is an amount of US\$1 500 with regards to advisory fees paid by HP.
- An additional cash payment of US\$4 064 will be payable in cash on 1 March 20.23.
- HP is required to make an additional cash payment of US\$15 000 on 31 August 20.20 if the share price of FF increases by more than 18%. The fair value of this contingent consideration was estimated to be US\$9 500 on 1 March 20.20.

All the assets and liabilities were fairly valued at the acquisition date, except for the following:

- Equipment with a carrying amount of US\$50 000 had a fair value of US\$95 000 on 1 March 20.20. The equipment had a remaining useful life of five years on 1 March 20.20 and a residual value of Rnil.
- On 1 March 20.20 the debtors with a carrying value of US\$40 000 had a fair value of US\$30 000. On 31 July 20.20 the debtors’ fair value adjustment was still unrealised.

No additional assets, liabilities or contingent liabilities were identified at the acquisition date.

Through the assistance of the health department, disgruntled customers instituted a claim against FF during February 20.20 due to unhealthy practices, including unhygienic seating areas and non-use of protective gear, despite recent laws passed in this regard. On 1 March 20.20 the financial manager of FF recognised a provision for the claim at its fair value. The fair value of the claim was reliably determined by an independent actuary and estimated at US\$12 000 on 1 March 20.20. Should such a claim be successful, any amount paid by FF will not be deductible for tax purposes.

By 31 July 20.20 the case against FF was finalised, with a court ruling that an amount of US\$10 000 be paid to the claimants. The accountant did not process any entries regarding the court ruling.

The equity of FF consisted of the following on the respective dates:

	1 March 20.20	31 July 20.20
	US\$	US\$
Share capital (25 000 shares)	26 400	26 400
Retained earnings	100 000	250 800
	<u>126 400</u>	<u>277 200</u>

On 4 March 20.20 FF acquired financial assets to the value of US\$70 000. On 31 July 20.20 the fair value of the financial assets increased with US\$51 800. The accountant was unsure how to account for the change in fair value and, therefore, did not record the fair value adjustment.

Exchange rates

The following exchange rates were applicable on the respective dates:

	\$US1 = R
1 March 20.20	14,00
Average for the period 1 March 20.20 to 31 July 20.20	14,70
30 June 20.20	15,20
31 July 20.20	16,00

ShoppersRite Ltd (“SR”)

HP acquired 35% of the ordinary shares of ShoppersRite Ltd (SR) on 15 February 20.19, thereby exercising significant influence over the financial and operating policy decisions of SR from that date. SR’s net asset value was considered fairly valued at the acquisition date. However, an intangible asset for which a revaluation decrease of R100 000 was previously recognised in profit and loss, had the same fair value increase of R100 000 on 15 February 20.19. The useful life of the intangible asset is indefinite. On 15 February 20.19 the accountant processed the following journal entry to account for the fair value increase in SR's separate financial records:

	Dr	Cr
	R	R
15 February 20.19		
Intangible asset (SFP)	100 000	
Fair value adjustment (P/L)		73 000
Deferred tax (SFP)		27 000
Fair value adjustment recognised i.t.o. IAS 38.85		

On 15 February 20.19 the share capital and retained earnings of SR amounted to R350 000 and R 450 000, respectively. The retained earnings balance is provided after the processing of the journal above. There were no additional assets or liabilities identified at the acquisition date. On 31 July 20.19 the equity of SR consisted of share capital of R350 000 and retained earnings of R600 000.

In accordance with the purchase agreement and as payment for the equity interest in SR, land owned by HP was transferred to SR on 15 February 20.19. This land will be used by SR for business purposes. The land is defined as a business in accordance with IFRS 3. The land had a carrying amount of R190 000 and a fair value of R250 000 on 15 February 20.19.

As the lockdown ended halfway through 20.20, land prices started recovering and the land of SR was, therefore, revalued during the current year. On 31 July 20.20 the value of land increased by R20 000.

Since acquisition, SR has been selling inventory to HP at a profit of 27% on cost. Inventory included in HP's inventory balance on 31 July 20.19 is R65 000 at the cost for HP. There is no inventory on hand on 31 July 20.20.

On 31 July 20.20 the income of SR equalled its expenses; therefore, SR did not make a profit or a loss during the 20.20 year and did not declare and pay any dividends during the year.

Despite the low economic activity in the current year, the investment in SR is not impaired on 31 July 20.20 and SR remains a going concern on that date.

Additional information

- It is the accounting policy of HP to account for investments in associates at cost, in accordance with IAS 27.10(a) in its separate financial statements.
- It is the accounting policy of the HP Group to account for all other investments in equity instruments, in accordance with IFRS 9 *Financial Instruments*. All the companies in the HP Group irrevocably elected to present subsequent changes in the fair value of these investments in other comprehensive income in a mark-to-market reserve.
- It is the accounting policy of the HP group to account for land according to the revaluation model in terms of IAS 16 *Property, Plant and Equipment*.
- HP's functional and presentation currency is the South African rand and FF's functional currency is the US dollar.
- Profits for all the companies accrued evenly throughout the respective years.
- FF declared and paid a dividend of US\$6 200 on 30 June 20.20.
- Assume a South African normal income tax rate of 27% and a capital gains tax inclusion rate of 80%. Ignore the effects of dividend tax and value added tax (VAT).
- Assume a United States normal income tax rate of 40% and a capital gains tax inclusion rate of 85%.
- Unless stated otherwise, assume a market related pre-tax discount rate of 5% per annum, compounded annually.

QUESTION 3**30 marks**

This question consists of two independent parts.

PART I**23 marks**

You are a trainee accountant for Dynamites-In-Small-Package Inc. ("DISP Inc.") and you have been assigned to the audit of RAF Industries Ltd ("RAF"). RAF is a company that is listed on the Johannesburg Stock Exchange with a 30 September year end. RAF produces targeted medical skin care range products and has partnered with pharmaceutical companies across the country as its main distribution line.

Your audit manager indicated that the Group Financial Accountant requested a formal memorandum in terms of the conclusions reached in the "Investments in Other Entities Working Paper" which has been allocated to you. The request emanates from disagreements between the audit team and management in the prior year relating to the accounting treatment of some of RAF's investments in the group financial statements.

The following is an extract of the working paper which you have completed with information received from the client through enquiries and inspection of the relevant supporting documents.

Investments in Other Entities Working Paper:

Dynamites-In-Small-Package Inc.	
Name of working paper:	Investments in Other Entities
Name of entity:	RAF Industries Ltd
Year end:	30 September 20.20
Prepared by:	CTA Student
Reviewed by:	Audit Manager
Date:	1 October 20.20
Objective of the working paper:	
The purpose of this working paper is to identify all the investments of the RAF group, including any new acquisitions during the year under review, and to determine the recognition and measurement thereof.	
1. Anaky Ltd	
Details about the investment:	
Number of issued share capital of Anaky Ltd	3 250 000
Number of shares held by RAF at the beginning of the year	1 300 000
Number of shares held by RAF at the end of the year	1 560 000
Type of investment	?
RAF first acquired shares in Anaky Ltd in January 20.15 and correctly classified the interest as an investment in an associate on that date. The following pertain to the acquisition:	
<ul style="list-style-type: none"> • No transaction costs were incurred. • The assets and liabilities recognised were considered to be fairly valued on this date. • No additional assets or liabilities were identified by RAF on the acquisition date. 	
Anaky Ltd's operating and financial policies are determined by its Board of Directors. All the directors of Anaky Ltd's Board are appointed by the shareholders at the annual general meetings by a simple majority vote. The company had 3 250 000 ordinary shares in issue throughout the period 1 October 20.13 – 30 September 20.20. Each ordinary share in Anaky Ltd entitles the holder to one vote at shareholders' meetings. The Memorandum of Incorporation of Anaky Ltd does not alter the minimum number of voting rights required to pass ordinary and special resolutions as specified in the Companies Act.	
The following are the details of the voting rights represented at the previous annual general meetings of Anaky Ltd's shareholders:	
Date of annual general meeting	Voting rights represented in person or by proxy
15 December 20.15	92%
15 December 20.16	93%
15 December 20.17	88%
15 December 20.18	94%
15 December 20.19	90%
The next annual general meeting of Anaky Ltd's shareholders is scheduled for 15 December 20.20.	

The remaining ordinary shares are widely held by shareholders, each holding less than 1% of the ordinary share capital, except for Stellen Ltd, which holds 11% of the ordinary shares of Anaky Ltd. Stellen Ltd is an unrelated South African company listed on the Johannesburg Stock Exchange.

2. Oliphants Ltd

Details regarding the investment:

Number of issued share capital of Oliphants Ltd	1 500 000
Number of shares held by RAF at the beginning of the year	0
Number of shares held by RAF at the end of the year	750 000
Type of investment	?

Oliphants Ltd was incorporated on 1 November 20.19 through a partnership between RAF and Lever Ltd, an unrelated third party, mainly to manufacture a skin care range product that targets pigmentation. Oliphants Ltd is a separate legal entity in terms of the South African Companies Act, 2008. RAF and Lever Ltd entered into a strategic agreement on the date of incorporation of Oliphants Ltd which governs its operations. The details as outlined in the strategic agreement were as follows:

- The appointment of management and decisions regarding supplies to be utilised are to be approved by shareholders holding at least 51% of Oliphants Ltd voting rights.
- Voting rights are awarded in proportion to the ownership of shares in Oliphants Ltd.
- The skin care range produced by Oliphants Ltd is to be purchased by RAF and Lever Ltd in a ratio of 50:50.
- Oliphants Ltd may not sell any of the skin care range products to third parties.
- RAF and Lever Ltd may sell their share of the skin care range products to international retailers for sales outside South Africa.
- The skin care range products are priced to ensure that the expenses incurred by Oliphants Ltd are recovered. These expenses include all direct costs associated with producing the skin care range, as well as administrative expenses of Oliphants Ltd.

General

All the entities in the group have a 30 September year end.

PART II

7 marks

Agrio Ltd was formally established on 1 October 20.10. Agrio Ltd is a major player in the agricultural industry and manufactures technology systems that offer a detailed soil analysis, plant analysis and the monitoring of the health of plants to ensure optimal crop health. The company has over the years provided technical support to upcoming businesses in the agricultural sector through their annual mentorship programme. Agrio Ltd has a financial year end of 30 September.

Agrio Ltd's major shareholder is Vet Ltd, owning 70% of its total issued share capital, and exercises control as per the definition of control, in accordance with IFRS 10 *Consolidated Financial Statements*. Crop Ltd holds 20% of the shares in Agrio Ltd and exercises significant influence over its financial and operating policy decisions.

TechNo Trust, of which the founders and beneficiaries, Mr Tshepang and Mr Lekgoi, are also the founding directors of Agrio Ltd, owns five percent of Agrio Ltd's shares. Mr Tshepang's and Mr Lekgoi's wives are part of the same book club. Years back, after a book club session while chatting, they realised their husbands were in the same industry and organised a double date. Little did the wives know that this date would be the beginning of a lucrative business partnership.

As part of their empowerment and mentoring strategy, Agrio Ltd selected Farmers-On-The-Go Ltd to be the beneficiary of its one-year mentorship programme. Farmers-On-The-Go Ltd is a start-up company owned by Ms Sarah Lekgoi, who is Mr Lekgoi's younger sister. Mr Lekgoi has been taking care of his younger sister since their parents were deceased and ensured that his sister gets the best tertiary education. Ms Sarah Lekgoi has recently started the company in the hope of easing the financial burden for her brother. Agrio Ltd will provide Farmers-On-The-Go Ltd with technical support tailor-made to their needs.

The directors took a decision during the current year to enter into a lease agreement with Newby Tractors Ltd, fully owned by Vet Ltd, to lease five agricultural tractors that will be utilised at Farmers-On-The-Go Ltd's premises. The lease will be for a period of 12 months, with lease payments payable monthly in advance and requiring one month's notice from both the lessee and lessor for termination.

CASE STUDY 5**REQUIRED**

YOU NOW HAVE 150 MINUTES TO COMPLETE THE CASE STUDY.

QUESTION 1

	Marks
Prepare the consolidated statement of changes in equity of the Nuts Ltd Group for the year ended 30 June 20.20. You only need to disclose the following columns:	44
<ul style="list-style-type: none"> Mark-to-market reserve Non-controlling interests 	
Communication skills: presentation and layout	1
Please note:	
<ul style="list-style-type: none"> Round off all amounts to the nearest rand. Show all calculations. Comparative figures are not required. Your answer must comply with International Financial Reporting Standards (IFRS). 	

QUESTION 2

	Marks
(a) Prepare the pro forma consolidation journal entries to account for the investment in Flavour Favourites Plc in the consolidated financial statements of the Haughty Pastas Ltd Group for the year ended 31 July 20.20.	15
Communication skills: presentation and layout	1
(b) Prepare the pro forma consolidation journal entries to account for the investment in ShoppersRite Ltd in the consolidated financial statements of the Haughty Pastas Ltd Group for the year ended 31 July 20.20.	9
Please note:	
<ul style="list-style-type: none"> You should use exchange rates provided in the information where applicable. Show all calculations. Journals relating to deferred taxation are required. Round off all amounts to the nearest rand. Your answer must comply with International Financial Reporting Standards (IFRS). 	

QUESTION 3

	Marks
PART I	
Draft a memorandum to the group financial accountant of RAF Industries Ltd, as requested by the audit manager, in which you discuss	
(i) whether RAF Industries Ltd controls Anaky Ltd as a result of acquiring the additional shares in Anaky Ltd at 30 September 20.20, and	14
(ii) the appropriate classification and measurement of Oliphants Ltd in RAF Industries Ltd's separate financial statements for the financial year ended 30 September 20.20	8
Communication skills: format and conclusion	1
PART II	
Discuss, with reasons, whether the companies and persons identified are related parties to Agrio Ltd for the year ended 30 September 20.20.	7
Please note:	
<ul style="list-style-type: none"> • You do not need to discuss any disclosures of transactions. • Your answer must comply with International Financial Reporting Standards (IFRS). 	

CASE STUDY 5**QUESTION 1 – Suggested solution****NUTS LTD GROUP****EXTRACT OF THE CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 20.20**

	Mark-to-market reserve R	Non- controlling interests R	
Balance as at 1 July 20.19 (a)	750 000	639 198	(8)
Changes in equity for 20.20			
Total comprehensive income for the year			
- Profit for the year (b)		602 982	(17)
- Other comprehensive income (c)	101 280	89 280	(4)
Transfer to retained earnings			
((15% x 150 000 x R40) – 675 000) x 78,4%)	(176 400)	-	(2)
Acquisition of subsidiary [C6]		2 261 785	(11)
Partial disposal of subsidiary [C5]		120 189	(4)
Dividends ((80 000 x 20%) + (150 000 x 45%) +10 000)		(93 500)	(2)
Balance as at 30 June 20.20	<u>674 880</u>	<u>3 619 934</u>	
		Total	<u>(48)</u>
		Maximum	<u>(44)</u>
		Communication skills: presentation and layout	<u>(1)</u>
 (a) Opening balance – Non-controlling interests			
Freshly - At acquisition [C1]		448 879	(4)
- Since acquisition [C1]		70 319	(3)
- Preference shares [C4]		120 000	(1)
		<u>639 198</u>	<u>(8)</u>
 (b) Current year – Non-controlling interests			
- TransTar Logistics [C8]		615 425	(11)
- Freshly [C3]		(22 443)	(5)
- Preference dividends [C4]		10 000	(1)
		<u>602 982</u>	<u>(17)</u>
 (c) Other comprehensive income – Non-controlling interests			
TransTar - Mark-to-market reserve			
- ((520 000 – 400 000) x 45%)		54 000	(1)
- Revaluation surplus – Land			
((100 000 x 78,4%) x 45%)		35 280	(1)
		<u>89 280</u>	<u>(2)</u>
 Other comprehensive income: Mark-to-market reserve			
- TransTar ((520 000 – 400 000) x 55%)		66 000	(1)
- Nuts ((15% x 150 000 x R2 (40 – 38)) x 78,4%)		35 280	(1)
		<u>101 280</u>	<u>(2)</u>

**COMMENT**

As disclosure in a statement was required good exam technique is to use the formats provided in the illustrative examples in IAS 1 and IAS 7 (statement of cash flows) as basis. It will ensure that you do not forget certain line items. Always start with the face of the statement first and as you complete calculations, to transfer the amounts to the face. This ensures that all calculations are used.

Only two columns (Mark-to-market reserve and non-controlling interests) were required. Do not waste time calculating or disclosing amounts not required. Did you notice that no comparative amounts were required? It illustrates the importance of reading AND understanding the required before starting with your answer.

CALCULATIONS**C1. Opening balance – Non-controlling interests****At acquisition**

Net asset value (given)	1 720 000	[1]
Revaluation of land ((1 050 000 – 500 000) x 78,4%)	431 200	[1]
Intangible assets (127 667 x 73%) [C2]	93 197	[1]
	<u>2 244 397</u>	

Non-controlling interests @ 20%	448 879	[1]
		<u>[4]</u>

Since acquisition

Retained earnings (1 876 500 – 1 520 000)	356 500	[1]
Intangible asset amortisation (6 720 [C2] x 73%)	(4 906)	[2]
	<u>351 594</u>	

Non-controlling interests @ 20%	70 319	
---------------------------------	--------	--

**COMMENT**

An easy way to calculate non-controlling interests' share to be included in the Statement of changes in equity is as follows: The consolidated statement of profit or loss and other comprehensive income includes 100% of the line-items of the subsidiary. The NCI's share in the profit and in the other comprehensive income for the period is attributed at the bottom of the statement. Therefore, to calculate NCI's share, first calculate 100% of the profits and other comprehensive income items and then secondly allocate NCI at their % shareholding to be included in the statement of changes in equity.

C2. Intangible asset

Carrying value 1 March 20.19 (given)	152 333
Fair value at 1 March 20.19	280 000
Fair value adjustment	<u>127 667</u>

Amortisation

1 March 20.19 – 30 June 20.19 (127 667 / (120 – 44) x 4)	6 720
1 July 20.19 – 30 June 20.20 (127 667 / 76 x 12)	20 160

C3. Loss for the period

30 June 20.20 (1 876 500 – 1 730 900)	(145 600)	[1]
Dividend paid	80 000	[1]
	<u>(65 600)</u>	
Unrealised profit inventories: 250 000 x 100/125 = 200 000 cost Write down to 230 000 – Nuts ∴ ((50 000 – 20 000 write down) = 30 000 x 73%)	(21 900)	[1]
	<u>(87 500)</u>	
Amortisation: Intangible asset (20 160 x 73%) [C2]	(14 717)	[1]
	<u>(102 217)</u>	
Cumulative preference dividend [C4]	(10 000)	[1]
	<u>(112 217)</u>	
Non-controlling interests @ 20%	(22 443)	<u>[5]</u>

**COMMENT**

The intragroup sale of the inventory has an unrealised profit on sale of R50 000. However, as the inventory balance of R250 000 was written down to its net realisable value of R230 000, the unrealised profit at year end is also reduced to R30 000. Remember the tax implications as items disclosed in the statement of changes in equity are after tax amounts.

C4. Analysis of cumulative preference owners' equity – Freshly

Preference shares	Total	At	Since	NCI
		Nuts (0%)		
Share capital	100 000			100 000
Goodwill	20 000			20 000
	120 000			120 000
Income attributable to preference shareholders (100 000 x 10%)	10 000			10 000
Dividends paid	(10 000)			(10 000)
	120 000			120 000

C5. Share transaction – Freshly

Non-controlling interests before transaction (448 879 [C1] + 70 319 [C1] – 22 443 [C3] – 16 000 (dividend))	480 755	
Change in non-controlling interests (480 755 x 5/20)	<u>120 189</u>	[4] [4]

**COMMENT**

If you still struggle with calculating the effects of change in degree of control transactions, please refer back to Example 1 and 2 in tutorial letter 104 for detailed explanations and guidance. You may also contact your lecturer at fac4864postgrad@unisa.ac.za for any specific questions or assistance.

C6. Acquisition of subsidiary - TransTar

Net asset value on 30 June 20.19 (given)	3 350 000	[1]
Movement in retained earnings up to 1 December 20.19 (given)	987 500	[1]
Contingent liability (50 000 x 73%) (after tax)	(36 500)	[1]
Indemnification asset (50 000 x 80% x 73%) (after tax)	29 200	[1]
Trailer: period adjusted (((48/42 x 150 000) – 360 000) x 73%) (after tax)	(137 657)	[2]
Right-of-use asset (1 190 125 [C7] x 73%) (after tax)	868 791	[2]
Lease liability (48 144 [C7] x 73%) (after tax)	(35 145)	[2]
	<u>5 026 189</u>	

Non-controlling interests @ 45%	<u>2 261 785</u>	[1]
		<u>[11]</u>

**COMMENT**

The trailer was sold on 31 May 20.20 for R150 000. Therefore, to calculate the fair value of the trailer at acquisition (1 December 20.19), the R150 000 will be grossed up to a value at acquisition five months earlier.

C7. Right-of-use asset and lease liability

	TransTar	Group	Difference
Right-of-use asset	1 682 761	2 872 886	1 190 125
Depreciation - (1 682 761/6 x 7/12)			
- (2 872 886/6 x 7/12)	163 602	279 308	115 706
Value 30 June 20.20	<u>1 519 159</u>	<u>2 593 578</u>	<u>1 074 419</u>
Lease liability (1 December 20.19)	2 161 769	2 209 913	48 144
Interest - (2 161 769 x 10,25% x 7/12)	129 256		
- (2 209 913 x 9,5% x 7/12)		122 466	(6 790)
Lease instalment (500 000 x 7/12)	(291 667)	(291 667)	-
	<u>1 999 358</u>	<u>2 040 712</u>	<u>41 354</u>

Lease liability – Group

HP10B11		SHARP EL-733A		SHARP EL-738	
2 nd FC	(Clear all)	2 nd FC	(Clear all)	2 nd FC	(Clear all)
PMNT	500 000	PMT	500 000	PMT	500 000
N	6	N	6	N	6
I	9,5%	I	9,5%	I	9,5%
FV	0	FV	0	FV	0
COMP PV	R2 209 913	COMP PV	R2 209 913	COMP PV	R2 209 913

Right-of-use asset – Group

HP10B11		SHARP EL-733A		SHARP EL-738	
2 nd FC	(Clear all)	2 nd FC	(Clear all)	2 nd FC	(Clear all)
PMT	650 000	PMT	650 000	PMT	650 000
N	6	N	6	N	6
I	9,5%	I	9,5%	I	9,5%
FV	0	FV	0	FV	0
COMP PV	R2 872 886	COMP PV	R2 872 886	COMP PV	R2 872 886

OR

HP10B11		SHARP EL-733A		SHARP EL-738	
2 nd FC	(Clear all)	2 nd FC	(Clear all)	2 nd FC	(Clear all)
PMT	(R650 000 – 500 000) – R150 000	PMT	(R650 000 – 500 000) – R150 000	PMT	(R650 000 – 500 000) – R150 000
N	6	N	6	N	6
I	9,5%	I	9,5%	I	9,5%
FV	0	FV	0	FV	0
COMP PV	R662 973 + R2 209 913 = R2 872 886	COMP PV	R662 973 + R2 209 913 = R2 872 886	COMP PV	R662 973 + R2 209 913 = R2 872 886

C8. Profit after tax – TransTar

Retained earnings 30 June 20.20	4 900 000	[1]
Dividends paid	150 000	[1]
Retained earnings 1 December 20.19	(3 637 500)	[1]
Contingent liability [C6]	36 500	[1]
Indemnification asset [C6]	(29 200)	[1]
Fair value adjustment on trailer reversed as sold [C6]	137 657	[1]
Profit on delivery vehicle (50 000 x 73%)	(36 500)	[1]
Depreciation on delivery vehicle ((50 000 x 25% x 6/12) x 73%)	4 563	[1]
Fair value adjustment on land ((1 020 000 – 920 000) x (1 - 80% x 27%))	(78 400)	[1]
Right-of-use asset depreciation (115 706 x 73%) [C7]	(84 465)	[1]
Finance cost (6 790 x 73%) [C7]	4 957	[1]
	<u>1 367 612</u>	
Non-controlling interests @ 45%	<u>615 425</u>	<u>[11]</u>

**COMMENT**

As the trailer was sold during the current financial period (on 31 May 20.20), the fair value adjustment at acquisition will have to be reversed.

C9. Analysis of owners' equity of Freshly (for completeness)

	Total	At	Since	NCI
		Nuts (80% - 75%)		(20 - 25%)
1 March 20.19				
Share capital	200 000			
Retained earnings	1 520 000			
Revaluation land ((1 050 000 – 500 000) x 78,4%)	431 200			
Intangible assets (127 667 x 73%) [C2]	93 197			
	2 244 397	1 795 518		448 879
Goodwill	54 482	54 482		
Consideration		1 850 000		
	351 594		281 275	70 319
Since acquisition				
Retained earnings (1 876 500 – 1 520 000)	356 500		285 200	71 300
Intangible asset amortisation (6 720 [C2] x 73%)	(4 906)		(3 925)	(981)
Current year				
Loss for the year [C3]	(102 217)		(81 774)	(20 443)
Income attributable to preference shareholders [C4]	(10 000)		(8 000)	(2 000)
Dividends paid	(80 000)		(64 000)	(16 000)
	2 458 256		127 501	480 755
Disposal of 5% (1 795 518 x 5/80); (127 502 x 5/80); (480 755 x 5/20)		(112 220)	(7 969)	120 189
	2 458 256		119 532	600 944

**COMMENT**

Any preference dividend payable will be deducted from the profit of the current operations when calculating the profit for the year attributable between the parent and NCI.

C10. Analysis of the owners' equity of TransTar Logistics Ltd (for completeness)

	Total	At	Since	NCI (45%)
		Nuts (15% - 55%)		
Share capital	300 000			
Retained earnings (2 650 000 + 987 500)	3 637 500			
Mark-to-market reserve	400 000			
Contingent liability (50 000 x 73%)	(36 500)			
Indemnification asset (50 000 x 80% x 73%)	29 200			
Trailer – period adjustment ((171 429 – 360 000) x 73%)	(137 657)			
Right-of-use asset ([C7] (1 190 125 x 73%)	868 791			
Lease liability [C7] (48 144 x 73%)	(35 145)			
	5 026 189	2 764 404		2 261 785
Goodwill	935 596	935 596		-
Consideration (2 800 000 + (150 000 x 15% x R40)		3 700 000		2 261 785
Current year				
Profit after tax [C8]	1 367 612		752 187	615 425
Mark-to-market reserve (520 000 – 400 000)	120 000		66 000	54 000
Revaluation – Land (100 000 x 78,4%)	78 400		43 120	35 280
Dividends paid	(150 000)		(82 500)	(67 500)
	7 377 797		778 807	2 898 990

[3]

**COMMENT**

The R100 000 revaluation comes from the scenario, where it is stated:

“On 27 December 20.19, TransTar purchased a warehouse for a cash consideration of R920 000 for investment purposes. This warehouse is rented by Nuts at a rental of R25 000 per month and is used as a storage facility for its dry goods. TransTar fairly valued this property at R1 020 000 on 30 June 20.20. TransTar elected the fair value model to measure investment property in terms of IAS 40 Investment Property.”

As the warehouse is rented to the parent, it is therefore owner occupied for the group and IAS 16 revaluation model will apply and not IAS 40 *Investment Property*.

QUESTION 2 – Suggested solution

- (a) Prepare the pro forma consolidation journal entries to account for the investment in Flavour Favourites Plc in the consolidated financial statements of the Haughty Pastas Ltd Group for the year ended 31 July 20.20

	Dr R	Cr R	
J1 Investment in associate (SFP) (balancing)	963 024		(1)
Dividend received (P/L) (\$6 200 x 30% x 15,20)	28 272		(1)
Share of profit of associate (P/L) (691 268 [C3] + 135 926 [C2])		827 194	(12)
Share of OCI of associate (OCI) ((51 800 x (1 – (85% x 40%) x 16) x 30%) or [C4])		164 102	(2)
<u>Recognition of foreign associate</u>			
J2 Investment in foreign associate (SFP) [C5]	148 084		(1)
Foreign currency translation reserve (OCI)		148 084	(2)
<u>Remeasure the investment in associate to closing rate</u>			
		Total	<u>(19)</u>
		Maximum	<u>(15)</u>
		Communication skills: presentation and layout	<u>(1)</u>

**COMMENT**

The definition of a foreign operation in IAS 21 includes an associate. The results of the foreign associate will be translated to the closing rate at year end. The difference in treatment between an associate and a subsidiary is that the associate's line items in the group financial statements are translated namely:

- Investment in associate (SFP)
- Dividend received (P/L)
- Share of profit of associate (P/L)
- Share of OCI of associate (OCI)

For a subsidiary, 100% of its trial balance needs to be added to the trial balance of the parent. Therefore, each foreign currency line-item is translated to rand.

- (b) Prepare the pro forma consolidation journal entries to account for the investment in ShoppersRite Ltd in the consolidated financial statements of the Haughty Pastas Ltd Group for the year ended 31 July 20.20

	Dr R	Cr R	
J3 Investment in SR (SFP) (balancing)	158 828		(1)
Retained Earnings (SCE) (100 840 [C6] + ((600 000 – 450 000) x 35%))		153 340	(4)
Share of OCI of associate (OCI) [C7]		5 488	(1)
<u>Recognition of excess and since reserves of associate</u>			

	Dr R	Cr R	
J4 Retained Earnings (SCE)	4 837		(1)
Share of profit of associate (P/L) (65 000 x 27/127 x 35%)		4 837	(1)
Elimination of unrealised profit in opening inventory of HP Ltd			
J5 Share of profit of associate (P/L) (4 837 x 27%)	1 306		(1)
Retained Earnings (SCE)		1 306	(1)
Tax on unrealised profit in opening inventory of HP Ltd			
		Total	<u>(10)</u>
		Maximum	<u>(9)</u>

CALCULATIONS

C1. Cash consideration: investment in FF Plc

	Amount US\$	Exchange rate US\$1 = R	Translated R
Cash paid	20 000		280 000
Advisory fees (IAS 28.10)	1 500		21 000
Contingent consideration	9 500		133 000
Deferred consideration (FV = US\$4 065; i = 5%; n = 3)	3 511		49 154
	<u>34 511</u>	14,00	<u>483 154</u>

[3]



COMMENT

In accordance with IAS 28, acquisition related costs are capitalised against the cost price of an associate. Do you know that the treatment is different to a subsidiary per IFRS 3?

C2. Net asset value of associate on 1 March 20.20

	Amount US\$	Exchange rate US\$1 = R	Translated R
Share capital	26 400		
Retained Earnings	100 000		
Equipment	45 000		
Debtors	(10 000)		
Deferred tax (equipment & debtors) ((45 000 – 10 000) x 40%)	(14 000)		
	<u>147 400</u>		
Net asset value of associate @ 30%	44 220	14,00	619 080

Consideration paid [C1]	34 511		483 154
Excess	9 709		135 926

[3]

C3. Profit for the year of FF Plc

	Amount US\$	Exchange rate US\$1 = R	Translated R	
Profit for the year				
Profit given (250 800 – 100 000)	150 800			[1]
Depreciation on equipment (45 000/5 x 5/12)	(3 750)			[1]
Tax on depreciation (3 750 x 40%)	1 500			[1]
Dividends (add back to retained earnings)	6 200			[1]
Net Legal expense	2 000			[1]
Payment of claim	(10 000)			
Provision already recognised	12 000			
	<u>156 750</u>			
Share of profit of associate (156 750 x 30%)	<u>47 025</u>	14,70	691 268	<u>[1]</u> <u>[6]</u>

C4. Other comprehensive income of FF Plc

	Amount US\$	Exchange rate US\$1 = R	Translated R	
Financial asset fair value remeasured	51 800			
Deferred tax (51 800 x 40% x 85%)	<u>(17 612)</u>			
	<u>34 188</u>			
Associate share of OCI at 31 July 20.20 (34 188 x 30%)	<u>10 256</u>	16,00	164 096	<u>—</u> <u>[2]</u>

C5. Associate share in FCTR

	Amount US \$	Exchange Rate US\$1 = R	Translated R	
Investment in associate at cost [C1, C2]	44 220	14,00	619 080	
Share of profit of associate [C3]	47 025	14,70	691 268	
Share of OCI of associate [C4]	10 256	16,00	164 096	
Dividends paid [J1] (\$6 200 x 30%)	<u>(1 860)</u>	15,20	<u>(28 272)</u>	
	99 641		<u>1 446 172</u>	[1]
Investment in associate restated at year end		16,00	<u>1 594 256</u>	[1]
FCTR of associate (1 594 256 – 1 446 172)			<u>148 084</u>	<u>[2]</u>

**COMMENT**

Goodwill is NOT remeasured separately to the closing rate at year end (as would be the case if this was a subsidiary). Goodwill is included in the initial cost price of the associate. Where there is an excess at acquisition, as in this scenario (refer to [C2]), the excess will result in the investment in associate amount increasing. When translating the carrying amount of the associate at year end (R99 641), this amount will also include the excess, which therefore do not need to be separately translated.

C6. Excess on acquisition of SR Ltd

Net asset value		
Share capital (given)	350 000	
Retained earnings (given)	450 000	
Land (250 000 x 78,4%)	196 000	
Deferred tax error [C8]	6 400	
	<u>1 002 400</u>	[2]
HP's share (1 002 400 x 35%)	350 840	
Consideration (Land at fair value)	<u>(250 000)</u>	
Excess	<u>100 840</u>	[1] [3]

**COMMENT**

IAS 28.28 is not applicable to the land transferred to the associate. It was stated in the scenario that the land is a business as defined per IFRS 3.

C7. Share of OCI of SR

SR's land revalued in the current year (given)	20 000	
Tax effect (20 000 x 80% x 27%)	<u>(4 320)</u>	
	15 680	
Portion attributable to HP at 35% interest	<u>5 488</u>	[1]

C8. Correction of error

Incorrect deferred tax added back to net asset value	28 000	
Correct deferred tax accounted for at CGT rate (100 000 x 80% x 27%)	<u>(21 600)</u>	
	6 400	
Portion attributable to HP at 35% interest	<u>2 240</u>	

QUESTION 3 - Suggested solution**PART I**

- (a) Draft a memorandum to the group financial accountant of RAF Industries Ltd, as requested by the audit manager, in which you discuss the following:**

MEMORANDUM

To: The Group Financial Accountant
From: CTA Level 2 Student
Date: October 20.20
Subject: Investments in other entities

To the Group Financial Accountant

Following your request for clarity in terms of the conclusions reached by the audit team on the investment in Anaky Ltd and investment in Oliphants Ltd, please refer below the considerations that were taken into account.

- (a) (i) Whether RAF Industries Ltd controls Anaky Ltd as a consequence of acquiring the additional share in Anaky Ltd as at 30 September 20.20**

RAF shall determine whether it is a parent by assessing whether it controls Anaky Ltd (IFRS 10.5).

RAF will control Anaky Ltd when it is exposed, or has rights, to variable returns from its involvement with Anaky Ltd and has the ability to affect those returns through its power over Anaky Ltd (IFRS 10.6).

RAF will have power over Anaky Ltd when it has existing rights that give it the current ability to direct the relevant activities (IFRS 10.10).

The relevant activities of Anaky Ltd are the operational and financial activities of the company. Changes through the operational and financial policies will affect Anaky Ltd's returns. It is evident that the board of directors determine and make the operating and financial decisions and, in turn, they direct the relevant activities of Anaky Ltd. (1)

The directors are appointed by the shareholders by a simple majority vote at the annual general meeting and a majority shareholder (>50%) would implicitly gain control over the relevant activities and, therefore, have power over Anaky Ltd. (1)

The memorandum of incorporation does not alter the minimum number of voting rights acquired to pass ordinary resolutions. Therefore, a simple majority of voting rights is required to pass ordinary resolutions. (1)

Power arises from rights (IFRS 10.11).

RAF can have power even if it holds less than a majority of the voting rights of Anaky Ltd, and in this case, RAF holds 48% (1 560 000/3 250 000) (IFRS 10. B38). (1)

Since RAF has less than a majority of the voting rights, it should be determined whether RAF has rights that are sufficient to give it power to have the practical ability to direct the relevant activities of Anaky Ltd unilaterally (IFRS 10. B41) and the following information should be considered in this assessment:

- RAF holds 48% (1 560 000/3 250 000) of Anaky Ltd's voting rights. This is a significant shareholding in relation to the other shareholders who are widely dispersed (IFRS 10. B42(a)(i) – (ii)). (1)
- Even with 11% shareholding, Stellen Ltd will need to act together with a substantial number of other shareholders to outvote RAF, as all the other shareholders hold less than 1% each of the issued shares of RAF (IFRS 10. B42(a)(iii)). (1)
- Voting patterns at previous annual general meetings, as well as attendance thereof, indicate that RAF has significantly more voting rights than any other vote holder and during the last five years 91,4% (average of 92%, 93%, 88%, 94% and 90%) of votes have been represented on average (IFRS 10. B42(d)). (1)
- Due to the fact that approximately 10% of shareholders' votes are not presented at shareholders meetings, fewer than 50% of the total votes would be required to achieve a majority. (1)
- Therefore, 45,7% (91,4% / 2) plus one vote of voting rights is generally required to achieve a majority vote. (1)
- Prior to the purchase of additional shares, RAF held 40% of Anaky's voting rights (1 300 000/3 250 000) and this would not have been enough to achieve a majority vote (40%/91,4% = 43,7%) OR (1 350 000/(3 250 000 x 91,4%)). (1)
- After the acquisition of additional shares, RAF crossed the majority threshold of 45,7% plus one vote (48%/91,4% = 52,5%) OR (1 560 000/(3 250 000 x 91,4%)). (1)
- Even though special resolutions require approval from at least 75% of voting rights represented, these are more protective in nature, since the special resolutions as outlined in the Companies Act (71 of 2018) are designed to protect the shareholder rather than give the shareholder power. (1)

In conclusion, by acquiring the additional shares during the year under review, it would, therefore, appear that RAF has power over Anaky Ltd through its voting rights that are due to 48% shareholding in Anaky Ltd and, therefore, is able to influence decisions which affect the returns of Anaky Ltd. (1)

RAF is exposed to variable returns of Anaky Ltd in the form of profits or dividends that will be received due its shareholding. (1)

RAF, therefore, has control over Anaky Ltd as a result of acquiring the additional shares, as at 30 September 20.20.

	<u>(1)</u>
Total	<u>(15)</u>
Maximum	<u>(14)</u>

(a) (ii) The appropriate classification and measurement of Oliphants Ltd in RAF Industries Ltd's separate financial statements for the financial year ended 30 September 20.20

A joint arrangement will be an arrangement in which RAF and Lever Ltd have joint control of Oliphant Ltd (IFRS 11.4). (1)

Joint control is the contractual sharing of control of an arrangement, which exists only when decisions regarding the relevant activities require unanimous consent of the parties sharing control (IFRS 11.7).

RAF and Lever Ltd entered into a strategic contractual agreement at the incorporation of Oliphants Ltd to produce a skin care range. (1)

The relevant activities of Oliphants Ltd are those related to the production of the skin care range, as these determines the returns. (1)

Appointment of management and decisions regarding the supplies to be utilised require the approval by shareholders holding at least 51% of its shares and voting rights are awarded in proportion to ownership of share. (1)

Both RAF and Lever Ltd hold 50% of the issued share capital of Oliphants Ltd (750 000/1 500 000). Unanimous consent is required to make decisions about relevant activities of Oliphants Ltd. (1)

Therefore, RAF and Lever Ltd have joint control over Oliphants Ltd and the arrangement is a joint arrangement. (1)

RAF shall determine the type of joint arrangement in which it is involved.

The rights and obligations of both parties to the joint arrangement must be assessed to determine the classification of the arrangement as either a joint operation or joint venture (IFRS 11.14).

Oliphants Ltd is structured through a separate legal entity and may represent either a joint operation or a joint venture (IFRS 11. B19). (1)

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets and obligations for the liabilities relating to the arrangement (IFRS 11.15).

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement (IFRS 11.16).

Whether Oliphant Ltd is a joint venture or joint operation will depend on RAF and Lever Ltd's rights to the assets and obligation for the liabilities relating to the arrangement that are held in the separate vehicle (IFRS 11.B20). (1)

RAF and Lever Ltd will need to assess whether the legal form of the separate vehicle, in terms of the contractual arrangement and, where relevant, any other facts and circumstances, give them rights to the assets and obligations for the liabilities of the arrangement (joint operation) or rights to the net assets of the arrangement (joint venture) (IFRS 11.B20). (1)

Oliphant Ltd is a separate entity formed, in accordance with the South African Companies Act 71 of 2008. (1)

The following details as outlined in the strategic agreement will be considered:

- Oliphants Ltd will sell the skin care range products to RAF and Lever Ltd on a 50:50 ratio at a determined price that will cover the expenses incurred during production. (1)
- This is an indication that RAF and Lever Ltd have rights to substantially all the economic benefits of the assets of Oliphants Ltd and are in substance responsible for the settlement of its liabilities. These expenses include all direct costs associated with producing the skin care range, as well as administrative expenses of Oliphants Ltd. (1)
- Furthermore, Oliphants Ltd may not sell any of the skin care range products to third parties, which implies that the cashflows from RAF and Lever Ltd will be sufficient for the obligations of Oliphants Ltd. (1)

In conclusion, RAF and Lever Ltd have rights to the assets and obligations for the liabilities of Oliphants Ltd. The investment in Oliphants Ltd, therefore, meets the definition of a joint operation. (1)

RAF should recognise 50% of the assets, liabilities, revenue and expenses of Oliphants Ltd, which it has held, earned and incurred jointly with Lever Ltd in its separate financial statements for the year ended 30 September 20.20. (1)

Kind regards,
Student

	Total	<u>(15)</u>
	Maximum	<u>(8)</u>
Communication skills: format and conclusion		<u>(1)</u>

PART II

Discuss, with reasons, whether the parties and persons identified are related parties to Agrio Ltd for the year ended 30 September 20.20

Vet Ltd is related to Agrio Ltd, as Vet Ltd is a parent company and, therefore, both are members of the same group (IAS 24.9 (b)(i)). (1)

Agrio Ltd is an associate of Crop Ltd, as Crop Ltd has significant influence. Therefore, the two are related parties (IAS 24.9 (b)(ii)). (1)

Both Mr Tshepang and Mr Lekgoi, as directors of Agrio Ltd, are related parties to Agrio Ltd, as they are members of key management (IAS 24.9 (a)(iii)). (1)

TechNo Trust is a related party to Agrio Ltd, as it is controlled by the directors of Agrio Ltd who are members of key management (IAS 24.9 (b)(vi)). (1)

Ms Sarah Lekgoi, who is a younger sister to one of the directors, Mr Lekgoi, is also a related party, as she is a dependant of Mr Lekgoi (IAS24.9 (a)(iii)) and as per definition a close member of the family. (1)

Farmers-On-The-Go Ltd is not a related party to Agrio Ltd, as it is owned by Ms Lekgoi who is a close member of the family of Mr Lekgoi. Although Mr Lekgoi is a member of the key management of Agrio Ltd (IAS24.9 (b)(vi)), he does not control or jointly control Agrio Ltd. (1)

Newby Tractors Ltd is a related party to Agrio Ltd, as it is owned by Vet Ltd (parent to Agrio Ltd) and is, therefore, part of the same group (IAS 24.9 (b)(i)). (1)

The wives of both Mr Tshepang and Mr Lekgoi are also related parties, as they are close family members of key management (IAS24.9 (a)(iii)). (1)

Total (8)
Maximum (7)



COMMENT

Knowledge of the applicable accounting standards is essential to answer a discussion question. Numerous accounting standards also include illustrative examples, such as IAS 24. Even though the scenario in a question might not be exactly similar to a specific illustrative example, it could provide a good base from which to attempt the question. In addition, if the logic and reasoning behind the accounting treatment in an illustrative example is understood, it is a good reference that you have a sound knowledge of the accounting standard.

CASE STUDY 6**100 marks****YOU HAVE 30 MINUTES' READING TIME. SPEND 30 MINUTES READING THE CASE STUDY BEFORE YOU CONTINUE TO THE REQUIRED SECTION.****QUESTION 1****40 marks**

This question consists of two independent parts.

PART I**26 marks**

Lockdown Health Ltd ("Lockdown Ltd") is a multinational company that manufactures various types of medical equipment and distributes drugs and other medical supplies to hospitals and pharmacies. Lockdown Ltd is listed on the Johannesburg Stock Exchange and has a 31 August year end.

Sanitize Ltd

On 1 September 20.19 Lockdown Ltd entered into a contract with Sanitize Ltd for the sale of virus testing equipment. The relevant equipment can process multiple tests at the same time to detect the presence of the COVID-19 virus.

The testing equipment requires specific testing software to function. The contract, therefore, includes the sale of software, testing equipment, installation of the testing equipment and the training of the users of the testing equipment.

The testing equipment also comes with a 12-month warranty from the date of installation. The warranty provides the customer assurance that the testing equipment complies with agreed-upon specifications and that it will operate as promised for a period of 12 months. Customers do not have the option to purchase the warranty separately. The warranty, or any part of the warranty, does not provide Sanitize Ltd with a service other than the assurance that the testing equipment complies with agreed specifications.

The testing equipment sold by Lockdown Ltd does not fulfil the requirements of Sanitize Ltd and must be substantially customised during the installation process to meet the specifications of Sanitize Ltd. The installation was completed on 15 October 20.19 and the equipment was ready for use by Sanitize Ltd on that date.

Once the installation was completed, Sanitize Ltd staff were trained to use the testing equipment. The customised installation and training can be provided by other entities as well.

Lockdown Ltd regularly sells the testing software, the testing equipment and training of the users individually, thereby establishing the following fair values:

The fair values of the various items	1 September 20.19	1 October 20.19
	R	R
Testing software	109 950	108 115
Testing equipment	699 300	685 145
Training of users on the testing equipment	92 000	92 000

Lockdown Ltd also regularly sells the testing equipment and the training services as a packaged deal for R781 050.

The contract price amounted to R891 000 and was settled by Sanitize Ltd on 15 October 20.19. Lockdown Ltd's financial accountant, Mr Rebellion, prepared the following journal entry to account for this contract:

	Dr R	Cr R
J1 Bank (SFP)	891 000	
Revenue (P/L)		891 000
Recognition of revenue contract		

StayHome Ltd

On 1 July 20.20 StayHome Ltd, one of Lockdown Ltd's loyal customers over the years, placed an order for 500 boxes of surgical masks. The surgical masks are sold per box of 100 masks. The masks are sold by Lockdown Ltd at a price of R545 per box. On 1 July 20.20 a refundable upfront deposit of R80 000 was paid by StayHome Ltd to Lockdown Ltd to secure the order. The outstanding amount will be settled by StayHome Ltd over 18 months from the delivery date at R12 300 per month in arrears. The first payment was made on 31 August 20.20.

Lockdown Ltd assessed and confirmed that this order contained a significant financing component in respect of the outstanding amount. The transaction price, however, did not contain any variable consideration. On 1 August 20.20 all 500 boxes were delivered to StayHome Ltd.

You may assume that the correct pre-tax market interest rate is 9,75%.

PART II

14 marks

Telecon Ltd is a telecommunications company which operates in the wireless telecommunications sector and is present in both developed and developing economies over four continents. Telecon Ltd provides over 12 million local and international customers with mobile devices, voice, messaging and data services. Telecon Ltd is listed on the Johannesburg Stock Exchange and has a 31 August year end.

During the 20.20 financial year Telecon Ltd entered into a contract with the South African National Defence Force (SANDF) to supply 5 000 smart phones for a total transaction price of R32 250 000. The agreement stipulated that this order would be fulfilled over three months due to a shortage of stock. The first 2 500 smart phones were delivered on 30 June 20.20 and the next delivery is expected to take place on 1 September 20.20. Payment will only be received after the contract has been completed.

The smart phone comes with a standard 30-day phone replacement guarantee that the phone will work as intended. Included in the contract with the SANDF is also a 24-month extended warranty provided by Telecon Ltd. The extended warranty covers all repairs except screen repairs.

The smart phones are purchased by Telecon Ltd from the manufacturer for R4 100 per smart phone. The cost incurred by Telecon Ltd to provide the 24-month extended warranty amounts to R250 per smartphone.

Telecon Ltd regularly sells a smart phone and a 24-month extended warranty separately to customers for R6 000 and R450, respectively.

The contract stipulates that the SANDF will qualify for a volume discount of 5% on the total contract price.

Historic data indicates that 2% of all smart phones purchased will be replaced under the 30-day guarantee and 4% of smart phones will be repaired under the extended warranty. No returns were logged for the period ending 31 August 20.20.

QUESTION 2**60 marks**

Amarok Raceway Ltd is a company that is listed on the Johannesburg Stock Exchange. Amarok Raceway Ltd and its respective subsidiaries are engaged in motorcar speed races across the country. The Amarok Raceway Ltd Group includes several local subsidiaries as well as investments in associates. The group has a 30 June year end.

1. Extract of the consolidated statement of financial position

The following extract of the consolidated statement of the financial position of the Amarok Raceway Ltd Group as at 30 June 20.20 was presented to you:

	20.20	20.19
	R	R
Investment in associates	8 857 191	5 554 444
Investment in equity instruments	8 622 044	6 655 885
Inventories	12 157 785	11 558 886
Retained earnings	(60 230 981)	(52 553 932)
Non-controlling interests	(3 308 943)	(3 796 717)
Deferred tax	(8 264 530)	(7 844 501)
Trade and other payables	(3 886 885)	(2 658 805)
Shareholders for dividends	(550 000)	(889 778)
Current tax payable	(3 758 776)	(4 478 565)

2. Extract of the consolidated statement of profit or loss and other comprehensive income

The following extract of the consolidated statement of profit or loss and other comprehensive income of the Amarok Raceway Ltd Group for the year ended 30 June 20.20 was presented to you:

	20.20
	Dr/(Cr)
	R
Cost of sales	21 358 866
Other expenses	23 599 880
Share of profit of associates	(124 329)
Income tax expense	3 327 215
Revaluation surplus	(142 500)
Mark-to-market reserve	(301 805)
Share of other comprehensive income of associates	(18 375)
Profit attributable to owners of the parent	(7 583 449)
Profit attributable to non-controlling interests	(972 248)
Total comprehensive income attributable to owners of the parent	(8 031 229)
Total comprehensive income attributable to non-controlling interests	(987 148)

3. Navarra Ltd

Amarok Raceway Ltd acquired a 10% interest for R350 000 in Navarra Ltd on 31 May 20.15. Navarra Ltd is an events company that assists with the organising of races.

Amarok Raceway Ltd acquired a further 50% interest in Navarra Ltd on 1 August 20.19 for a consideration of R2 million. The consideration consisted of undeveloped land that was leased to an unrelated third party. From 1 August 20.19 Amarok Raceway Ltd had control over Navarra Ltd as per the definition of control in terms of IFRS 10 *Consolidates Financial Statements*. The fair value of the existing 10% interest amounted to R628 000 on this date, and the net asset value amounted to R4 244 845 (before any IFRS 3 *Business Combinations* items were taken into account). Amarok Raceway Ltd has elected to measure the non-controlling interests for the acquisition of Navarra Ltd at proportionate interest in the identifiable net assets at acquisition date.

All the assets and liabilities of Navarra Ltd were regarded to be fairly valued on 1 August 20.19, except for the following:

- In 20.18 one of the contestants crashed during the race. The contestant instituted a legal claim for R2,2 million against Navarra Ltd for medical expenses, as well as for pain and suffering. Navarra Ltd's legal advisors concluded on 30 June 20.19 that Navarra Ltd has a present obligation due to negligence; however, it is unlikely that the contestant will proceed with legal action against Navarra Ltd. For this reason, the financial manager of Navarra Ltd did not raise a provision, but only disclosed the claim as a contingent liability in the 20.19 financial statements. On 1 August 20.19 the fair value of the claim was estimated by an independent actuary at R900 000.

The purchase agreement between Amarok Raceway Ltd and the previous shareholders stipulates that the previous shareholders agree to reimburse Navarra Ltd for 65% of the damages, should the legal claim against Navarra Ltd be successful.

Both the contingent liability and indemnification asset were included in the consolidated statements for the 20.20 year in trade and other payables, and trade and other receivables, respectively. The claim will be deductible for taxation purposes should it succeed. The fair value of the claim remained unchanged at year end.

- Navarra Ltd also sells merchandise (goods such as caps, t-shirts and water bottles) at races. Due to a nationwide lockdown because of the Covid-19 virus, Navarra Ltd had a contractual order backlog for 35 boxes of merchandise on 1 August 20.19. A box of merchandise is sold at R25 000 per box at a profit mark-up of 50% on sales. The order backlog was completed and distributed by the end of June 20.20. The price for a box of merchandise remained unchanged at R25 000 per box for the duration of the current financial year.
- The entire inventory balance of Navarra Ltd (carrying amount of R723 840) was considered to have a net realisable value of R700 540 (determined in accordance with IAS 2) and a fair value of R838 600 on 1 August 20.19. The inventory was still on hand at year end.

4. Raptor Ltd

On 1 December 20.17 Amarok Raceway Ltd acquired an 80% controlling interest in Raptor Ltd for R10 000 000 cash. Raptor Ltd specialises in the manufacturing of spare parts for speed cars. On that date the issued share capital of Raptor Ltd amounted to R1 550 000 (100 000 ordinary shares).

All the assets and liabilities of Raptor Ltd were deemed to be fairly valued on the acquisition date, except for the following:

- Raptor Ltd owns a plant with a carrying amount of R1 698 535. At acquisition date this plant had a remaining useful life of four years and a negligent residual value. Raptor Ltd leases this plant as an operating lease to an unrelated third party. At acquisition date the remaining lease term was 36 months. The lease instalments, payable annually in arrears, are R325 000. The market pays less for similar leases and the fair value of this off-market component is R250 000. The fair value of the plant, without considering the off-market component of the operating lease, was estimated at R2 059 535 on 1 December 20.17.
- Raptor Ltd has incurred research and development costs during 20.18 and 20.19. The financial manager of Raptor Ltd expects an annual cost saving of R675 000 per annum from 1 December 20.17 to 30 November 20.21 as a result of the research. Raptor Ltd did not recognise an intangible asset in terms of IAS 38 *Intangible Assets*. The South African Revenue Service does not allow the research and development costs as a deduction for taxation purposes.
- Raptor Ltd has an internally generated client list. This client list is contingent on a privacy agreement and cannot be sold to third parties. The client list had a fair value of R250 000 on 1 December 20.17.

No additional assets, liabilities or contingent liabilities were identified on that date.

An appropriate pre-tax discount rate applicable to Amarok Raceway Ltd in respect of the Raptor Ltd purchase consideration is 10% per annum.

Amarok Raceway Ltd elected to measure non-controlling interests for the acquisition of Raptor Ltd at fair value at the acquisition date. The fair value of the non-controlling interests at acquisition date amounted to R2 200 000.

On 1 February 20.20 Amarok Raceway Ltd sold 55 000 of their Raptor Ltd shares to non-controlling interests for R11 000 000. The consideration consisted of land, inventory and shares in equity instruments at a fair value of R4 295 000, R3 424 000 and R3 281 000, respectively.

From that date, Amarok Raceway Ltd exercises significant influence over the financial and operating decisions of Raptor Ltd.

The disposal of the interest in Raptor Ltd did not comply with the criteria of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* until the date of disposal.

The equity of Raptor Ltd was as follows on the respective dates:

Date	Retained earnings R	Mark-to-market reserve R	Revaluation surplus R
1 December 20.17	5 599 875	658 000	558 660
1 February 20.20	11 728 329	950 000	801 500

On 1 February 20.20 the carrying amount of the non-controlling interests amounted to R3 025 885 and the remaining interest held by Amarok Raceway Ltd had a fair value of R3 125 000.

The value of the assets and liabilities according to the trail balance of Raptor Ltd as at 1 February 20.20 was as follows:

	Dr/(Cr) R
Property, plant and equipment	5 468 501
Land	4 652 696
Investments in equity instruments	2 368 840
Trade receivables	2 254 875
Inventories	1 987 500
Cash and cash equivalents	1 455 877
Deferred tax	(759 802)
Trade payables	<u>(2 398 658)</u>
	<u><u>15 029 829</u></u>

All the assets and liabilities of Raptor Ltd were fairly valued on 1 February 20.20.

5. Hillux Ltd

After a strategic meeting held in August 20.18, the directors of Amarok Raceway Ltd decided to expand its business further by investing in manufacturers of speed cars. A suitable company was subsequently found and on 1 October 20.18 Amarok Raceway Ltd purchased a 75% interest (150 000 ordinary shares) in Hillux Ltd, for a consideration of R2 075 000. Amarok Raceway Ltd had control over Hillux Ltd as per IFRS 10 *Consolidated Financial Statements* from 1 October 20.18.

The assets and liabilities of Hillux Ltd were considered to be fairly valued at that date and no additional assets, liabilities or contingent liabilities were identified. Amarok Raceway Ltd elected to measure the non-controlling interests for the acquisition of Hillux Ltd at fair value at the acquisition date. The fair value of the non-controlling interests was R691 667 on 1 October 20.18. Total goodwill of R57 762 (parent R43 321 and non-controlling interests R14 441) arose on the acquisition date.

On 31 May 20.20 Amarok Raceway Ltd disposed of 3 000 ordinary shares for a cash consideration of R78 138 to the non-controlling interests. Amarok Raceway Ltd still had control over Hillux Ltd after the transaction on 31 May 20.20.

The following balances were presented in the statement of changes in equity of Hillux Ltd on the respective dates:

	1 October 20.18	30 June 20.19	31 May 20.20*	30 June 20.20
	R	R	R	R
Share capital	150 000	150 000	150 000	150 000
Retained earnings	2 558 905	3 287 540	4 043 891	4 314 389
	<u>2 708 905</u>	<u>3 437 540</u>	<u>4 193 891</u>	<u>4 464 389</u>

6. Additional information

- It is the accounting policy of Amarok Raceway Ltd to measure investments in subsidiaries and associates at cost in the separate financial statements, in accordance with IAS 27.10(a).
- It is the accounting policy of Amarok Raceway Ltd to account for investments in equity instruments, other than investments in subsidiaries and associates, in accordance with IFRS 9 *Financial Instruments*. Amarok Raceway Ltd irrevocably elected to present any subsequent changes in the fair value of the investments in equity instruments in other comprehensive income in a mark-to-market reserve.
- Amarok Raceway Ltd elected to transfer any cumulative gains or losses within equity in terms of IFRS 9.B5.7.1.
- Amarok Raceway Ltd recognises any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received (attributable to the owners of the parent in an equity transaction) directly in a change in ownership reserve in equity.
- Other income, as presented in the consolidated statement of profit or loss and other comprehensive income, consists only of three items: a cash dividend of R565 805 that Amarok Raceway Ltd received from an investment in equity instruments, the fair value adjustments on the investment properties, and the group's profit on the disposal of Raptor Ltd.
- Amarok Raceway Ltd and Navarra Ltd declared dividends on 30 June 20.20.
- No other investments in associates were acquired or sold during the current financial year, unless otherwise stated in the information provided.
- Owner-occupied land is accounted for on the revaluation model, and all other property, plant and equipment items on the cost model, in accordance with IAS 16.
- Investment properties are accounted for using the fair value model, in accordance with IAS 40.
- The revaluation surplus relates to land of Raptor Ltd and Amarok Raceway Ltd, respectively, that was revalued during the current financial year.

- The group reclassifies items recognised in other comprehensive income to retained earnings on disposal of the affected assets when permitted to do so.
- Included in other expenses in the consolidated statement of profit or loss and other comprehensive income for the year ended 30 June 20.20 is depreciation amounting to R598 236.
- Assume a normal income tax rate of 27% and a Capital Gains Tax inclusion rate of 80%. Ignore the effect of Value Added Tax (VAT) and Dividend Tax.

CASE STUDY 6**REQUIRED**

YOU NOW HAVE 150 MINUTES TO COMPLETE THE CASE STUDY.

QUESTION 1

	Marks
PART I	
<p>(a) Discuss in detail, with reference to the principles of IFRS 15 <i>Revenue from Contracts with Customers</i>, whether Lockdown Health Ltd should recognise the following elements of the revenue contract with Sanitize Ltd as separate performance obligations:</p> <ul style="list-style-type: none"> • the testing equipment • the installation of testing equipment, and • the 12-month warranty. 	7
<p>(b) Assume for this section of the question that there are three separate performance obligations, namely the testing software, testing equipment and training services in the revenue contract with Sanitize Ltd.</p> <p>Criticise the journal entry that was processed with regards to the allocation of the transaction price for revenue recognition to the separate performance obligations listed above, for the year ended 31 August 20.20. Support your answer with calculations and amounts.</p> <p style="text-align: right;">Communication skills: logical flow and conclusion</p>	9
<p>(c) Prepare the journal entries to be processed by Lockdown Health Ltd to account for the transaction with StayHome Ltd for the year ended 31 August 20.20.</p>	9
PART II	
<p>Prepare the journal entries in the financial statements of Telecon Ltd to account for all the journal entries arising from the contract with the South African National Defence Force for the year ended 31 August 20.20.</p> <p>Please note:</p> <ul style="list-style-type: none"> • Round off all amounts to the nearest rand. • Journal narrations are not required. • Deferred tax journal entries are not required. • Ignore any Value Added Tax (VAT) implications. • Your answer must comply with International Financial Reporting Standards (IFRS). 	14

QUESTION 2

	Marks
<p>(a) Prepare the “Disposal of subsidiary note” to the consolidated financial statements of the Amarok Raceway Ltd Group to disclose information that would enable the users to evaluate the consequences of losing control of Raptor Ltd for the year ended 30 June 20.20. Include all items related to the loss of control in this note, except disclosure required by IAS 7 <i>Statement of Cash Flows</i>.</p> <p style="text-align: right;">Communication skills: presentation and layout</p>	11 1
<p>(b) Calculate the amounts of the following line items to be presented in the consolidated statement of cash flows of the Amarok Raceway Ltd Group for the year ended 30 June 20.20:</p> <ol style="list-style-type: none"> 1. Cash paid to suppliers and employees 2. Dividends paid 3. Dividends received 4. Income taxes paid/refunded 5. Acquisition/proceeds of/from investments in equity instruments 	40
<p>(c) Prepare the note to the consolidated statement of cash flows of the Amarok Raceway Ltd Group for the year ended 30 June 20.20, relating to the business combination on 1 August 20.19.</p> <p>End the note clearly with the amount that would be shown on the face of the statement of cash flows relating to the business combination.</p> <p style="text-align: right;">Communication skills: presentation and layout</p>	7 1
<p>Please note:</p> <ul style="list-style-type: none"> • Comparative figures are not required. • Round off all amounts to the nearest rand. • Your answer must comply with International Financial Reporting Standards (IFRS). 	

CASE STUDY 6**QUESTION 1 – Suggested solution****PART I**

(a) **Discuss in detail, with reference to the principles of IFRS 15 Revenue from Contracts with Customers, whether Lockdown Health Ltd should recognise the following elements of the revenue contract with Sanitize Ltd as separate performance obligations:**

- **the testing equipment**
- **the installation of testing equipment, and**
- **the 12-month warranty**

At contract inception, Lockdown Ltd must assess the goods and services promised in a customer contract and identify a separate performance obligation for each promise to transfer a good or service (or a bundle of goods or services) that is distinct.

Goods and services promised are distinct if both of the following criteria are met:

- (a) The customer can benefit from the good or services either on their own or together with other resources that are readily available to the customer.
- (b) The entity's promise to transfer the good or services to the customer is separately identifiable from other promises in the contract.

Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:

- (a) The entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted.
- (b) One or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.
- (c) The goods or services are highly interdependent or highly interrelated.

Testing equipment and installation thereof

The testing equipment is capable of being distinct, because Sanitize Ltd can benefit from the use of the testing equipment on its own, as it can be sold for an amount that is greater than scrap value in its unmodified form or otherwise held in a way that generates economic benefits, i.e., Lockdown Ltd regularly sells testing equipment. (2)

The testing equipment is, however, not separately identifiable because:

The testing equipment is customised and consequently significantly modified during installation to suit customer needs, which would otherwise not be achieved. (1)

Therefore, the equipment and related installation service are integrated into a combined output. (1)

Two of the three criteria in paragraph 29 are met; therefore, the testing machine and installation service are not separately identifiable in terms of IFRS 15.27(b). (1)

12-month warranty

The 12-month warranty provides Sanitize Ltd with an assurance that the testing equipment will function as intended after the installation of the testing equipment (IFRS 15.B28). (1)

Customers do not have the option to purchase the warranty separately, as Lockdown Ltd does not sell it separately. (1)

Furthermore, the promised warranty or any part of the warranty does not provide Sanitize Ltd with a service in addition to the assurance that the testing equipment complies with agreed specifications (IFRS 15.B30). (1)

Therefore, the warranty is not a distinct service and not a separate performance obligation. (1)

Lockdown Ltd shall account for the warranty in terms of IAS 37 *Provision, Contingent Liabilities and Contingent Assets*, unless the warranty provides Sanitize Ltd with a service in addition to the assurance that the product complies with the agreed-upon specifications (IFRS 15.B30). (1)

Therefore, the 12-month warranty should be bundled together and included with the sale of the testing equipment and installation services. (1)

Total	<u>(11)</u>
Maximum	<u>(7)</u>

- (b) Assume for part b of the question, that there are three separate performance obligations, namely the testing software, testing equipment and training services in the revenue contract with Sanitize Ltd.**

Criticise the journal entry that was processed with regard to the allocation of the transaction price for revenue recognition to the separate performance obligations listed above, for the year ended 31 August 20.20. Support your answer with calculations and amounts.

The journal entry processed did not allocate the transaction price to the separate performance obligations identified, as required by IFRS 15. (1)

The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled, in exchange for transferring the promised goods or service to the customer (IFRS 15.73).

Lockdown Ltd shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis (IFRS 15.74). (1)

Lockdown Ltd shall determine the stand-alone selling prices of each of those performance obligations at contract inception (1 September 20.19). (1)

Since Lockdown Ltd regularly sells the testing software, the testing equipment and the training services individually, the stand-alone selling prices of these performance obligations are directly observable. (1)

For the testing software and testing equipment, Lockdown Ltd could use an adjusted market assessment approach, namely, to evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services. Lockdown Ltd shall, therefore, use the fair values at contract inception (1 September 20.19) to estimate the stand-alone selling price for the testing software and testing equipment. (2)

The contract between Lockdown Ltd and Sanitize Ltd includes a discount, since the stand-alone selling prices at contract inception of the testing software, the testing equipment and the training service in total is R901 250 (R109 950 + R699 300 + R92 000), which exceeds the promised consideration of R891 000 (IFRS 15.81). The discount amounts to R10 250. (2)

Lockdown Ltd shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met (IFRS 15.82): (1)

- (a) The entity regularly sells each distinct good or service in the contract on a stand-alone basis.
- (b) The entity also regularly sells on a stand-alone basis a bundle of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle.
- (c) The discount attributable to each bundle of goods or services described in paragraph 82(b) is substantially the same as the discount in the contract.

Lockdown Ltd regularly sells the testing equipment and the training service as a package deal for R781 050. (1)

The package deal (R781 050) plus the testing software (R109 950) equal R891 000. This is substantially the same as the discount price of the contract. (1)

The discount of R10 250 should thus be allocated to the testing equipment and training service performance obligation. (1)

The transaction price should be allocated to each performance obligation as follows:

Performance obligations	Undiscounted stand-alone selling price R	Allocation of discount R	Allocation of transaction price R	
Testing software	109 950	-	109 950	(1)
Testing equipment	699 300	¹ 9 058	690 242	(1)
Training service	92 000	² 1 192	90 808	(1)
	<u>901 250</u>	<u>10 250</u>	<u>891 000</u>	

¹(10 250 x 699 300/791 300)

²(10 250 x 92 000/791 300)

Total	<u>(15)</u>
Maximum	<u>(9)</u>
Communication skills: logical flow and conclusion	<u>(1)</u>

**COMMENT**

Good exam technique for a discussion question is to use the information in the question as a guide as to which additional theory to discuss in order to apply the information in the question and, lastly, to conclude.

It is always good to use the theory in the standards as a starting and guiding point. Do not write down the theory, as there will be no marks given for that and you will only waste time. Rather, apply the theory to the scenario in the question.

(b) Prepare the journal entries to be processed by Lockdown Health Ltd to account for transaction with StayHome Ltd for the year ended 31 August 20.20.

		Dr R	Cr R	
	1 July 20.20			
J1	Bank (SFP)	80 000		(1)
	Revenue received in advance (SFP)		80 000	
	Recognise revenue received in advance			
	1 August 20.20			
J2	Accounts receivables (SFP) [C1]	205 198		(2)
	Revenue received in advance (SFP)	80 000		
	Revenue (P/L) (80 000 + 205 198)		285 198	(1)
	Recognise revenue			
	31 August 20.20			
J3	Bank (SFP)	12 300		(1)
	Interest income (P/L) [C2] or (205 198 x 9,75%/12)		1 667	(2)
	Accounts receivables (SFP) (12 300 – 1 667)		10 633	(1)
	Recognise interest income			
J4	Non-current asset (financial asset) (13 AMORT)	60 029		(1)
	Accounts receivables (SFP)		60 029	
	Reclassification to non-current assets			
				<u>(9)</u>

CALCULATIONS

C1. Present value of outstanding transaction price on 1 August 20.20

HP	SHARP
FV = 0	FV = 0
N = 18	N = 18
P/YR = 12	I = 9,75%/12
I = 9,75%	PMT = 12 300
PMT = 12 300	PV = 205 198
PV = 205 198	

(2)

C2. Interest income

Date	Principal	Interest at 0,8125%	Payments	Outstanding
31 Aug 20.20	205 198	1 667	(12 300)	194 565

PART II

Prepare the journal entries in the financial statements of Telecon Ltd to account for all the possible journal entries arising from the contract with the South African National Defence Force for the year ended 31 August 20.20.

	Dr R	Cr R	
30 June 20.20			
J1	Accounts receivables (SFP) (32 250 000/2 x 95%)	15 318 750	(2)
	Revenue - smart phones (P/L) (27 941 860 [C3]/2)		13 970 930 (2)
	Replacement liability (SFP) (2 500 x 6 000 x 2%)		300 000 (1)
	Warranty repairs liability (SFP) (2 095 640 [C3]/2)		1 047 820 (2)
	Recognition of revenue		
J2	Cost of sales (P/L) (balancing)	10 045 000	
	Asset for right to recover product to be returned (SFP) (2 500 x 4 100 x 2%)	205 000	(2)
	Inventory (SFP) (2 500 x 4 100)		10 250 000 (1)
	Recognition of cost of sales and right to recover inventory		
31 August 20.20			
J3	Replacement liability (SFP) [J1]	300 000	(1)
	Revenue - smart phones (P/L)		300 000
	Recognise revenue for the 30-day replacement policy		
J4	Cost of sales (P/L)	205 000	(1)
	Asset for right to recover product to be returned (SFP)		205 000
	Recognise cost of sales for the 30-day replacement policy		
J5	Warranty repairs liability (SFP) (1 047 820 [J1] x 2/12)	174 637	(2)
	Revenue - warranty repairs (P/L)		174 637
	Recognise revenue for warranty repairs		
			<u>(14)</u>

CALCULATIONS**C1. Step 2: Identify the performance obligations**

1. Smart phone with a 30-day replacement guarantee
2. A 24-month extended repair warranty

C2. Step 3: Determine transaction price

Contract price	32 250 000
30-day replacement guarantee (6 000 x 5 000 x 2%)	(600 000)
Volume discount (32 250 000 x 5%)	(1 612 500)
	<u>30 037 500</u>

C3. Step 4: Allocation of transaction price

	Stand-alone selling price	Allocation of transaction price	
Smart phone with 30-day replacement guarantee	6 000	27 941 860	[2]
24-month extended repair warranty	450	2 095 640	[1]
	6 450	30 037 500	[3]

OR ALTERNATIVE SOLUTION

	Dr R	Cr R	
30 June 20.20			
J1	14 250 000		
		14 250 000	(3)
			Recognition of revenue
J2	1 068 750		
		1 068 750	(2)
			Providing for warranty repairs
J3	205 000		
		205 000	(2)
			Providing for the 30-day replacement policy
J4	10 250 000		
		10 250 000	(2)
			Recognition of cost of sales
31 August 20.20			
J5	205 000		
		205 000	(1)
			Recognise revenue for the 30-day replacement policy
J6	89 063		
		89 063	(2)
			Recognise the trade receivable for the warranty repairs
J7	89 063		
		89 063	(2)
			Recognise revenue for warranty repairs
			(14)

**COMMENT**

The alternative solution is due to the fact that the question could be interpreted in different forms. If it was concluded that the warranty is not a separate performance obligation, it would have been treated in terms of IAS 37 as a provision (IFRS 15.B30 and IFRS 15.B33).

If treated as a separate performance obligation, then revenue would be recognised over the warranty period as done in the first alternative above (IFRS 15.B25).

CALCULATIONS**C1. Step 2: Identify the performance obligations**

1. Smart phone with 30-day replacement guarantee
2. A 24-month extended repair warranty

C2. Step 3: Determine transaction price

Contract price	32 250 000
Volume discount (32 250 000 x 5%)	(1 612 500)
	<u>30 637 500</u>

C3. Step 4: Allocation of transaction price

	Stand-alone selling price	Allocation of transaction price	
Smart phone with 30-day replacement guarantee	6 000	28 500 000	[2]
24-month extended repair warranty	450	2 137 500	[1]
	<u>6 450</u>	<u>30 637 500</u>	<u>[3]</u>

QUESTION 2 - Suggested solution

- (a) Prepare the note to the consolidated financial statements of the Amarok Raceway Ltd Group to disclose information that would enable the users to evaluate the consequences of losing control of Raptor Ltd for the year ended 30 June 20.20. Include all items related to the loss of control in this note, except disclosure required by IAS 7 *Statement of Cash Flow*.

AMAROK RACEWAY LTD GROUP**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 20.20****10. Disposal of subsidiary**

During the current year, Amarok Raceway Ltd sold a 55% interest in Raptor Ltd and lost control over Raptor Ltd. This resulted in a total amount of R826 935 being included in the line item "other income" in profit or loss. Included in this amount is a loss of R1 030 645 that relates to the measuring of the retained investment to its fair value. Amarok Raceway Ltd now has significant influence over Raptor Ltd and accounts for its interest in the associate by applying the equity method. (2)

	20.20	
	R	
Included in profit before tax		
Other income		
Consolidated profit or loss on disposal of interest in subsidiary [C1]	826 935	(9)
Portion of profit or loss attributable to fair value adjustment of remaining interest [C3]	(1 030 645)	<u>(2)</u>
	Total	<u>(13)</u>
	Maximum	<u>(11)</u>
Communication skills: presentation and layout		<u>(1)</u>

- (b) Calculate only the amounts of the line items to be presented in the consolidated statement of cash flows of the Amarok Raceway Ltd Group for the year ended 30 June 20.20.

	R	
1. Cash paid to suppliers and employees [C4]	(39 863 321)	(16)
2. Dividends paid [C7]	(1 193 290)	(15)
3. Dividends received [C14]	1 163 219	(3)
4. Income taxes (paid)/refunded [C15]	(3 053 643)	(6)
5. Acquisition of investments in equity instruments [C16]	(1 297 044)	<u>(3)</u>
	Total	<u>(43)</u>
	Maximum	<u>(40)</u>

**COMMENT**

When asked for cashflow disclosures and/ calculations remember to pay attention to correct sign of your amounts as this can significantly change your solution and you may also lose out on easy marks if your signs are incorrect and inconsistent in your approach.

- (c) Prepare the note to the consolidated statement of cash flows of the Amarok Raceway Ltd Group for the year ended 30 June 20.20 relating to the business combination on 1 August 20.19.

AMAROK RACEWAY LTD GROUP**NOTES TO THE CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 20.20****15. Acquisition of subsidiary**

During the current year Amarok Raceway Ltd obtained control over Navarra Ltd by acquiring an additional 50% interest in Navarra Ltd. The fair value of the assets acquired and the liabilities assumed were as follows:

	20.20	
	R	
Net asset value	4 244 845	
Contingent liability	(900 000)	
Indemnification asset	585 000	
Intangible asset (backlog order) (35 x 25 000 x 50%)	437 500	(1)
Inventory (838 600 – 723 840)	114 760	(1)
Deferred tax [C6]	(64 060)	
Net assets acquired	4 418 045	(1)
Non-controlling interests (4 418 045 x 40%)	(1 767 218)	(1)
Gain on bargain purchase [C6]	(22 827)	
Total consideration	2 628 000	
Consideration paid by non-cash transfers	(2 628 000)	(1)
- Fair value of the original equity interest	(628 000)	
- Land	(2 000 000)	
Cash consideration	-	
Less: cash of subsidiary acquired	-	
Cash paid to obtained control, net of cash acquired	-	(1)

Communication skills: presentation and layout (1)

CALCULATIONS**C1. Consolidated profit on disposal of subsidiary**

Derecognise net assets (given)	(15 029 829)	[½]
Derecognise goodwill [C2]	(1 294 121)	[7]
Derecognise non-controlling interests (given)	3 025 885	[½]
Recognise fair value of consideration received (given)	11 000 000	[½]
Recognise fair value of retained investment (given)	3 125 000	[½]
	<u>826 935</u>	<u>[9]</u>

**COMMENT**

Whenever there is a disposal of there is a couple of steps that you need to remember to successfully record the disposal in the consolidated statement of cash flow.

Step 1: Derecognise assets, liabilities and goodwill.

In this step, credit all the assets, and debit all the liabilities. Always use the list of assets and liabilities given in the scenario. Also remember to take into account the IFRS 3 adjustments at acquisition. Credit the goodwill as well.

Step 2: Derecognise non-controlling interests

Debit the non-controlling interests on the date of acquisition.

Step 3: Recognise the fair value of the remaining investment

If the subsidiary lost control, but still have a remaining IFRS 9 investment, remember to debit the IFRS 9 investment with the fair value amount at the date of disposal. If the full interest

Step 4: Recognise the fair value of the consideration received

Paragraph 42 of IAS 7 indicates that the amount received from the disposal needs to disclose on the face of the statement of cash flow under investing activities as the net amount of cash. This means that the amount received needs be adjusted by the amount in the subsidiary's bank account.

Step 5: Add back the non-cash profit or loss

The consolidated profit or loss calculated will usually be part of "other expenses" and therefore it should be added back as a non-cash item.

Remember that in a consolidated statement of cash flow the profit of loss in the separated financial statements of the holding company are already reversed and already journalised. You don't have to reverse it again, unless if the scenario stated that the reversal hasn't been done.

C2. Goodwill Raptor Ltd

Consideration transferred at acquisition date (given)	10 000 000	
Non-controlling interests at acquisition date (given)	<u>2 200 000</u>	
	12 200 000	[1]
Net asset value at acquisition date:		
- Share capital (given)	1 550 000	
- Retained earnings (given)	5 599 875	
- Mark-to-market reserve (given)	658 000	
- Revaluation surplus (given)	558 660	
- Intangible assets (research) (pmt = 675 000; i = 10%; n = 4)	2 139 659	[1]
- Plant remeasurement [(2 059 535 – 1 698 535 + 186 514) x 73%] [pmt = (325 000 – 250 000 = 75 000; l = 10%; n = 3) = 186 514]	<u>399 685</u>	[3]
Net asset value	<u>10 905 879</u>	[2]
Goodwill	<u>1 294 121</u>	<u>[7]</u>

**COMMENT**

In accordance with IFRS 3.1E24, a customer list does not usually arise from contractual or other legal rights. However, customer lists are often leased or exchanged. Therefore, a customer list acquired in a business combination normally meets the separability criterion. However, per IFRS 3.B33, a customer list acquired in a business combination would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its customers. In this question, the client list is contingent on a privacy agreement and cannot be sold to third parties. It is therefore not separable and would not be recognised at acquisition.

C3. Portion of loss attributable to fair value adjustment of remaining interest

Remaining portion (25/80 x (-15 029 829 [C1] – 1 294 121 [C2] + 3 025 885 [C1]))	(4 155 645)	[1]
Fair value of remaining interest in investment in associate	<u>3 125 000</u>	
	<u>(1 030 645)</u>	[1]
		[2]

C4. Cash paid to suppliers and employees

Cost of sales	(21 358 866)	
Other expenses	<u>(23 599 880)</u>	
	(44 958 746)	[1]
Adjusted for non-cash items:		
Depreciation	598 236	[1]
Amortisation (Navarra Ltd – backlog order) (35 x 25 000 x 50%)	437 500	[1]
Amortisation (Raptorrr Ltd – research) (2 139 659 [C1] /4 x 7/12)	312 034	[1]
Excess from acquisition of associate – Raptorrr Ltd [C5]	(632 457)	[1]
Gain on bargain purchase of subsidiary – Navarra Ltd [C6]	(22 827)	[6]
Changes in working capital:		
Inventories - increase in inventory (12 157 785 – 11 558 886)	(598 899)	[1]
- disposal of subsidiary – Raptorrr Ltd	(1 987 500)	
- consideration received on disposal – Raptorrr Ltd	3 424 000	[1]
- acquisition of subsidiary – Navarra Ltd	838 600	[1]
Trade and other payables		
- increase in trade payables (3 886 885 – 2 658 805)	1 228 080	[1]
- disposal of subsidiary – Raptorrr Ltd	2 398 658	
- contingent liability – Navarra Ltd	<u>(900 000)</u>	[1]
	<u>(39 863 321)</u>	[16]

C5. Excess from acquisition of associate – Raptorrr Ltd

Net asset value at acquisition date (given)	15 029 829	
Equity investment @ 25%	3 757 457	
Fair value of the remaining interest after disposal of controlling interest	<u>(3 125 000)</u>	
Excess	<u>(632 457)</u>	[1]
		[1]

C6. Gain on bargain purchase of subsidiary - Navarra Ltd

Consideration transferred at acquisition date (2 000 000 + 628 000)	2 628 000	
Non-controlling interests at acquisition date (4 418 045 x 40%)	<u>1 767 218</u>	
	4 395 218	[1]
Net asset value at acquisition date:		
- Net asset value (given)	4 244 845	
- Contingent liability	(900 000)	
- Indemnification asset (900 000 x 65%)	585 000	[1]
- Intangible asset – backlog order (35 x 25 000 x 50%) or [C4]	437 500	
- Inventory (838 600 – 723 840)	114 760	[1]
- Deferred tax ((-900 000 + 585 000 + 114 760 + 437 500) x 27%)	<u>(64 060)</u>	[2]
	4 418 045	
Gain on bargain purchase	<u>(22 827)</u>	[1]
		<u>[6]</u>

**COMMENT**

Remember that Navara is the acquisition of a subsidiary and the undeveloped land given as payment is a non-monetary asset and it is not used in the business after the transfer to the parent because it is already leased to a third party. Therefore, we use the full R2 000 000 which is the fair value of the land at acquisition date of Navarra Ltd, and we include this in the consideration paid calculation.

C7. Dividends paid

Dividends paid to shareholders of parent [C8]	(892 002)	[6]
Dividends paid to shareholders of non-controlling interests [C10]	<u>(301 288)</u>	[9]
	<u>(1 193 290)</u>	<u>[15]</u>

C8. Dividend paid to shareholders of parent

Decrease in shareholders for dividends (550 000 – 889 778)	(339 778)	[1]
Dividends declared [C9]	<u>(552 224)</u>	[5]
	<u>(892 002)</u>	<u>[6]</u>

C9. Dividends declared

Increase in retained earnings (60 230 981 – 52 553 932)	7 677 049	[1]
Profit for the period attributable to owners of the parent (given)	(7 583 449)	[1]
Transferred from mark-to-market reserve		
((950 000 – 658 000) x 80% = 233 600) (Raptor Ltd) +		
((628 000 – 350 000) x 78,4% = 217 952) (Navarra Ltd)	(451 552)	[2]
Transferred from revaluation surplus (Raptor Ltd (801 500 – 558 660) = 242 840 x 80%)	<u>(194 272)</u>	[1]
	<u>(552 224)</u>	<u>[5]</u>

**COMMENT**

In this scenario it is only stated that Amarok Raceway Ltd declared a dividend, but the amount was not given. Therefore, the retained earnings account should be reconciled, and the balancing figure will be the dividends declared by Amarok Ltd.

Many of the students did not include the transfer from mark-to-market reserve to retained earnings. Amarok Raceway Ltd acquired an additional interest in Navarra Ltd. Amarok Raceway Ltd has elected to transfer any cumulative gains or losses within equity in accordance with IFRS 9.B5.7.1. This means that Amarok Raceway Ltd (as the separate company and not the group of companies) should transfer the fair value adjustments currently in mark-to-market reserve (only relating to the Navarra Ltd investment) to retained earnings. Remember that this amount is already after tax, as the deferred tax was already taken into account in the year that the fair value adjustments arose.

On the other hand, Amarok Raceway Ltd disposed of Raptor Ltd during the current financial year, and again because of the election of IFRS 9.B5.7.1 the mark-to-market reserve of Raptor Ltd should be transferred to retained earnings. Only 80% of the mark-to-market reserve of Raptor Ltd would be present in the mark-to-market reserve column, as the other 20% is already included in non-controlling interests. Remember during the consolidation process, the following pro forma journal would have been done, to allocated the 20% of the mark-to-market reserve to non-controlling interests:

Dr:	Non-controlling interests (OCI)	xxx	
	Cr: Non-controlling interests (SFP/SCE)		xxx

**COMMENT**

In the scenario it is stated that the group reclassifies items recognised in other comprehensive income to retained earnings on disposal of the affected assets when permitted to do so. Therefore, when Raptor Ltd was disposed, the revaluation surplus should also be transferred to retained earnings.

C10. Dividend paid to shareholders of non-controlling interests

Decrease in non-controlling interests (3 308 943 – 3 796 717)	(487 774)	
Total comprehensive income for the period attributable to non-controlling interests (given)	(987 148)	[1]
Acquisition of Navarra Ltd [C6]	(1 767 218)	[1]
Disposal of Raptor Ltd [C1]	3 025 885	[1]
Partial disposal of Hillux Ltd [C11]	(85 033)	[6]
	<u>(301 288)</u>	<u>[9]</u>

**COMMENT**

In this scenario it is only stated that Navarra Ltd declared a dividend, but the amount was not given. Therefore, the non-controlling interests account should be reconciled, and the balancing figure will be the dividends declared by Navarra Ltd to non-controlling interests.

C11. Partial disposal of Hillux Ltd

Proceeds received	78 138	[1]
Change in non-controlling interests	(85 033)	
Non-controlling interests before the transaction [4 251 653 [C12] x 25%]	1 062 913	[2]
Non-controlling interests after the transaction ((4 193 891 x 27% [C13]) + (43 321 x 2/75) + 14 441 (given))	(1 147 946)	[3]
	<u>(6 895)</u>	<u>[6]</u>

**COMMENT**

Remember that the partial disposal or acquisition of a subsidiary, with control retained both before and after the transaction, is a financing activity.

C12. Net asset value of Hillux Ltd

Net asset value after the share sale (given)	4 193 891	
Goodwill (given)	57 762	
	<u>4 251 653</u>	[2]
		[2]

C13. Change in Hillux Ltd's shareholding

	Total	Parent	NCI	
Before share sale	150 000	112 500	37 500	
Sale of shares	-	(3 000)	3 000	
	<u>150 000</u>	<u>109 500</u>	<u>40 500</u>	[1]
New interest in subsidiary		73%	27%	[1]
				[2]

**COMMENT**

Any share buy-backs and rights issues transaction are excluded from SAICA's examinable pronouncements. It is also important to note that the acquisition of an additional interest in an associate that leads to the retention of significant influence and the disposal of an interest in an associate, but with significant influence both before and after, is excluded.

Despite certain change in control transactions being at an awareness level or excluded from SAICA's examinable pronouncements, a chartered accountant will observe many different types of transactions in practice. As a result, the examples below include such transactions with the proficiency level required for CTA for each example indicated.

C14. Dividends received

Dividends received from other investments (given)	565 805	[1]
Dividends received from investments in associates	597 414	[2]
Increase in investments in associates (8 857 191 – 5 554 444)	(3 302 747)	
Share of profits from associates	124 329	
Share of other comprehensive income from associates	18 375	
Excess – Raptorrr Ltd [C5]	632 457	
Disposal of subsidiary (Raptorrr Ltd) becoming an associate	3 125 000	
	<u>1 163 219</u>	<u>[3]</u>

**COMMENT**

Why did we use the “investment in associate” to calculate the dividends received?

When the associate has declared a dividend, the consolidated journal would be:

Dr: Dividend received xxx
Cr: Investment in associate xxx

Meaning that the dividend received from the associates are not included in “other income” and therefore the investment in associate account should be reconciled to calculate the dividend received.

It may also happen that the dividends received from associates has been given in the scenario, in that case the balancing figure will indicate either the acquisition of additional associates or disposal of associates.

C15. Income taxes paid

Increase in deferred taxation (8 264 530 – 7 844 501)	420 029	
Deferred tax on fair value adjustment on assets and liabilities at acquisition of Navarra Ltd ((-900 000 + 585 000 + 114 760 + 437 500) x 27%) or [C6]	(64 060)	
Deferred tax on revaluation of land (142 500/(1 – (27% x 80%)) = 181 760 – 142 500)	(39 260)	[1]
Deferred tax on the movement of the mark-to-market reserve (301 805/(1 – (27% x 80%)) = 384 955 – 301 805)	(83 150)	[1]
Disposal of Raptorrr Ltd	<u>759 802</u>	
Movement of deferred tax included in profit or loss	993 361	[2]
Income tax expense included in profit or loss (given)	<u>(3 327 215)</u>	[1]
	(2 333 854)	
Decrease in South African Revenue Services (3 758 776 – 4 478 565)	<u>(719 789)</u>	[1]
	<u>(3 053 643)</u>	<u>[6]</u>

**COMMENT**

Many students did not include the deferred tax on the fair value adjustments on the assets and liabilities at acquisition of Navarra Ltd.

The reason why it should be included is because it is a non-cash movement on the deferred tax balance, and should be added back to calculate the income taxes paid for the year.

C16. Acquisition of investments in equity instruments

Increase in equity instruments balance (8 622 044 – 6 655 885)	(1 966 159)	[½]
Disposal of subsidiary – Raptor Ltd	(2 368 840)	[½]
Mark-to-market reserve (301 805/(1 – (27% x 80%))	384 955	[1]
Consideration received – Raptor Ltd	3 281 000	[½]
IFRS 9 investment becoming a subsidiary – Navarra Ltd	<u>(628 000)</u>	[½]
	<u>(1 297 044)</u>	<u>—</u>
		<u>[3]</u>

CASE STUDY 7**100 marks**

YOU HAVE 30 MINUTES' READING TIME. SPEND 30 MINUTES READING THE CASE STUDY BEFORE YOU CONTINUE TO THE REQUIRED SECTION.

QUESTION 1**100 marks**

Just One Energy Ltd (JOE) is a leading renewable energy solutions company listed on the Johannesburg Stock Exchange. It provides turn-key solar and wind energy services and related products to its customers. JOE acquired various smaller competitors to obtain innovative products and to increase its market share.

The consolidated financial statements of the JOE group for the year ended 30 June 20.19 are in the process of being finalised. The relevant information required to finalise the consolidated financial statements is provided below. All the companies in the group have a 30 June year end.

Investment in Better Electricity Now Ltd

JOE acquired its investment in Better Electricity Now Ltd (BEN) on 1 January 20.17, when it obtained 60 000 of the ordinary shares of BEN. The equity balances of BEN on 1 January 20.17 were as follows:

	R
Share capital (100 000 ordinary shares)	1 000 000
Retained earnings	9 754 000
Revaluation surplus	4 551 000

JOE obtained control over BEN as per the definition of control, in accordance with IFRS 10 *Consolidated Financial Statements* from that date. The details of the consideration paid to the selling shareholders are as follows:

- A cash payment of R9 000 000 on 1 January 20.17. JOE utilised its overdraft facility to affect this payment. The overdraft facility carries interest at 21% per annum, compounded monthly.
- Included in the cash payment on 1 January 20.17 is an amount of R14 000 relating to JOE's contribution towards lawyers' fees, in accordance with the contract.
- An additional payment of R500 000, due on 1 January 20.20.

JOE also transferred a manufacturing machine to BEN, in accordance with the agreement. BEN will use this machine to produce components used in the manufacturing of inverters, much faster and at a higher quality. The carrying value of the machine was R2 000 000 on 1 January 20.17. The fair value was independently assessed to be R2 500 000 on the acquisition date, with the remaining useful life of five years and no residual value which remained unchanged.

The assets and liabilities of BEN were assessed to be at fair value, except for the following:

- **Other intangible assets**
On the acquisition date, a technology patent and trademark were recognised in BEN's separate financial statements as other intangible assets. Only the trademark was fairly valued.

The technology patent was registered by BEN on 1 July 20.16. The cost of the patent recognised in its financial statements was R750 000 on that date. The patent had a remaining useful life of 10 years and a residual value of Rnil on 1 July 20.16. The fair value of this patent was assessed at R1 225 000 on 1 January 20.17, with the assessment of the useful life and residual value remaining unchanged from its 1 July 20.16 values.

The patent is also licensed to a company in Namibia for use in its operations. The terms of the license agreement stipulates that a market related annual fee of R125 000 is payable on 31 December each year with the last payment due on the expiry of the agreement on 31 December 20.20. It is not practical to sell the license agreement separately from the patent.

- **Lawsuit**

A competitor has instituted legal proceedings against BEN. The competitor accused BEN of illegally copying one of its designs and is claiming an amount of R5 000 000.

The dispute arose when a former employee of the competitor, who left to join BEN, was accused of copying and providing unauthorised files of the competitor to BEN. The employee admitted to taking an encrypted memory stick, but claims it only contained his personal documents.

Even though it can be proven that a memory stick was taken, BEN's lawyers are of the opinion that no compensation will be awarded by the court. After taking all the possible outcomes into consideration, including a possible settlement, a fair value of R400 000 can be placed on the value of the claim on 1 January 20.17. Due to the highly technical nature of the claim, it was still not finalised by 30 June 20.19, with the fair value of the claim increasing to R1 000 000. The claim will not be deductible for taxation purposes, should it be successful.

The selling shareholders have contractually agreed to reimburse JOE 90% of any losses as a result of the claim.

No additional assets, liabilities or contingent liabilities were identified at the acquisition date.

Investment in Renewable Optimum Base Ltd

Renewable Optimum Base Ltd (ROB) was incorporated during 1995 and manufactures and sells solar panels, inverters, batteries and related consumables to both private and commercial customers. The management of ROB followed an effective strategy of acquiring all the business properties from which it operates and currently owns 15 of such properties throughout South Africa.

JOE acquired 55% of the issued ordinary shares in ROB on 1 July 20.17 for a cash consideration of R12 000 000. JOE obtained control over ROB as per the definition of control, in accordance with IFRS 10 *Consolidated Financial Statements* from that date. ROB had the following equity balances on 1 July 20.17:

	R
Share capital (100 000 ordinary shares)	200 000
Retained earnings	17 320 000

The assets and liabilities of ROB were fairly valued at the acquisition date, except for the following:

- **Plant**

ROB owns a plant that was used in the manufacturing of plastic components. ROB leased this plant to an independent third party from 1 July 20.15. The carrying amount of the plant on 1 July 20.17 amounted to R3 700 000 and the remaining useful life was correctly assessed at 20 years. The fair value of the plant was estimated at R4 500 000 on that date, based on market-related rentals over the remaining useful life. The terms of the agreement are as follows:

Lease start date	1 July 20.15
Lease term at start date	10 years
Lease payment date	Annually in advance
Lease payment amount	R550 000 per annum
Similar market related rentals	R466 100 per annum
Present value of favourable component on 1 July 20.17	R500 000

This plant is correctly classified as property, plant, and equipment, in accordance with IAS 16 *Property, Plant and Equipment*.

- **Factory building**

One of ROB's factory buildings was undervalued at the acquisition date. The details of this factory building on 1 July 20.17 were as follows:

Original cost	R3 500 000
Accumulated depreciation recognised	R275 000
Fair value	R3 400 000
Residual value	R525 000
Estimated remaining useful life	25 years

ROB sold the factory building to JOE for an amount of R3 600 000 on 1 July 20.18. The factory building was correctly assessed to have a remaining useful life of 24 years and an estimated residual value of R550 000 at that date. These estimates have been assessed and confirmed.

No additional assets, liabilities or contingent liabilities were identified at the acquisition date.

Intragroup lease agreement

On 1 January 20.19, JOE and ROB entered into an agreement whereby JOE leased an empty office building from ROB for a period of five years. The rentals are payable annually in advance and were determined at R250 000 for the first year with an escalation of 6% per annum thereafter. The details on the fair value and carrying amount of the office building are as follows:

- The fair value and carrying amount of the office building amounted to R2 750 000 on 1 January 20.19. The remaining useful life and residual value were correctly assessed at 25 years and R500 000, respectively.
- The fair value of the office building increased with R50 000 between 1 January 20.19 and 30 June 20.19.

The office and factory buildings on which rental is earned are classified as investment property, and the accounting policy of the JOE Group is to recognise investment property in accordance with the fair value model, in accordance with IAS 40 *Investment Property*. The JOE Group elected to early adopt IFRS 16 *Leases* where the risks and rewards incidental to ownership of its rented buildings do not transfer to the respective lessees at the conclusion of the lease terms.

Investment in Mozambique Lumens Usage LLC

JOE diversified its operations into another African country by acquiring a 75% interest in the ordinary share capital of Mozambique Lumens Usage LLC (MLU) on 1 January 20.18 at MLU's fair value per share.

JOE obtained control over MLU as per the definition of control, in accordance with IFRS 10 *Consolidated Financial Statements* from that date.

All the assets and liabilities were considered to be fairly valued, except for machinery with a carrying amount of MZN2 050 000 and a fair value of MZN2 300 000 on 1 January 20.18. The machinery had a remaining useful life of four years and a residual value of MZN0 at that date. No additional assets, liabilities or contingent liabilities were identified at that date.

The management of JOE decided to realise a portion of its investment in MLU and, on 30 June 20.19, disposed of 15% of the issued shares of MLU at its fair value to an independent third party for cash. JOE still had control over MLU after the disposal of the shares.

The equity of MLU consisted of the following at the respective dates:

	1 January 20.18	30 June 20.18	30 June 20.19
	MZN	MZN	MZN
Share capital (100 000 ordinary shares)	1 100 000	1 100 000	1 100 000
Retained earnings	14 250 000	14 900 000	15 825 000
	<u>15 350 000</u>	<u>16 000 000</u>	<u>16 925 000</u>

Exchange rates and fair value per share

The following exchange rates were applicable at the respective dates:

	MZN1 = R
1 January 20.18	0,21
Average for the period 1 January 20.18 to 30 June 20.18	0,22
30 June 20.18	0,23
Average for the period 1 July 20.18 to 30 June 20.19	0,25
30 June 20.19	0,27

The fair value of the share price of MLU was as follows at the respective dates:

	1 January 20.18	30 June 20.19
	MZN	MZN
Value per share	190,00	250,00

Financial information

The table below provides an extract from the relevant trial balances of the respective companies as at 30 June 20.19. You can assume that the information provided in the scenario has been correctly taken into account, except where stated otherwise. All the balances provided represent their respective carrying amounts:

	JOE Dr/(Cr) R	BEN Dr/(Cr) R	ROB Dr/(Cr) R	MLU Dr/(Cr) R
Property, plant and equipment	72 521 000	4 895 000	19 657 000	8 687 000
Investment property	11 500 000	-	14 853 000	-
Other intangible assets	-	856 000	-	-
Financial investments ¹	29 128 000	-	-	-
Deferred tax asset	2 365 000	356 000	412 000	1 245 000

¹ The financial investments include both investments in subsidiaries, where applicable, and financial investments classified, in accordance with IFRS 9 *Financial Instruments*.

The following amounts have been **correctly** determined for disclosure in the consolidated financial statements of the JOE Group for the year ended 30 June 20.19:

	R
Non-controlling interests (SCE/SFP) balance in BEN on 1 July 20.18	8 100 000
Non-controlling interests (SCE/SFP) balance in ROB on 1 July 20.18	9 200 000
Total comprehensive income attributable to non-controlling interests of BEN	260 000
Total comprehensive income attributable to non-controlling interests of ROB	340 000

Investment in Solar Business Unlimited Ltd

Solar Business Unlimited Ltd (SBU) was incorporated on 1 July 20.17 in Botswana with JOE subscribing for all the issued shares. The activities of SBU were restricted through its incorporation documents with its only objective being to carry out research and development activities. Due to the availability of sunlight all year round, Botswana is a suitable country to perform solar energy research and development.

The company was established in collaboration with a leading research centre, INUSA, and a comprehensive arrangement was entered into between JOE and INUSA. The contractual arrangement stated that the voting rights in SBU relate to administrative tasks only, with INUSA directing the relevant activities by means of the contractual arrangement.

The terms of the arrangement required JOE to provide financial support to SBU upon incorporation to fund the research and development activities. It was envisaged that SBU will be able to obtain research grants to fund its future research costs. JOE provided a loan amounting to R10 000 000 to SBU on 1 July 20.17, carrying interest at 10% per annum, compounded annually. The loan has no fixed repayment terms, and no interest or capital has been repaid up to 30 June 20.19. If SBU requires additional funding and is unable to obtain external finance, JOE will be required to provide additional financial support.

SBU has been relatively successful during the 20.18 financial year, but due to an extremely competitive research environment, losses have been incurred during the 20.19 financial year. This has necessitated SBU to obtain and utilise an overdraft facility. A condition of the overdraft facility was the subordination (JOE is last in line) of the loan to SBU by JOE.

Investment in Simple Alternative Manufacturing Ltd

Simple Alternative Manufacturing Ltd (SAM) is primarily involved in the manufacture of low-cost solar panels and consumables. Its vision is to provide the majority of South Africans with an affordable alternative to grid-tied electricity systems.

SAM was founded by Ms Ra and three friends, with each owning 25% of the issued share capital and voting rights. One share equals one vote. Recently, the company reached a glass ceiling in terms of growth and identified the need to attract funding and expertise to take it to the next level.

Ms Ra contacted the Chief Executive Officer of JOE to discuss its proposal. The CEO was very keen, with the result that JOE acquired shareholding and voting rights in SAM on 1 July 20.19. Each of the previous shareholders sold 5% of their respective shares in SAM to JOE.

A shareholders' agreement was drafted and signed on 2 July 20.19, which contained the following terms:

- JOE will be entitled to appoint four executive directors to the board of directors in addition to Ms Ra and her three friends, who will remain as executive directors.
- In the case of a vote deadlock, the chairperson of the board of directors has the deciding vote. Ms Ra is appointed as the chairperson of the board of directors.
- The board of directors has the ability to direct the administrative activities.
- The board of directors has the ability to direct the manufacturing and distribution of solar systems, but all such decisions require the unanimous approval of all of JOE's appointed directors.
- JOE is required to provide a loan amounting to R25 000 000 to fund the expansion of SAM. The loan is repayable after seven years and carries interest at 9% per annum.

Additional information

1. JOE has elected to measure the non-controlling interests in its investments in subsidiaries at its proportionate share of the acquiree's identifiable net assets at acquisition, in accordance with IFRS 3.19(a).
2. The profit after tax for all the companies in the group accrued evenly throughout the year, unless otherwise indicated.
3. The appropriate pre-tax discount rate applicable to each company in the group is 9,44%, compounded annually. The interest rate implicit in all the respective leases is 10,25% per annum.
4. None of the companies in the group have declared or paid a dividend in any of the respective years.
5. The JOE Group classifies all interest income received as part of other income.
6. JOE recognises any difference between the amount by which the non-controlling interests are adjusted, and the fair value of the consideration paid or received (attributable to the owners of the parent in an equity transaction) directly in a changes of ownership reserve in equity.

7. It is the accounting policy of JOE to account for its investments in subsidiaries at cost in its separate financial statements, in accordance with IAS 27.10(a).
8. You can assume that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised.
9. It is the accounting policy of the JOE Group to account for financial assets, in accordance with IFRS 9 *Financial Instruments*. The group has irrevocably elected to present subsequent changes in the fair value of the investments in other comprehensive income in a mark-to-market reserve.
10. It is the accounting policy of the group to account for property, plant and equipment, in accordance with the cost model in terms of IAS 16 *Property, Plant and Equipment*.
11. There were no changes in the issued ordinary share capital of any of the companies during the respective financial years.
12. BEN, ROB and MLU are all acquisitions of a business, in accordance with IFRS 3 *Business Combinations*.
13. Assume a normal South African income tax rate of 27% and a Capital Gains Tax inclusion rate of 80%. Ignore Value Added Tax (VAT) and Dividend Tax.
14. Assume a normal Mozambique income and Capital Gains Tax rate of 32%.

CASE STUDY 7**REQUIRED**

YOU NOW HAVE 150 MINUTES TO COMPLETE THE CASE STUDY.

QUESTION 1

	Marks
<p>(a) Prepare only the non-current assets section of the consolidated statement of financial position of the Just One Energy Ltd Group as at 30 June 20.19.</p> <p style="text-align: right;">Communication skills: presentation and layout</p> <p>Please note:</p> <ul style="list-style-type: none"> • Comparative figures are not required. 	<p>54</p> <p>1</p>
<p>(b) Prepare the consolidated statement of changes in equity of the Just One Energy Ltd Group for the year ended 30 June 20.19. You only need to present the following columns:</p> <ul style="list-style-type: none"> - Changes in ownership reserve - Foreign currency translation reserve - Non-controlling interests <p style="text-align: right;">Communication skills: presentation and layout</p> <p>Please note:</p> <ul style="list-style-type: none"> • Comparative figures are not required. • Ignore dividends per share. 	<p>19</p> <p>1</p>
<p>(c) Prepare the unconsolidated structured entity note, for the investment in Solar Business Unlimited Ltd, to the consolidated financial statements of the Just One Energy Ltd Group for the year ended 30 June 20.19.</p> <p style="text-align: right;">Communication skills: presentation and layout</p> <p>Please note:</p> <ul style="list-style-type: none"> • Accounting policies are not required. • Comparative figures are not required. 	<p>11</p> <p>1</p>
<p>(d) Discuss, in accordance with IFRS 10 <i>Consolidated Financial Statements</i>, whether Just One Energy Ltd controls Simple Alternative Manufacturing Ltd.</p> <p style="text-align: right;">Communication skills: logical flow and format</p> <p>Please note:</p> <ul style="list-style-type: none"> • Round off all amounts to the nearest rand. • Clearly show and reference all your calculations. • Your answer must comply with International Financial Reporting Standards (IFRS). 	<p>12</p> <p>1</p>

CASE STUDY 7**QUESTION 1 – Suggested solution****COMMENT**

As disclosure in a statement was required in part (a) and (b), good exam technique is to use the formats provided in the illustrative examples in IAS 1.. It will ensure that you do not forget certain line items. Always start with the face of the statement first and, as you complete any calculations, to transfer the amounts to the face. This ensures that all calculations are used.

(a) JUST ONE ENERGY LTD GROUP**EXTRACT OF THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.19**

	20.19	
	R	
ASSETS		
Non-current assets		
Property, plant and equipment [C1]	109 300 313	(16)
Investment property [C2]	22 736 455	(6)
Goodwill [C3]	4 287 867	(17)
Other intangible assets [C4]	2 284 038	(8)
Financial investments [C5]	2 768 046	(3)
Deferred tax asset [C6]	3 962 425	(8)
	<u>145 339 144</u>	
	Total	<u>(58)</u>
	Maximum	<u>(54)</u>
	Communication skills: presentation and layout	<u>(1)</u>

(b) JUST ONE ENERGY LTD GROUP**EXTRACT OF THE STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 20.19**

	Changes in ownership reserve	Foreign currency translation reserve	Non- controlling interests	
	R	R	R	
Balance at 1 July 20.18 [C21]; [C20]	-	289 875	18 228 553	(9)
Total comprehensive income for the year [C23]; [C22]		602 738	821 056	(8)
Disposal of interest [C19]; [C19]	469 937	-	542 563	(5)
Transfer foreign currency translation reserve [C19]	-	(147 203)	147 203	(2)
Balance at 30 June 20.19	<u>469 937</u>	<u>745 410</u>	<u>19 739 375</u>	
			Total	<u>(24)</u>
			Maximum	<u>(19)</u>
			Communication skills: presentation and layout	<u>(1)</u>

**COMMENT**

The requirement limited the statement to only three columns. Do not waste time presenting other non-required columns, such as share capital and total equity.

(c) JUST ONE ENERGY LTD GROUP**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 20.19****Unconsolidated structured entity**

JOE owns all the shares in an unconsolidated structured entity, SBU, through a contractual arrangement with INUSA. (IFRS 12.26) (1)

The contractual arrangement with INUSA states that JOE's voting rights relates to administrative tasks only and the relevant activities are directed by INUSA through the contractual arrangement. (1)

JOE, therefore, does not have control over SBU. (IFRS 12.26) (1)

SBU was incorporated with one objective: to carry out research and development activities in Botswana. (IFRS 12.26) (1)

The contractual arrangement includes a provision that JOE will be required to provide additional finance to SBU, should it be required and should SBU not be able to obtain external finance. (IFRS 12.B26(a)) (1)

JOE earned interest income (included in other income) from its involvement with SBU during the 20.19 financial year. (IFRS 12.B26(c)) (1)

During the current year, SBU obtained and utilised credit (overdraft facility) to finance its operations. As a result, JOE has had to subordinate its loan to SBU. JOE is exposed to a potential loss of its loan capital plus interest. Its interest in SBU now ranks lower than other parties. (IFRS 12.B26(d)) (2)

Due to an extremely competitive research environment, SBU has been experiencing financial difficulties in 20.19 and incurred losses. (IFRS 12.B26(f)) (1)

The following table summarises the carrying values recognised in the statement of financial position and maximum exposure to loss from its involvement at 30 June 20.19 with the structured entity: (IFRS 12.29)

Description	Carrying amount	Maximum exposure to loss	Line item in the statement of financial position	
	R	R		
Long-term loan to SBU	12 100 000*	12 100 000*	Financial investments	(4)
* R10 000 000 x 1.1 x 1.1				
			Total	<u>(13)</u>
			Maximum	<u>(11)</u>
			Communication skills: presentation and layout	<u>(1)</u>

**COMMENT**

Please also refer to Energise Ltd under section B of tutorial letter 102 for a similar question. The information to disclose in the note is provided in IFRS 12. Having sufficient knowledge of the relevant standards will enable students to quickly refer to and reference the correct theory in order to answer the question quickly and obtain maximum marks.

**IMPORTANT COMMENT**

Remember that you are only allowed to use the SAICA handbooks during the assessment. To have and or use your tutorial letter(s) or other material during a test and exam is plagiarism.

(d) Discussion on IFRS 10

JOE will control SAM when it is exposed, or has rights, to variable returns from its involvement with SAM and has the ability to affect those returns through its power over the SAM. (1)

Power

To have power over an investee, an investor must have existing rights that gives it the current ability to direct relevant activities (IFRS 10.B9).

SAM is a manufacturer of low-cost solar panels and consumables. Its relevant activities are the manufacturing and distribution of solar systems. (1)

JOE acquired 20% (5% x 4) of the ordinary shares in SAM and, therefore, has a substantive existing right. (1)

However, JOE does not have the majority of voting rights, as all the shareholders have an equal 20% of the shares and voting rights. (1)

However, JOE could still have power if it has sufficient voting and other rights to direct the relevant activities unilaterally, and other factors should be considered (IFRS 10.B41). (1)

The contractual arrangement between JOE and the other shareholders must be considered (IFRS 10.B38). (1)

According to the shareholders' agreement, JOE can appoint four of the eight members of key management personnel, which could indicate that JOE is able to direct the relevant activities. (1)

However, the chairperson, Ms Ra, has the deciding vote and JOE, therefore, does not control the board of directors. (1)

The board of directors have the ability to direct administrative activities, but it does not qualify as relevant activities (IFRS 10.B8). (1)

The board of directors have the ability to direct the manufacturing and distribution of solar systems, but the unanimous approval of all four of JOE's appointed directors are required. (1)

JOE can, therefore, unilaterally direct the relevant activities of SAM. (1)

This is an indication that JOE, through a combination of voting and contractual rights, has the current ability to direct the relevant activities and has power. (1)

Exposure, or rights, to variable returns from an investee

JOE is exposed to a return from SAM in the form of dividends through its 20% shareholding, as well as through interest income on its loan to SAM. (2)


Link between power and returns

JOE has sufficient rights to direct the manufacturing and distribution of the solar system activities of SAM, which significantly affect its returns in the form of dividends. (1)


Conclusion

JOE, therefore, has control over SAM.

	(1)
Total	<u>(16)</u>
Maximum	<u>(12)</u>
Communication skills: logical flow and layout	<u>(1)</u>

	COMMENT
<p>A good exam technique for a discussion question on control, is to start with both the definitions of control and power. Secondly, the information in the question should guide you as to which additional theory to discuss in order to apply the information in the question and, lastly, to conclude.</p> <p>However, please note that marks are not awarded for theory or definitions. Marks are only awarded for the correct application of the theory and/or definition.</p> <p>For instance, IFRS 10.B41 states that JOE could still have power if it has sufficient voting and other rights to direct the relevant activities unilaterally, and other factors should be considered.</p>	

CALCULATIONS

	COMMENT
<p>When a subsidiary is consolidated, 100% of its trial balance is added line-by-line to the line items of the parent. It can be noticed in [C1], as an example, that 2 marks were awarded for merely doing this easy step. Try to always earn these easy marks first in the exam.</p>	

C1. Property, plant and equipment

Property, plant and equipment in separate financial statements:

JOE (given)	72 521 000	
BEN (given)	4 895 000	
ROB (given)	19 657 000	
MLU (given)	8 687 000	
	105 760 000	[2]

Pro forma consolidation adjustments:

Intragroup transaction between ROB and JOE [C7]	2 705 000	[2]
Plant of ROB [C8]	1 095 000	[4]
Factory building of ROB [C9]	(301 875)	[4]
Machinery of MLU [C10]	42 188	[4]
	109 300 313	[16]

C2. Investment property

JOE (given)	11 500 000	
ROB (given)	14 853 000	
	<u>26 353 000</u>	[1]
Intragroup transaction between ROB and JOE [C7]	(2 800 000)	[1]
Right-of-use asset ROB and JOE [C7]	<u>(816 545)</u>	[4]
	<u>22 736 455</u>	<u>[6]</u>

**COMMENT**

The investment property in the separate records of ROB is classified as PPE in the group, because, from the group's perspective, the property is owner occupied.

C3. Goodwill

Investment in BEN [C11]	1 811 379	[8]
Investment in ROB [C17]	1 771 788	[4]
Investment in MLU [C18]	704 700	[5]
	<u>4 287 867</u>	<u>[17]</u>

C4. Other intangible assets

BEN (given)	856 000	
Technology patent BEN [C14]	377 632	[3]
License agreement BEN [C15]	150 407	[4]
Indemnification asset BEN (1 000 000 x 90%)	900 000	[1]
	<u>2 284 038</u>	<u>[8]</u>

C5. Investments in equity instruments

JOE (given)	29 128 000	
Investment in BEN [C12]	(11 367 454)	[1]
Investment in ROB [C17]	(12 000 000)	[1]
Investment in MLU [C18]	(2 992 500)	[1]
	<u>2 768 046</u>	<u>[3]</u>

C6. Deferred tax asset

Deferred tax asset in separate financial statements:

JOE (given)	2 365 000	
BEN (given)	356 000	
ROB (given)	412 000	
MLU (given)	1 245 000	
	<u>4 378 000</u>	[2]
Technology patent BEN [C14]	(101 961)	[1]
License agreement BEN [C15]	(40 610)	[1]
Plant of ROB [C8]	(295 650)	[1]
Factory building of ROB [C9]	36 146	[1]
Machinery of MLU [C10]	(13 500)	[2]
	<u>3 962 425</u>	
		<u>[8]</u>

C7. Intragroup rental of office building between JOE and ROB (IFRS 16.56)

Value of office building as at 30 June 20.19:

Owner occupied CA (2 750 000 - (2 750 000 - 500 000/25 x 6/12))	2 705 000	[2]
Investment property (2 750 000 + 50 000)	2 800 000	[1]
		<u>[3]</u>

Right-of-use asset:

(5 cashflows over 5 years and [Cf0] is R250 000, payable in advance)

[use at 6% escalation]		[1]
Cf0	250 000	[1]
Cf1	265 000	
Cf2 (escalates with 6%)	280 900	
Cf3 (escalates with 6%)	297 754	
Cf4 (escalates with 6%)	315 619	
Interest rate implicit in the lease	<u>10,25%</u>	[1]
Present value of right-of-use asset (NPV)	907 272	
Amortisation on right-of-use asset (907 272/5 x 6/12)	(90 727)	[1]
	<u>816 545</u>	
		<u>[4]</u>

**COMMENT**

Remember, when consolidating the leased building gets transferred as property, plant and equipment. When you consolidate JOE and ROB are considered one entity, therefore you cannot lease to yourself. So, we account for the building as PPE.

Furthermore, the 816 545 is the calculated fair value of the right of use which is an intangible asset in terms of the new IFRS 16 Leases standard. This intangible asset fair value is then amortised for the 6 months it is in use until year end (January 20.19 to June 20.19) as this is its carrying amount at year end in the separate financial statements. Therefore, it is the investment property and intangible asset right of use asset that is removed/derecognised in the consolidated books, and the building recognised as PPE.

**COMMENT**

Please refer to Group Statements volume 2 for additional examples on lessee and lessor treatment, in accordance with IFRS 3.

C8. Plant of ROB Ltd

Fair value at acquisition (given)	4 500 000	
Carrying amount (given)	<u>(3 700 000)</u>	
Fair value on plant only	800 000	[1]
Present value of favourable component (given)	<u>500 000</u>	
Total Fair value adjustment on 1 July 20.17	1 300 000	[1]
Depreciation of plant up to 30 June 20.19 (800 000/20 x 2)	(80 000)	[1]
Depreciation of fav comp to 30 June 20.19 (500 000/(10-2) x 2)	<u>(125 000)</u>	[1]
Carrying amount of fair value adjustment on 30 June 20.19	1 095 000	<u>[4]</u>
Deferred tax at acquisition (1 300 000 x 27%)	(351 000)	
Deferred tax realised ((80 000 + 125 000) x 27%)	<u>55 350</u>	
	<u>(295 650)</u>	[1]

C9. Factory building of ROB Ltd

Fair value at acquisition (given)	3 400 000	
Carrying amount (3 500 000 - 275 000)	<u>(3 225 000)</u>	
Fair value adjustment at acquisition	<u>175 000</u>	[1]
JOE cost of factory building on 1 July 20.18	3 600 000	
Depreciation for 20.19 ((3 600 000 - 550 000)/24)	<u>(127 083)</u>	[1]
JOE carrying amount on 30 June 20.19	3 472 917	
Unrealised gain on intragroup transaction (3 600 000 - 3 285 000)	(315 000)	[1]
Realised gain/additional depreciation (315 000/24)	<u>13 125</u>	[1]
Consolidated carrying amount on 30 June 20.19	<u>3 171 042</u>	
OR Fair value on 1 July 20.17	3 400 000	
Depreciation 20.17: ((3 400 000 - 525 000)/25)	<u>(115 000)</u>	[1]
Consolidated carrying amount 1 July 20.18	3 285 000	
OR 1 Jul 20.18 (3 400 000 - (3 400 000 - 525 000)/25)	3 285 000	[2]
Depreciation 20.18: ((3 285 000 - 550 000)/24)	<u>(113 958)</u>	[1]
Consolidated carrying amount on 30 June 20.19	<u>3 171 042</u>	
Adjustment in consolidated records (3 472 917 - 3 171 042)	(301 875)	<u>[4]</u>
Deferred tax at acquisition (175 000 x 27%)	(47 250)	
Deferred tax realised ((175 000/25 + 301 875) x 27%)	<u>83 396</u>	
	<u>36 146</u>	[1]

**COMMENT**

The factory building has a different value in the separate records, compared to the group financial statements. The starting point of the consolidation is a 100% trial balance of the parent plus a 100% trial balance of the subsidiary.

Therefore, the starting amount for the factory building will be the amount disclosed in the separate records. When consolidating, a pro forma consolidation journal entry needs to be processed to correctly adjust the value to the correct consolidated carrying amount.

C10. Machinery of MLU Ltd

	MZN	FX	R	
Fair value at acquisition	2 300 000		483 000	
Carrying amount	<u>(2 050 000)</u>		<u>(430 500)</u>	
Fair value adjustment at acquisition	250 000	0,21	52 500	[2]
Depreciation up to 1 July 20.18 (250 000/4 x 0.5)	(31 250)			[1]
Depreciation up to 30 June 20.19 (250 000/4)	<u>(62 500)</u>			
Carrying amount of FV adjustment at 30 June 20.19	<u>156 250</u>	0,27	<u>42 188</u>	<u>[1]</u>
				<u>[4]</u>
DT at acquisition (250 000 x 32%)	(80 000)			
DT realised depr ((31 250 x 32% = 10 000 x 3)	30 000			[1]
Deferred tax balance at 30 June 20.19	<u>(50 000)</u>	0,27	<u>(13 500)</u>	<u>[1]</u>
				<u>[2]</u>
Consolidated CA machinery (FCTR [C21] and [C23]):				
On 1 July 20.18 (250 000 - 80 000 - 31 250 + 10 000)			148 750	[1]
On 30 June 20.19 (148 750 - 62 500 + 20 000)			106 250	<u>[1]</u>
				<u>[2]</u>

**COMMENT**

IFRS 3 adjustments of foreign operation: Assets and liabilities that are created or that require a fair value adjustment at the acquisition date in terms of IFRS 3, will be accounted for in pro forma journal entries if they were not accounted for in the separate records of the acquiree (refer to Learning unit 2, Business combinations, in Tutorial Letter 102).

Therefore, these adjustments that have not been made in the separate records of the acquiree will also require FCTR adjustments at group level, since they were not automatically converted to the closing rate upon consolidation.

C11. Calculation of goodwill – BEN Ltd [IFRS 3.32]

Net asset value	(15 926 792)	
Equity at acquisition (1 000 000 + 9 754 000 + 4 551 000)	15 305 000	[1½]
Patent [C14]	512 500	[½]
Deferred tax [C14]	(143 500)	[½]
License agreement [C16]	401 085	[½]
Deferred tax (401 085 x 27%)	(108 293)	[½]
Contingent liability (given)	(400 000)	[½]
Indemnification asset (400 000 x 90%)	360 000	[½]
Consideration transferred at acquisition date [C12]	11 367 454	[3]
Amount of non-controlling interests (15 926 792 x 40%)	6 370 717	[½]
Goodwill	<u>1 811 379</u>	<u>[8]</u>

C12. Consideration paid to acquire interest in BEN Ltd

Manufacturing machine (given)	2 000 000	
Cash payment (given)	9 000 000	[1]
Acquisition-related costs (given)	(14 000)	[1]
Future payment [C13]	381 454	[1]
	<u>11 367 454</u>	<u>[3]</u>

C13. Future payment payable to acquire interest in BEN Ltd

HP 10BII	SHARP EL-733A	SHARP EL-738
1. 2nd F C (Clear All)	1. 2nd FC (Clear All)	1. 2ndF MODE (Clear All)
2. 1 2nd F PMT	2. -	2. -
3. 0 PMT	3. 0 PMT	3. 0 PMT
4. 9,44 I/YR	4. 9,44 i	4. 9,44 I/Y
5. 3 N	5. 3 n	5. 3 N
6. 500 000 FV	6. 500 000 FV	6. 500 000 FV
7. Comp PV = 381 454	7. Comp PV = 381 454	7. Comp PV = 381 454

[1]**C14. Technology patent**

Fair value at acquisition	1 225 000	
Carrying amount (750 000 – (750 000/10 x 0,5))	<u>(712 500)</u>	[2]
Fair value adjustment on 1 January 20.17	512 500	
Amortisation up to 30 June 20.19 (512 500/9.5 x 2,5)	<u>(134 868)</u>	[1]
Carrying amount of fair value adjustment	<u>377 632</u>	<u>[3]</u>
Deferred tax at acquisition (512 500 x 27%)	(138 375)	
Deferred tax realised (134 868 x 27%)	<u>33 414</u>	
	<u>(101 961)</u>	<u>[1]</u>

C15. License agreement

Fair value at acquisition date [C16]	401 085	[3]
Amortisation up to 30 June 20.19 (401 085/4 x 2.5)	(250 678)	[1]
Carrying amount of fair value adjustment	<u>150 407</u>	<u>—</u>
		<u>[4]</u>
Deferred tax at acquisition (401 085 x 27%)	(108 293)	
Deferred tax realised (250 678 x 27%)	67 683	
	<u>(40 610)</u>	<u>[1]</u>

C16. Present value of the license agreement

HP 10BII	SHARP EL-733A	SHARP EL-738	
1. 2nd F C (Clear All)	1. 2nd FC (Clear All)	1. 2ndF MODE (Clear All)	
2. 1 2nd F PMT	2. -	2. -	
3. 125 000 PMT	3. 125 000 PMT	3. 125 000 PMT	[1]
4. 9,44 I/YR	4. 9,44 i	4. 9,44 I/Y	[1]
5. 4 N	5. 4 n	5. 4 N	[1]
6. 0 FV	6. 0 FV	6. 0 FV	
7. Comp PV = 401 085	7. Comp PV = 401 085	7. Comp PV = 401 085	<u>—</u>
			<u>[3]</u>

C17. Calculation of goodwill – ROB Ltd [IFRS 3.32]

Net asset value	(18 596 750)	
Equity at acquisition (200 000 + 17 320 000)	17 520 000	[1]
Plant [C8]	1 300 000	[½]
Deferred Tax (1 300 000 x 27%)	(351 000)	[½]
Factory building [C9]	175 000	[½]
Deferred Tax (175 000 x 27%)	(47 250)	[½]
Consideration transferred at acquisition date (given)	12 000 000	[½]
Amount of non-controlling interests (18 596 750 x 45%)	8 368 538	[½]
Goodwill	<u>1 771 788</u>	<u>—</u>
		<u>[4]</u>

C18. Calculation of goodwill – MLU Ltd [IFRS 3.32]

Net asset value	(3 259 200)	
Equity at acquisition (15 350 000 x 0,21)	3 223 500	[1]
Machinery [C10]	52 500	[½]
Deferred Tax (52 500 x 32%)	(16 800)	[½]
Consideration transferred at acquisition date (75 000 x 190 x 0,21)	2 992 500	[1½]
Amount of non-controlling interests (3 259 200 x 25%)	814 800	[½]
Goodwill at acquisition	<u>548 100</u>	
Translated to closing rate (548 100 / 0,21 x 0,27)	<u>704 700</u>	<u>[1]</u>
		<u>[5]</u>

C19. Change in ownership [IFRS 10.23]

Fair value of consideration (15 000 x 250 x 0,27)	1 012 500	[2]
Amount by which NCI are adjusted (4 598 438 [C23] x 15%)	(689 766)	[1]
NCI after transaction (4 598 438 [C23] x 40%)	1 839 375	
NCI before transaction (4 598 438 x 25%)	(1 149 609)	
Total amount in equity	322 734	
FCTR ((237 675 [C21] + 498 338 [C23]) x 15%/75%)	147 203	[2]
Change in ownership	469 937	<u>—</u>
		<u>[5]</u>
Amount by which NCI is adjusted (689 766 – 147 203)	542 563	

**COMMENT**

Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary, are equity transactions (IFRS 10.23).

When the proportion of the equity held by non-controlling interest changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted, and the fair value of the consideration paid or received, and attribute it to the owners of the parent (IFRS 10.B96).

C20. Non-controlling interests - opening balance

	MZN	FX	R	25%	
Opening balance - MLU					
NCI at acquisition [C18]				814 800	[1]
Since acquisition share of P/L	628 750		138 113	34 528	
- given (14 900 000 - 14 250 000)	650 000	0,22	143 000		[1]
- Acc depreciation (machinery)	(31 250)	0,23	(7 188)		
- Deferred tax	10 000	0,23	2 300		
(depreciation net of tax at correct rate)					[1]
Since acquisition share of FCTR [C21]				79 225	[1]
NCI - MLU				928 553	
NCI - BEN (given)				8 100 000	
NCI - ROB (given)				9 200 000	[1]
				18 228 553	<u>—</u>
					<u>[5]</u>

C21. Foreign Currency Translation reserve (FCTR) - opening balance

	MZN	FX	R	
Net asset value of MLU - 1 July 20.18 (given)	16 000 000			[½]
Machinery [C10]	148 750			[½]
Translated net asset value - 1 July 20.18	16 148 750	0,23	3 714 213	[½]
At acquisition equity of MLU [C18]			(3 259 200)	[½]
Retained earnings of MLU [C20]			(138 113)	[½]
FCTR (ex-goodwill) on 1 July 20.18			316 900	
				<u>[2½]</u>
Goodwill at acquisition [C18]			(548 100)	[½]
Goodwill at 1 July 20.18 (548 100 [C13]/0,21 x 0,23)			600 300	[1]
FCTR on goodwill			52 200	
				<u>[1½]</u>
Att to parent [(316 900 x 75%) = 237 675 + 52 200]			289 875	[4]
Att to NCI (316 900 x 25%)			79 225	
				<u>[4]</u>

**COMMENT**

The FCTR on goodwill is only attributable to the parent, as NCI is measured at proportionate share. Therefore, NCI does not share in the goodwill. If NCI was measured at fair value, then the FCTR on goodwill will be apportioned between the parent and NCI, in accordance with their shareholding percentage.

C22. Total comprehensive income attributable to NCI

	MZN	FX	R	25%	
Profit for the year	882 500		219 775		
- given (15 825 000 - 14 900 000)	925 000	0,25	231 250		[1]
- Acc depreciation (machinery)	(62 500)	0,27	(16 875)		
- Deferred tax	20 000	0,27	5 400		
(Depreciation net of tax at correct rate)					[1]
			219 775	54 944	
FCTR for 1 July 20.18 - 30 June 20.19 [C23]				166 113	[1]
OCI of NCI of BEN				260 000	
OCI of NCI of ROB				340 000	[1]
Total OCI attributable to NCI				821 056	
					<u>[4]</u>

C23. Foreign Currency Translation reserve – OCI

	MZN	FX	R	
Net asset value of MLU - 30 June 20.19 (given)	16 925 000			[½]
Machinery [C10]	<u>106 250</u>			[½]
Translated net asset value - 30 June 20.19	17 031 250	0,27	<u>4 598 438</u>	[½]
Translated net asset value - 1 July 20.18 [C16]			(3 714 213)	[½]
Profit of MLU [C22]			<u>(219 775)</u>	[½]
			<u><u>664 450</u></u>	<u>[2½]</u>
Goodwill at 1 July 20.18 [C21]			(600 300)	[½]
Goodwill at 1 July 20.18 (548 100 [C13]/0,21 x 0,27)			<u>704 700</u>	[1]
FCTR on goodwill			<u><u>104 400</u></u>	<u>[1½]</u>
Att to parent ((664 450 x 75%) = 498 338 + 104 400)			602 738	[4]
Att to NCI (664 450 x 25%)			166 113	

CASE STUDY 8**100 marks****YOU HAVE 30 MINUTES' READING TIME. SPEND 30 MINUTES READING THE CASE STUDY BEFORE YOU CONTINUE TO THE REQUIRED SECTION.****QUESTION 1****60 marks**

Busco Ltd ("Busco") is a company listed on the Johannesburg Stock Exchange. Busco is a leading passenger transport company with numerous subsidiaries and associates.

The group accountant of Busco, Mr Clueless, approached you to be of assistance in two outstanding matters for the financial year ended 30 June 20.19.

Matter 1: Consolidated statement of cash flows**1. Consolidated trial balance**

The following consolidated trial balance as at 30 June 20.19 for the Busco Group is presented to you:

	20.19	20.18
	R	R
Property, plant and equipment	7 659 000	8 435 000
Intangible asset	320 000	390 000
Investment in associates	278 600	450 000
Investment in financial assets	710 000	145 000
Goodwill	89 000	326 500
Inventories	305 000	456 000
Trade and other receivables	540 000	601 000
Share capital	(1 435 000)	(1 035 000)
Retained earnings	(5 433 340)	(4 375 340)
Mark-to-market reserve	(98 100)	(47 660)
Non-controlling interests	(556 392)	(1 828 500)
Lease liability	(477 110)	-
Deferred tax	(998 104)	(1 120 000)
Current portion of lease liability	(191 850)	-
Trade and other payables	(620 364)	(750 000)
Bank overdraft	(91 340)	(1 647 000)
	<u>-</u>	<u>-</u>

2. Property, plant and equipment

On 1 July 20.18 Busco acquired bus-washing equipment at a cost of R800 000 by means of a lease agreement. The liability is payable in five annual instalments of R191 850 each, payable annually in advance, commencing on 1 July 20.18. The accrued interest is included in finance costs. Busco did not elect the simplified accounting treatment for the equipment.

One of Busco's busses was damaged by protesters during the year. On the date of the incident the following values were applicable to the bus:

	R
Carrying amount	870 000
Selling price	900 000
Cost to sell	45 000
Value in use	845 000

The proceeds from the disposal of property, plant and equipment amounted to R650 000 for the year and the carrying amount of the assets on the date of disposal was R584 000. It is estimated that R1 500 000 of the property, plant and equipment acquisitions are investments in future operations, the remaining balance being replacements.

Depreciation for the group amounted to R520 000 for the year.

3. Current assets and liabilities

Trade and other receivables comprised the following:

	20.19 R	20.18 R
Trade receivables	491 000	505 000
Allowance for credit losses	(36 000)	(24 000)
Prepaid expenses	85 000	120 000
	<u>540 000</u>	<u>601 000</u>

Bad debts written off during the current financial year amounted to R15 600.

Trade and other payables comprised the following:

	20.19 R	20.18 R
Trade payables and accruals	307 764	584 000
South African Revenue Services	272 600	142 000
Shareholders for dividends	40 000	24 000
	<u>620 364</u>	<u>750 000</u>

4. Town-to-Town Ltd

Busco acquired a 30% interest in Town-to-Town Ltd ("Town-to-Town") on 1 June 20.15 for R150 000 and exercised significant influence over the financial and operating policy decisions of Town-to-Town from that date. The fair value of the net assets of Town-to-Town on that date amounted to R400 000 and the acquisition of Town-to-Town did not result in the recognition of an excess on 1 June 20.15. On 1 January 20.19 Busco acquired an additional 50% interest in Town-to-Town and obtained control of Town-to-Town as per IFRS 10 *Consolidated Financial Statements* from that date. The purchase consideration was settled as follows:

- A cash payment of R110 000 on 1 January 20.19.
- The issue of 2 500 ordinary shares of Busco to the seller. The fair value of these shares was R120 per share on 1 January 20.19 and R130 per share on 30 June 20.19.
- The transfer of equipment to Town-to-Town to be used for business purposes, with a carrying amount of R66 000 and a fair value of R75 000 on 1 January 20.19.

The fair value of the previously held 30% interest amounted to R320 000 on the date of change in the shareholding, and the fair value of the non-controlling interests was R195 000.

The assets and liabilities according to the trial balance of Town-to-Town as at 1 January 20.19 were as follows:

	R
Property, plant and equipment	780 000
Inventory	95 000
Trade and other receivables	120 000
Cash and cash equivalents	52 000
Trade and other payables	<u>(109 000)</u>
	<u>938 000</u>

All the assets and liabilities of Town-to-Town were deemed to be fairly valued on 1 January 20.19, with the exception of:

- Equipment, which was undervalued by R110 000 on the acquisition date. Town-to-Town did not record the revaluation.
- Trade receivables were overvalued by R8 900. The receivables were still outstanding as at 30 June 20.19.
- Town-to-Town had an assessed tax loss of R70 000 on 1 January 20.19, for which no deferred tax asset was recognised on this date or at year end. On acquisition date the group held the opinion that Town-to-Town would earn profits in the future, as Town-to-Town's budget reflected sufficient taxable profits to fully utilise the assessed tax loss.

Busco elected to measure non-controlling interests for the acquisition of Town-to-Town at fair value at the acquisition date. Busco did not acquire another subsidiary during the current financial year.

5. Carrylux Ltd

On 1 October 20.15 Busco acquired a 55% controlling interest in Carrylux Ltd ("Carrylux") for R1 750 000 cash. On that date the issued share capital of Carrylux amounted to R250 000, while the retained earnings amounted to R2 500 000. All the assets and liabilities of Carrylux were deemed to be fairly valued on the acquisition date.

On 1 March 20.19 Busco disposed of a 45% interest in Carrylux for R2 500 000, resulting in a remaining interest of 10%. The remaining 10% interest had a fair value of R500 000 on 1 March 20.19. From that date, Busco did not exercise control or significant influence over the financial and operating policy decisions of Carrylux.

The settlement amount consisted of a cash payment of R2 000 000 and inventory valued at R500 000.

The assets and liabilities extracted from the trial balance of Carrylux as at 1 March 20.19 were as follows:

	R
Property, plant and equipment	4 300 000
Inventory	260 000
Trade and other receivables	450 000
Bank overdraft	(130 000)
Trade and other payables	(210 000)
	<u>4 670 000</u>

Busco elected to measure non-controlling interests for the acquisition of Carrylux at their proportionate interest in the acquiree's identifiable net assets at the acquisition date. Busco did not dispose of another subsidiary during the current financial year.

6. Bluehound Ltd

On 1 May 20.19 Busco acquired a 40% interest in Bluehound Ltd ("Bluehound") for cash. Busco exercised significant influence over the financial and operating policy decisions of Bluehound from that date. No other associates were acquired or disposed of, except for Town-to-Town (refer note 4) during the current financial year.

7. Statement of cash flows

The following extract of the consolidated statement of cash flows of the Busco Ltd Group for the year ended 30 June 20.19 was prepared by Mr Clueless:

	R
Cash flows from investing activities	
Acquisition of property, plant and equipment	(3 210 850)
Proceeds from disposal of subsidiary	2 500 000
Acquisition of subsidiary	(476 000)
Net cash used in investing activities	<u>(1 186 850)</u>
Cash flows from financing activities	
Proceeds from shares issued	400 000
Goodwill	(237 500)
Proceeds from lease liability	668 960
Net cash from financing activities	<u>831 460</u>

8. Additional information

- The following amounts were included in the 20.19 consolidated financial statements for the group:

	R
Share of profit of associates	75 000
Finance cost	(84 000)
Profit before tax	2 588 392
Income tax expense	(780 000)
Profit for the period attributable to owners of the parent	1 123 000
Profit for the period attributable to non-controlling interests	685 392

- Total dividends of R55 000 were received during the current financial year (R40 000 from associates and R15 000 from other financial assets).
- Busco discloses cash flows from interest and dividends as operating cash flows.
- Goodwill in the consolidated financial statement of the Busco Ltd Group was not impaired for the current financial year.
- No intangible assets were acquired or disposed of during the current financial year.
- No financial asset was acquired (except for Carrylux) or disposed of during the current financial year.
- Assume the total amount disclosed as part of investing activities for “Acquisition of property, plant and equipment” (refer note 7) is correct.
- Assume a normal income tax rate of 27% and a Capital Gains Tax inclusion rate of 80%. Ignore Value Added Tax (VAT) and Dividend Tax.

Matter 2: Draft agreement

The management of Busco is considering an agreement with a tour operator, Mzansi Travel Ltd (“Mzansi Travel”). According to the agreement a new company, Phuti Ltd (Phuti), will be established to transport tourists to and from the Kruger National Park in small luxury minivans. The draft agreement is provided below:

DRAFT AGREEMENT	
Parties:	Busco and Mzansi Travel, herein after collectively referred to as “the Parties”
Purpose:	To provide a framework for a future binding contract governing the establishment of Phuti
Terms, conditions and obligations:	<ol style="list-style-type: none"> 1. The Parties agree to subscribe to the ordinary shares of Phuti in the following ratio: <ul style="list-style-type: none"> • Busco: 50% • Mzansi Travel: 50% 2. The Parties will share in the profit or loss of Phuti in a ratio equal to the Parties’ shareholding percentage. 3. The Parties will each be entitled to equal representation on the board of directors. 4. Phuti will render transport services for tours arranged by Mzansi Travel. However, such services may also be rendered to other tour operators. 5. Decisions regarding operational strategies and the implementation thereof will require the majority approval of the board. 6. Decisions regarding the acquisition of significant assets and/or debt, will require a 75% majority vote. Voting rights for such decisions will be exercised in accordance with the Parties’ profit-sharing ratio, whereby each share held will be equal to one vote. 7. The Parties agree to provide the necessary funding to honour any commitments made by Phuti to financial institutions. 8. The Parties agree that any financed assets and their corresponding liabilities will be registered in Phuti’s name.

QUESTION 2**40 marks**

This question consists of two independent parts.

PART I**20 marks**

Green Ltd ("Green") is a manufacturer and distributor of paint and is listed on the Johannesburg Stock Exchange. Green is a registered Value Added Tax (VAT) vendor. On 25 May 20.19 Green entered into a non-cancellable contract with the Gauteng Department of Education (Gauteng DoE) to deliver 100 000 litres of roof paint for school maintenance projects during the June school holiday. Roof paint is sold in 20-litre tubs for R600 (excluding VAT) each. Due to the sizable order, the Gauteng DoE requested a 10% discount. Green initially declined the discount request, as Green's prices are already very competitive. The Gauteng DoE subsequently agreed to settle the contract upfront (before delivery of the paint) in order to secure a 10% early settlement discount. Green considered it probable that the discount will be granted.

The contract payment date was agreed as 10 June 20.19 and the paint would be delivered on 15 June 20.19.

Green delivered the paint as agreed on the delivery date. However, the Gauteng DoE only settled their account on 31 July 20.19. Due to the late payment, the Gauteng DoE forfeited the early settlement discount.

PART II**20 marks**

Bulawayo Ltd ("Bulawayo") is a company listed on the Johannesburg Stock Exchange. The Bulawayo Ltd Group consists of investments in various entities. The year end of all entities in the group is 31 August. Details of one such investment is provided below.

Bulawayo acquired 25% of the ordinary share capital of Mutare Ltd (Mutare) for R400 000 on 1 September 20.17, thereby exercising significant influence over the financial and operating policies of Mutare from that date. At this date, Mutare's net asset value was considered to be fairly valued, with the exception of inventory that was overstated by R45 000.

On 1 March 20.18 Mutare sold equipment to Bulawayo at a profit of 50% on cost. The equipment is still included in the equipment of Bulawayo on 31 August 20.19. The selling price of the equipment to Bulawayo was R222 000.

Details of the equity value of Mutare at the relevant dates were as follows:

	1 September 20.17	31 August 20.18	31 August 20.19
	R	R	R
Share capital (100 000 shares)	100 000	100 000	100 000
Preference shares (issued at R2 each)	50 000	50 000	50 000
Retained earnings	1 600 000	1 400 000	1 500 000
Mark-to-market reserve	60 000	65 000	80 000

The preference shares are cumulative, non-redeemable and attract an annual preference dividend of R7 500. Preference dividends were last declared and paid on 31 August 20.16. On 31 August 20.19 Mutare declared and paid the outstanding preference share dividends and an ordinary dividend to shareholders of R25 000.

Additional information

- It is the policy of Bulawayo to account for its investments in subsidiaries and associates in accordance with IAS 27 at cost.
- All entities in the group account for property, plant and equipment on the cost model in terms of IAS 16 *Property, Plant and Equipment*. Depreciation on equipment is provided at 20% per annum on the straight-line method.
- Assume an income tax rate of 27% and a Capital Gains Tax inclusion rate of 80%. Ignore the effects of Dividend Tax (both parts) and Value Added Tax (VAT) in Part II only.

CASE STUDY 8**REQUIRED**

YOU NOW HAVE 150 MINUTES TO COMPLETE THE CASE STUDY.

QUESTION 1

	Marks
(a) Prepare only the cash flows from the operating activities section of the consolidated statement of cash flows of the Busco Ltd Group for the year ended 30 June 20.19 according to the indirect method .	39
Communication skills: presentation and layout	1
(b) Critically discuss any non-compliance with IAS 7 in the investing and financing sections of the consolidated statement of cash flows of the Busco Ltd Group for the year ended 30 June 20.19 that was prepared by Mr Clueless. Where necessary, include how the amount should have been calculated and/or disclosed.	12
(c) Explain, with reasons, the appropriate classification and recognition of the proposed joint arrangement, Phuti Ltd, in accordance with IFRS 11 <i>Joint Arrangements</i> in the financial statements of the Busco Ltd Group, should the draft agreement be formalised.	8
Please note:	
<ul style="list-style-type: none"> • Comparative figures are not required. • Round off all amounts to the nearest rand. • Your answer must comply with International Financial Reporting Standards (IFRS). 	

QUESTION 2

	Marks
PART I	
(a) Discuss "Step 3: Determine the transaction price" of the five steps of revenue recognition in the accounting records of Green Ltd relating to the contract with the Gauteng Department of Education, in accordance with IFRS 15 <i>Revenue from Contracts with Customers</i> .	6
Communication skills: logical flow and conclusion	1
(b) Prepare the journal entries in the accounting records of Green Ltd to account for the contract with the Gauteng Department of Education, in accordance with IFRS 15 <i>Revenue from Contracts with Customers</i> .	10
Please note:	
• Ignore any income tax consequences.	
(c) Briefly discuss how the journal entries in (b), above, would have been different if the contract between Green Ltd and the Gauteng Department of Education was cancellable.	3
Please note:	
• Ignore any income tax consequences.	
PART II	
Prepare the pro forma consolidated journal entries to account for the investment in Mutare Ltd in the consolidated financial statements of Bulawayo Ltd Group for the year ended 31 August 20.19.	19
Communication skills: presentation and layout	1
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).	

CASE STUDY 8**QUESTION 1 – Suggested solution****(a) BUSCO LTD GROUP****EXTRACT OF CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 20.19**

	R	
Cash flows from operating activities		
Profit before taxation (given)	2 588 392	(1)
Adjustments for:		
Other income [C1]	(323 303)	(14)
Share of profit of associates (given)	(75 000)	(1)
Finance cost (given)	84 000	(1)
Bad debts written off (given)	15 600	(1)
Depreciation (given)	520 000	(1)
Amortisation/impairment (390 000 – 320 000)	70 000	(1)
Impairment loss [C6]	15 000	(1)
	2 894 689	
Increase in trade and other receivables [C7]	(293 500)	(3)
Decrease in inventories [C8]	486 000	(2½)
Decrease in trade payables and accruals [C9]	(175 236)	(2)
Cash generated from operations	2 911 953	
Interest paid [C10]	(23 190)	(2½)
Income tax paid [C11]	(793 590)	(5)
Dividend received (given)	55 000	(1)
Dividend paid [C12]	(100 000)	(4)
Net cash from operating activities	2 050 173	—
	Total	(41)
	Maximum	(39)
Communication skills: presentation and layout		(1)

**COMMENT**

Part B of the SAICA handbook includes illustrative examples of the direct and indirect methods of a statement of cash flows.

CALCULATIONS**C1. Other income**

Dividends received (given)	(15 000)	[1]
Fair value adjustment (Town-to-Town) [C2]	(8 600)	[2]
Gain on bargain purchase (Town-to-Town) [C3]	(39 703)	[5½]
Consolidated profit on disposal of subsidiary (Carrylux) [C4]	(194 000)	[4½]
Profit on disposal of property, plant and equipment (650 000 - 584 000)	(66 000)	[1]
	(323 303)	[14]

C2. Fair value adjustment

Cost price of investment in Town-to-Town (associate)	150 000	
Since reserves ((938 000 – 400 000) x 30%)	161 400	
Carrying amount of investment in Town-to-Town as at 1 January 20.19	<u>311 400</u>	[1]
Fair value as at 1 January 20.19 (given)	<u>(320 000)</u>	[1]
	<u>(8 600)</u>	<u>[2]</u>

**COMMENT**

The change in control for an associate to a subsidiary is on level Awareness (refer to tutorial letter 104 Example 2C). In accordance with IFRS 3, the previously held investment (associate) should be measured at fair value on the day that control is obtained. This fair value adjustment is non-cash and should be added back.

C3. Gain on bargain purchase

Consideration transferred at acquisition date:		
- Cash (given)	110 000	
- Shares (2500 x R120)	300 000	
- Equipment transferred	66 000	
	<u>476 000</u>	[1]
Non-controlling interests at acquisition date (given)	195 000	[½]
Acquisition date fair value of previous investment	<u>320 000</u>	[½]
	991 000	
Net asset value at acquisition date:		
- Net asset value (given)	938 000	[½]
- Fair value adjustment on equipment (110 000 (given) x 73%)	80 300	[1]
- Fair value adjustment on receivables (8 900 (given) x 73%)	(6 497)	[1]
- Deferred tax asset (70 000 x 27%)	18 900	[1]
	<u>1 030 703</u>	
Gain on bargain purchase	<u>(39 703)</u>	<u>[5½]</u>

C4. Consolidated profit on disposal of subsidiary

Derecognise net assets (given)	4 670 000	[½]
Derecognise goodwill [C5]	237 500	[2]
Derecognise non-controlling interests (4 670 000 x 45%)	(2 101 500)	[1]
Recognise fair value of consideration received (given)	(2 500 000)	[½]
Recognise fair value of retained investment (given)	<u>(500 000)</u>	[½]
	<u>(194 000)</u>	<u>[4½]</u>

C5. Goodwill Carrylux

Consideration transferred at acquisition date (given)	1 750 000	
Non-controlling interests at acquisition date (2 750 000 x 45%)	1 237 500	
	<u>2 987 500</u>	[1]
Net asset value at acquisition date:		
- Share capital (given)	250 000	
- Retained earnings (given)	2 500 000	
	<u>2 750 000</u>	[1]
Goodwill	<u>237 500</u>	<u>[2]</u>

C6. Impairment loss

Recoverable amount is the higher of:		
Fair value less costs to sell (900 000 – 45 000)	855 000	
Value in use	845 000	
Carrying amount of machine	870 000	
Recoverable amount	<u>(855 000)</u>	
Impairment loss	<u>15 000</u>	[1]

C7. Increase in trade and other receivables

Movement (601 000 – 540 000)	61 000	[1]
Town-to-town acquired	120 000	[½]
Bad debts written off	(15 600)	[½]
Town-to-town acquisition fair value adjustment	(8 900)	[½]
Carrylux disposed	<u>(450 000)</u>	[½]
	<u>(293 500)</u>	<u>[3]</u>

C8. Decrease in inventories

Movement (456 000 – 305 000)	151 000	[1]
Town-to-town acquired	95 000	[½]
Carrylux (inventory received as payment)	500 000	[½]
Carrylux disposed	<u>(260 000)</u>	[½]
	<u>486 000</u>	<u>[2½]</u>

C9. Decrease in trade payables and accruals

Movement (307 764 – 584 000)	(276 236)	[1]
Town-to-town acquired	(109 000)	[½]
Carrylux disposed	210 000	[½]
	<u>(175 236)</u>	<u>[2]</u>

C10. Interest paid

Lease - initial capital amount	(800 000)	
Less: Instalment paid on 1 July 20.18	191 850	
Outstanding balance as at 1 July 20.18	<u>(608 150)</u>	[1]
Outstanding balance as at 30 June 20.19 (477 110 + 191 850)	<u>668 960</u>	[1]
Accrued interest on lease liability	60 810	
Finance cost (given)	<u>(84 000)</u>	[½]
	<u>(23 190)</u>	<u>[2½]</u>

**COMMENT**

The bus washing equipment acquired during the year was acquired through a non-cash transaction (lease). According to note 2, the accrued interest on the lease was included in finance cost. Accrued interest is non-cash and should, therefore, be removed from finance cost to calculate interest paid.

The accrued interest is calculated as the difference between the opening and closing balance of the lease liability account.

C11. Income tax paid

Deferred taxation – movement (998 104 – 1 120 000)	(121 896)	[1]
Deferred tax on fair value adjustment on equipment at acquisition of Town-to-Town (110 000 x 27%)	(29 700)	[½]
Deferred tax on fair value adjustment on receivables at acquisition of Town-to-Town (8 900 x 27%)	2 403	[½]
Deferred tax on assessed loss at acquisition of Town-to-Town (70 000 x 27%)	18 900	[½]
Deferred tax on the movement of the mark-to-market reserve ((98 100 – 47 660)/0,784) = 64 337 (64 337 x 80% x 27%)	<u>(13 897)</u>	[1]
Movement of deferred tax included in profit or loss	(144 190)	
Income tax expense included in profit or loss (given)	<u>(780 000)</u>	[½]
	(924 190)	
South African Revenue Services – movement (272 600 – 142 000)	<u>130 600</u>	[1]
	<u>(793 590)</u>	<u>[5]</u>

C12. Dividend paid

Dividend paid to shareholders of parent [C13]	(49 000)	[2]
Dividend paid to shareholders of non-controlling interests [C15]	<u>(51 000)</u>	[2]
	<u>(100 000)</u>	<u>[4]</u>

C13. Dividend paid to shareholders of parent

Shareholders for dividends – movement (40 000 – 24 000)	16 000	[1]
Dividends declared [C14]	<u>(65 000)</u>	[1]
	<u>(49 000)</u>	<u>[2]</u>

**COMMENT**

If the question does not state that the parent did not declare dividends and the amount is not given, you should reconcile the retained earnings account to calculate the dividends declared by the parent.

C14. Dividends declared

Retained earnings - opening balance	(4 375 340)	
Profit for the period attributable to owners of the parent (given)	(1 123 000)	
Retained earnings - closing balance	5 433 340	
	<u>(65 000)</u>	[1]

C15. Dividend paid to shareholders of non-controlling interests

Non-controlling interests – movement (556 392 – 1 828 500)	(1 272 108)	[1]
Profit for the period attributable to non-controlling interests (given)	(685 392)	[½]
Acquisition of Town-to-Town (given)	(195 000)	[½]
Disposal of Carrylux [C4]	2 101 500	
	<u>(51 000)</u>	[2]

- (b) Critically discuss any non-compliance with IAS 7 in the investing and financing sections of the consolidated statement of cash flows of the Busco Ltd Group for the year ended 30 June 20.19 that was prepared by Mr Clueless.**

Investing activities

The amount for “Acquisition of property, plant and equipment” should be split between the cash flow to maintain operating capacity and to increase operating activity (IAS 7.50(c)). Therefore, the amount should be disclosed as follows:

- maintaining operating activity = R1 710 850 (3 210 850 – 1 500 000)
- increase in operating activity = R1 500 000 (given) (2)

The “Proceeds from disposal of subsidiary” amount should be presented net of the cash of the subsidiary given up. The cash amount received was R2 000 000 and the bank overdraft of Carrylux was R130 000. Therefore, the net cash inflow should be disclosed as R2 130 000. (1)

The “Acquisition of subsidiary” amount should also be presented net of cash of the subsidiary acquired. The cash amount paid was R110 000 and the bank balance of Town-to-Town was R52 000. Therefore, the net cash outflow should be disclosed as R58 000. (1)

The proceeds from the disposal of property, plant and equipment of R650 000 should be disclosed on the face of the statement as an investing activity. (1)

During the current year Busco acquired 40% interest in Bluehound (an associate) for cash. This should be presented as an investing activity. The amount should be calculated as follows: (3)

	R
Investment in associate: carrying amount at the beginning of year	450 000
Town-to-Town (associate derecognise)	(311 400)
Share of profit of associates (given)	75 000
Dividends received from associates (given)	(40 000)
Investment in associate: carrying amount at the end of year	<u>(278 600)</u>
Bluehound acquired for cash amount	<u>(105 000)</u>

Financing activities

The "Proceeds from the shares issued" amount should only include shares issued for cash. As part of the consideration paid for the step acquisition of Town-to-town, Busco issued R300 000 (2 500 x R120) shares. Therefore, the "Proceeds from the shares issued" amount should be disclosed as R100 000 (400 000 – 300 000). (1)

The movement in goodwill is not a cash flow and should not be included in the statement of cash flows. (1)

The lease liability was incurred to acquire bus washing equipment at a cost of R800 000 by means of a lease agreement. Therefore, there will be no cash inflow from obtaining the lease. The lease payment of R191 850 for the year will be presented as an outflow of cash under financing activities. (2)
(12)

- (c) **Discuss, with reasons, the appropriate classification and recognition of the proposed joint arrangement, Phuti Ltd, in accordance with IFRS 11 Joint Arrangements in the financial statements of the Busco Ltd Group, should the draft agreement be formalised.**

Structure of the joint arrangement – legal form

The contractual agreement is carried out through a separate vehicle, Phuti. Therefore, the joint arrangement can either be classified as a joint venture or a joint operation (IFRS 11.19B). (1)

Terms of the contractual arrangement

The commitment by the parties to provide funding if Phuti is not able to meet commitments made to financial institutions, is not by itself a determinant that the parties have an obligation for the liabilities of Phuti (IFRS 11.B27). (1)

Considering that all financed assets and their corresponding liabilities will be registered in Phuti's name, the parties to the arrangement will have no claim to these assets or obligation towards such liabilities and will resultantly only be entitled to the arrangement's net assets. (1)

Other facts and circumstances

Transport services will be rendered to Mzansi Travel. However, such services may also be rendered to other tour operators. Settling of the liabilities incurred by the joint arrangement will, therefore, not be dependent only on the cash flows received from the parties to the arrangement, which indicates that the parties do not have rights to substantially all the economic benefits of the assets and do not have an obligation for the liabilities relating to the joint arrangement (IFRS 11.B31 and B32). (2)

Conclusion

Busco and Mzanzi Travel do not have rights to the assets and obligations for the liabilities relating to the arrangement. (1)

The proposed joint arrangement will resultantly be classified as a joint venture in the financial statements of the Busco Group. (1)

Busco will recognise its rights to the net assets of Phuti as an investment in a joint venture and account for the investment by applying the equity method, in accordance with IAS 28 *Investments in Associates and Joint Ventures*. (1)
(8)

QUESTION 2 - Suggested solution**PART I**

- (a) Discuss “Step 3: Determine the transaction price” of the five steps of revenue recognition, in the accounting records of Green Ltd relating to the contract with the Gauteng Department of Education, in accordance with IFRS 15 *Revenue from Contracts with Customers*.

Step 3: Determine the transaction price

The transaction price is the amount of consideration to which Green expects to be entitled in exchange for 5 000 (100 000/20) tubs of roof paint, excluding amounts collected on behalf of third parties. VAT is collected on behalf of the Receiver of Revenue; therefore, the VAT amount will not be included in transaction price. (1)

The consideration may include fixed amounts, variable amounts, or both. (1)

The contract between Green and the Gauteng DoE includes an element of variable consideration in the form of a discount. (1)

Green expects (entity’s intention) that it will grant the 10% early settlement discount, resulting in the transaction price calculated, excluding the discount (IFRS 15.52(b)). (1)

Green should estimate the amount of variable consideration by either using probabilities or the most likely amount, depending on which method Green expects to better predict the amount of consideration to which it will be entitled. The most likely outcome is that the discount will be given. (1)

The variable consideration, estimated in line with the above requirements, should only be recognised if it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. (1)

Therefore, the transaction price will be calculated as R3 000 000 – (10% x R3 000 000) = R2 700 000. (1)

If, at settlement date, the discount is forfeited, the discount amount of R300 000 will then be recognised as revenue. (1)

Total (8)
Maximum (6)
Communication skills: logical flow and conclusion (1)

**COMMENT**

The standard should be used as basis for the answer. IFRS 15.51 states: An amount of consideration can **vary** because of **discounts**, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items.

IFRS 15.50: If the consideration promised in a contract includes a **variable amount**, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

- (b) Prepare the journal entries in the accounting records of Green Ltd to account for the contract with the Gauteng Department of Education, in accordance with IFRS 15 *Revenue from Contracts with Customers*.

	Dr R	Cr R	
25 May 20.19			
No entry			
10 June 20.19			
J1	3 450 000		(1)
			(1)
		345 000	(1)
		405 000	(1)
		2 700 000	(1)
Recognising the receivable on due date for payment (contract is non-cancellable) and contract liability			
15 June 20.19			
J2	2 700 000		(1)
		2 700 000	(1)
Recognising the revenue and reversing the contract liability			
31 July 20.19			
J3	345 000		(1)
		300 000	(1)
		45 000	(1)
Reversing the discount allowance account and recognising it as revenue			
J4	3 450 000		(1)
		3 450 000	(1)
Recognition of settlement of contract			
		Total	<u>(11)</u>
		Maximum	<u>(10)</u>

- (c) Briefly discuss how the journal entries in (b), above, would have been different if the contract between Green Ltd and the Gauteng Department of Education was cancellable.

No journal entry will be processed on 10 June 20.19, as the right to the consideration is not unconditional. Neither Green nor the Gauteng Department of Education has performed in terms of the contract thus far. (1)

A receivable and revenue will be recognised on 15 June 20.19, since Green performed by delivering the roof paint to the customer on this date. (1)

The amount of revenue recognised on 15 June will be the full transaction price without the discount (R3 000 000), as this is the most likely amount. (1)

On payment date, 31 July 20.19, the receivable and bank accounts will be netted off and no reversal of discount will be required. (1)

Total (4)
Maximum (3)

PART II

Prepare the pro forma consolidated journal entries to account for the investment in Mutare Ltd in the consolidated financial statements of Bulawayo Ltd Group for the year ended 31 August 20.19.

		Dr R	Cr R	
J1	Investment (SFP) [C1]	29 913		(3)
	Retained earnings (SCE)		29 913	(1)
	Recognition of the excess on acquisition			
J2	Retained earnings (SCE) [C1]	43 663		(2)
	Dividend income (P/L)	6 250		(1)
	Mark-to-market reserve (SCE)		1 250	(1)
	Share of profit of associate (P/L)		35 000	(2)
	Share of other comprehensive income of associate (OCI)		3 750	(1)
	Investment (SFP) (balancing)		9 913	(1)
	Recognition of share of associates since reserves			
J3	Retained earnings (SCE) (balancing)	12 154		(1)
	Deferred tax (SFP) [(18 500 – 1 850) x 27%]	4 496		(1)
	Accumulated depreciation (SFP) (18 500 x 20% x 6/12)	1 850		(2)
	Equipment (SFP) (222 000 x 50/150 x 25%)		18 500	(2)
	Correction of retained earnings in respect of unrealised profit included in the equipment of Bulawayo			
J4	Accumulated depreciation (SFP) (18 500 x 20%)	3 700		(1)
	Share of profit of associate (P/L)		3 700	(1)
	Realisation of unrealised profit in the current year through depreciation			
J5	Share of profit of associate (P/L) (3 700 x 27%)	999		(1)
	Deferred tax (SFP)		999	(1)
	Tax implication of realisation of unrealised profit in current year			
			Total	<u>(22)</u>
			Maximum	<u>(19)</u>
			Communication skills: presentation and layout	<u>(1)</u>

**COMMENT**

Unless the scenario clearly states that there was goodwill at the acquisition of the interest in the associate or that no excess arose at the acquisition, good exam technique is to always calculate an excess.

There is only one way to eliminate intragroup transactions, ensure that you practice and am able to do the various scenarios. You can refer back to tutorial letter 103 and group statements chapter 11 for additional examples.

CALCULATION**C1. Owners' equity analysis of Mutare Ltd**

	100%	Bulawayo Ltd 25%	
		At	Since
At acquisition			
Retained earnings (given)	1 600 000		
Inventory overstated (given)	(45 000)		
Deferred tax on inventory (45 000 x 27%)	12 150		
Preference dividends outstanding (given)	(7 500)		
	1 559 650	389 913	
Share capital (given)	100 000	25 000	
Mark-to-market reserve (given)	60 000	15 000	
	1 721 650	429 913	
Excess		(29 913)	
Consideration transferred (given)		400 000	
Since acquisition up to current year			
Retained earnings movement (1 400 000 – 1 600 000)	(200 000)		
Inventory overstated realised (45 000 -12 150)	32 850		
Preference dividends outstanding (given)	(7 500)		
	(174 650)		(43 663)
Mark-to-market reserve movement (65 000 – 60 000)	5 000		1 250
Current year			
Retained earnings movement (1 500 000 – 1 400 000)	100 000		
CY ordinary dividend paid (given)	25 000		
Preference dividends paid in CY relating to PY (7 500 + 7 500)	15 000		
	140 000		35 000
Mark-to-market reserve movement (80 000 – 65 000)	15 000		3 750
Dividend (given)	(25 000)		(6 250)
	1 682 000		(9 913)

CASE STUDY 9**100 marks**

YOU HAVE 30 MINUTES' READING TIME. SPEND 30 MINUTES READING THE CASE STUDY BEFORE YOU CONTINUE TO THE REQUIRED SECTION.

QUESTION 1**75 marks**

Mumbai Ltd ("Mumbai") is a company that is listed on the Johannesburg Stock Exchange. Mumbai sources, mixes and packages herbs and spices for the South African retail market. Mumbai and all its investments have a 31 August year end.

The following trial balances are presented as at 31 August 20.18:

	Mumbai Ltd R	Phi-Phi Ltd THB	New Delhi Ltd R	Kolkata Ltd R
Ordinary share capital (100 000 shares; 500 000 shares; 100 000 shares; 100 000 shares)	(200 000)	(500 000)	(100 000)	(100 000)
Preference share capital	-	-	-	(20 000)
Retained earnings	(3 125 000)	(1 850 000)	(750 000)	(195 000)
Mark-to-market reserve	(130 000)	-	(430 000)	-
Other comprehensive income for the year: Mark-to-market reserve	(60 000)	-	(70 000)	(20 000)
Trade and other payables	(405 000)	(110 000)	(135 000)	(75 000)
Contingent consideration (relating to acquisition of Kolkata)	(30 000)	-	-	-
Revenue	(5 700 000)	(2 100 000)	(1 200 000)	(1 300 000)
Other income	(165 000)	-	-	(47 000)
Property, plant and equipment	1 420 000	1 320 000	450 000	245 000
Investments				
Ordinary shares of Phi-Phi Ltd	114 764	-	-	-
Ordinary shares of New Delhi Ltd	350 000	-	-	-
Ordinary shares of Kolkata Ltd	250 000	-	-	-
1 000 Preference shares of	15 000	-	-	-
Other equity investments at fair value	810 000	-	700 000	180 000
Inventory	780 000	610 000	125 000	45 000
Trade and other receivables	450 000	340 000	285 000	88 000
Cash and cash equivalents	265 236	310 000	155 000	11 000
Cost of sales	2 222 000	830 000	600 000	700 000
Administrative expenses	1 560 000	620 000	80 000	350 000
Income tax expense	1 078 000	130 000	230 000	90 000
Preference dividend declared and paid on 31 August 20.18	-	-	-	18 000
Ordinary dividend declared and paid on 31 August 20.18	500 000	-	60 000	30 000
Ordinary dividend declared and paid on 31 July 20.18	-	400 000	-	-
	-	-	-	-
Profit for the year	(1 005 000)	(520 000)	(290 000)	(207 000)

Phi-Phi Ltd (“Phi-Phi »)

During 20.17, the directors of Mumbai decided to expand their business into Asia. Mumbai acquired 70% of the ordinary shares in Phi-Phi on 1 September 20.17, thereby obtaining control over Phi-Phi, in accordance with IFRS 10 *Consolidated Financial Statements*. Phi-Phi is incorporated in Thailand and their functional currency is the Thai Baht (THB). Mumbai settled the acquisition with a cash consideration of THB1 600 000.

On 15 July 20.17 a number of customers found mealworms in Chia seeds packed and distributed by Phi-Phi. A legal claim was instituted against Phi-Phi. The group’s lawyers were of the opinion that the claim against Phi-Phi will probably not succeed. On 1 September 20.17 the fair value of the claim, considering all possible outcomes, was determined at THB280 000. The amount of any settlement will be tax deductible in Thailand.

All other assets and liabilities of Phi-Phi were considered to be fairly valued at the date of acquisition.

No additional assets, liabilities or contingent liabilities, except as stated above, were identified at the date of acquisition.

During the current year Mumbai sold inventory to Phi-Phi. On 31 August 20.18, inventory purchased from Mumbai Ltd amounting to THB47 500 was still on hand. Total sales from Mumbai to Phi-Phi for the 20.18 financial year amounted to THB100 000. Mumbai sells inventory at a mark-up of 20% on cost to Phi-Phi.

On 31 December 20.17 Phi-Phi settled the claim relating to the mealworms for THB450 000.

On 31 August 20.18 Mumbai sold 50 000 of their shares in Phi-Phi for THB300 000. After the sale of these shares, Mumbai Ltd still had control over Phi-Phi as per the definition of control, in accordance with IFRS 10 *Consolidated Financial Statements*.

New Delhi Ltd (“New Delhi”)

Mumbai acquired 25% of the ordinary shares of New Delhi, a company incorporated in South Africa, for R350 000 on 1 May 20.18, thereby exercising significant influence over the financial and operating policies of New Delhi from that date. New Delhi’s net asset value was considered to be fairly valued at acquisition date, with the exception of equipment with a carrying amount of R515 000, which was considered to have a fair value of R580 000. The equipment was deemed to have a useful life of five years from 1 May 20.18.

Since acquisition, New Delhi has been selling inventory to Mumbai at a profit of 50% on cost. Included in Mumbai’s inventory balance on 31 August 20.18 is R30 000 in respect of such inventory (at cost for Mumbai). Total sales from New Delhi to Mumbai amounted to R60 000 for the period 1 May 20.18 to 31 August 20.18.

The other comprehensive income for the year arose on 31 August 20.18 when New Delhi fair valued its equity investments. Mumbai’s management considers the investment in New Delhi as material for the group. On 31 August 20.18 the fair value of New Delhi’s shares amounted to R17 per share.

Kolkata Ltd (“Kolkata”)

Mumbai acquired a controlling 80% interest of the ordinary shares of Kolkata on 1 August 20.17. The details of the acquisition of Kolkata were as follows:

- The purchase price agreed on was payable in cash of R225 000.
- A contingent consideration of R50 000 will be payable on 31 August 20.19 if certain profit targets are met. The fair value of the contingent consideration was R25 000 on 1 August 20.17, R30 000 on 31 August 20.17 and R42 000 on 31 August 20.18.
- Kolkata’s retained earnings amounted to R180 000 on 1 August 20.17.
- With the exception of the items listed below, all assets and liabilities of Kolkata were deemed to be fairly valued at acquisition date:

	Carrying amount R	Fair value R
Inventory	20 000	36 000
Receivables	27 000	20 000

The inventory on hand on 1 August 20.17 was sold during the 20.18 financial year and the receivables balance on 1 August 20.17 was written down to its net realisable value on 31 August 20.17.

The interest in the preference shares of Kolkata was also acquired on 1 August 20.17. Kolkata has previously issued 2 000 preference shares, which are correctly classified as equity. The preference shares have a nominal value of R10 each. The preference shares give their holders a right to a preferential dividend in priority to the payment of any dividend to the holders of ordinary shares. Upon liquidation of Kolkata, the holders of the preference shares are entitled to receive out of the assets available for distribution the amount of R10 per share in priority to the holders of ordinary shares. The holders of the preference shares do not have any further rights on liquidation. The acquisition date fair value of the preference shares is R12 per share. No preference dividends were outstanding at the acquisition date.

Mumbai sold equipment to Kolkata to the value of R75 000 on 1 September 20.17. Mumbai sells equipment at cost plus 25%. Kolkata uses the equipment in the production of inventory and depreciates equipment at 20% per annum on a straight-line basis.

Kolkata purchases all its inventory from Mumbai at a gross profit percentage of 20%. Inventory purchased from Mumbai still on hand at 31 August 20.17 amounted to R25 000.

Additional information

- The following exchange rates were applicable at the respective dates:

	R1 = THB
1 September 20.17	11,95
31 December 20.17	10,50
Average for the period 1 September 20.17 to 31 August 20.18	9,62
31 July 20.18	10,00
31 August 20.18	9,50

- It is the accounting policy of Mumbai to account for investments in subsidiaries and associates at cost, in accordance with IAS 27.10(a) in its separate financial statements.
- Unless specifically identified, all income and expenses accrued evenly throughout the year for all companies in the group.
- The Mumbai Group elected to measure the non-controlling interests at the proportionate share of the acquiree's net assets at acquisition date for all acquisitions.
- Mumbai's functional and presentation currency is the South African rand.
- There were no changes in the share capital of any of the entities during the year.
- Assume a South African normal income tax rate of 27% and a capital gains tax inclusion rate of 80%, and that Thailand's corporate income tax rate is 20%. Ignore the effects of dividend tax and value added tax (VAT).

QUESTION 2**25 marks**

You have recently passed the Initial Test of Competence of the South African Institute of Chartered Accountants' and have been assigned to the audit of Healthy Future Holdings Ltd ("HFH"). HFH is a company listed on the Johannesburg Stock Exchange and operates in the healthcare sector.

Your first task was to update the "Understanding the entity and its environment" audit work paper. During discussions with HFH's management and accounting staff the following came to light:

- In the current financial year HFH acquired a struggling company, Planet Active Ltd ("PA"). PA manages a chain of health clubs in South Africa.
- PA's business model is as follows: Customers who wish to join the health club have two options. Customers can sign up for a month-to-month contract for R500 per month, or they can sign up for a two-year contract totalling R7 200. If customers choose the two-year contract, the amount can either be paid in cash or by credit card on the customers budget facility over the same term as the health club contract. As part of the two-year contract, customers also receive a free gym bag, towel and four training sessions with a personal trainer.
- The Chief Financial Officer of HFH, Mr Hamstring, is worried about the revenue recognition model used by the new subsidiary, PA. Apparently, PA recognises revenue for the month-to-month contracts on a monthly basis and for the two-year contract revenue is recognised immediately with the signing of the contract. Mr Hamstring admitted he is not familiar with IFRS 15 *Revenue from Contracts with Customers*.
- Mr Bicep, the Chief Financial Officer of PA, confirmed Mr Hamstring's understanding of how PA recognises revenue. However, Mr Bicep is of the opinion that IFRS 15 is not applicable to their revenue model, as the counterparty of the contract (customer) has contracted with PA to participate in the development of an asset (the customer's health).

QUESTION 2

	Marks
(a) Explain, with reasons, whether each of the persons and entities identified in the information provided are related or non-related parties of Planet Active Ltd.	4
(b) Prepare a letter to Mr Hamstring explaining how the proceeds from the two-year contracts should be recognised and measured in the accounting records of Planet Active Ltd, with reference to step 1 to step 5 of revenue recognition in terms of IFRS 15 <i>Revenue from Contracts with Customers</i> .	20
Communication skills: logical flow and format	1
<p>Please note:</p> <ul style="list-style-type: none"> Reference to calculations is not required. <p>Please note:</p> <ul style="list-style-type: none"> Your answer must comply with International Financial Reporting Standards (IFRS). 	

CASE STUDY 9**QUESTION 1 – Suggested solution****(a) MUMBAI LTD GROUP****STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 AUGUST 20.18**

	Share capital	Retained earnings	Mark-to-market reserve	Foreign Currency Translation Reserve (FCTR)	Change in ownership reserve	Non-controlling interests	
	R	R	R	R	R	R	
Balance at 1 August 20.17	200 000	C ¹³ 137 438	130 000	-	-	C ² 73 336	(10)
Changes in equity for 20.18							
Total comprehensive income for the year		C ³ 1 147 635	C ⁶ 93 500	C ⁷ 35 107		C ⁹ 85 092	(48)
Dividends (R5 per share)		(500 000)				C ¹⁰ (27 000)	(2)
Acquisition of interest						C ¹¹ 53 372	(4)
Disposal of interest					C ¹² 10 249	C ¹² 21 330	(6)
Transfer of FCTR				C ¹² (4 670)		4 670	(1)
Balance at 31 August 20.18	<u>200 000</u>	<u>3 785 236</u>	<u>223 500</u>	<u>30 437</u>	<u>10 249</u>	<u>210 800</u>	<u> </u>
						Total	(71)
						Maximum	(63)
						Communication skills: presentation and layout	(1)

**EXAM TECHNIQUE**

Overall, students usually spend most of their time answering question 1, thereby neglecting question 2. This is poor exam technique as time management is very important to ensure that all questions are attempted.

Remember to allocate your time per question at the beginning by taking the marks multiplied by 1,5 minutes. Stick to this and move on if the time allocated has expired. Practice this when you are preparing for the exam.

CALCULATIONS**C1. Retained earnings: Opening balance**

Mumbai (given)	3 125 000	
	20 110	
Kolkata (given)	195 000	[1]
Kolkata at acquisition	(180 000)	[1]
Kolkata debtor's adjustment ((27 000 – 20 000) x 73%)	5 110	[1]
Kolkata NCI (20 110 x 20%)	(4 022)	[1]
Kolkata intragroup unrealised profit (25 000 x 20% x 73%)	(3 650)	[2]
	<u>3 137 438</u>	<u>[5]</u>

C2. Non-controlling interest: Opening balance

Kolkata preference shares (1 000 x R12)	12 000	[1]
Kolkata ordinary shares at acquisition ((100 000 + 180 000 + 11 680 [C3] - 5 110 [C1]) x 20%)	57 314	[2]
Kolkata since reserve [C1]	4 022	[1]
	<u>73 336</u>	
		<u>[4]</u>

C3. Profit for the year**Mumbai**

Profit for the year (given)	1 005 000	
Fair value adjustment on contingent consideration (42 000 - 30 000)	(12 000)	[1]
Intragroup dividends received:		
Phi-Phi (400 000/10 x 70%)	(28 000)	[2]
Kolkata ordinary shares (30 000 x 80%)	(24 000)	[1]
Kolkata preference shares (18 000 x 50%)	(9 000)	[1]
New Delhi (60 000 x 25%)	(15 000)	[1]
Phi-Phi eliminate intragroup profit (47 500/9,50 x 20/120 x 73%)	(608)	[2]
Phi-Phi eliminate profit on sale of shares in separate:	(12 452)	
Proceeds (300 000/9,50)	(31 579)	[1]
Sold 50 000 of 350 000 shares (50/350 x 1 600 000/11,95) OR (133 891 [C8] – 114 764 (given))	19 127	[2]
Kolkata eliminate intragroup profit on equipment (75 000 x 25/125 x 73%)	(10 950)	[2]
Kolkata realisation of intragroup profit on equipment (10 950 x 20%)	2 190	[1]
Kolkata eliminate intragroup profit on opening inventory [C1]	3 650	
Kolkata eliminate intragroup profit on closing inventory (45 000 x 20% x 73%)	(6 570)	[2]
Phi-Phi		
Profit for the year (520 000/9,62)	54 054	[1]
Derecognise contingent liability (280 000/10,50 x 80%)	21 334	[2]
	<u>75 388</u>	
NCI (75 388 x 30%)	(22 616)	
New Delhi		
Excess [C4]	30 196	[4]
Share of profit for the period (96 667 [C5] x 25%)	24 167	[1]
Depreciation adjustment on at acquisition fair value adjustment [(65 000 [C4] – 17 550 [C4]) x 4/60 x 25%]	(791)	[2]
Mumbai eliminate intragroup profit (30 000 x 50/150 x 25% x 73%)	(1 825)	[2]
Kolkata		
Profit for the year (given)	207 000	
Reversal of fair value adjustment at acquisition ((36 000 - 20 000) x 73%)	(11 680)	[2]
Preference dividends (given)	(18 000)	
	<u>177 320</u>	
NCI ordinary shares (177 320 x 20%)	(35 464)	[1]
Profit attributable to preference shares	18 000	[1]
NCI preference shares (18 000 x 50%)	(9 000)	[1]
	<u>1 147 635</u>	
		<u>[33]</u>

C4. Excess on acquisition of New Delhi

Net asset value	1 520 783	[1]
Share capital (given)	100 000	
Retained earnings (given)	750 000	
Profit for the period [C5]	193 333	[1]
Mark-to-market (given)	430 000	
Equipment fair value adjustment (580 000 - 515 000)	65 000	
Deferred tax (65 000 x 27%)	(17 550)	[1]
Mumbai's share at 25%	380 196	[1]
Consideration	(350 000)	[1]
	<u>30 196</u>	<u>[5]</u>

C5. Profit for the period of New Delhi

Profit for the year (given)	290 000
Before acquisition (290 000 x 8/12)	193 333
After acquisition (290 000 x 4/12)	96 667

C6. Mark-to-market: Other comprehensive income for the year

Mumbai	60 000	
Kolkata (20 000 x 80%)	16 000	[1]
New Delhi (70 000 x 25%)	17 500	[1]
	<u>93 500</u>	<u>[2]</u>

**COMMENT**

Many students included the opening balance of the mark-to-market reserve of R130 000 in the movement for the year. On the trial balance given in the scenario, it is clearly separated between the opening balance and the other comprehensive income, which is the current year movement.

For the current year's movement, many students included the full amounts for the mark-to-market reserves of Kolkata and New Delhi, instead of only the 80% attributable to Mumbai and the 25% in respect of New Delhi.

Remember that on the SPLOCI we would include 100% of the subsidiary (Kolkata), but then we will attribute NCI's part to them, meaning that with the accounting process only 80% of the R20 000 will end up in the mark-to-market column in the consolidated statement of changes in equity, and the other 20% which is attributable to NCI, will be in the non-controlling interests' column.

Regarding the intragroup profit on sale of equipment to Kolkata in C3, the profit (R10 800) is eliminated from Mumbai's accounting records (parent), as the sale is from the parent to subsidiary. Therefore, the unrealised profit is included the parent's accounting records and will not impact NCI.

Similarly, the realisation of the profit (R2 160) is also recorded in Mumbai's accounting records.

C7. FCTR: Other comprehensive income for the year

	THB	Rate	R	
Ordinary share capital	(500 000)	11,95	(41 841)	[1]
Retained earnings	(1 850 000)	11,95	(154 812)	
Trade and other payables	(110 000)	9,50	(11 579)	[1]
Profit for the period	(520 000)	9,62	(54 054)	[1]
Property, plant and equipment	1 320 000	9,50	138 947	[½]
Inventory	610 000	9,50	64 211	[½]
Trade and other receivables	340 000	9,50	35 789	[½]
Cash and cash equivalents	310 000	9,50	32 632	[½]
Ordinary dividend declared and paid on 31 July 20.18	400 000	10,00	40 000	[1]
FCTR	<u>-</u>		<u>(49 293)</u>	
Goodwill remeasurement				
At acquisition date [C8]	111 805	11,95	9 356	[1]
Exchange differences on translation (balancing)			2 413	[½]
Year end	<u>111 805</u>	<u>9,50</u>	<u>11 769</u>	
Legal claim (net of tax)				
At acquisition date	(224 000)	11,95	(18 745)	
Realisation	224 000	10,50	21 333	
Exchange differences on translation (balancing)			(2 588)	
Year end	<u>-</u>	<u>9,50</u>	<u>-</u>	[1]
Total FCTR as at 31/08/20.18				
From conversion trial balance			49 293	
Legal claim (net of tax)			<u>(2 588)</u>	
			46 705	
Mumbai's share (46 705 x 70%)			32 694	[1]
Goodwill remeasurement			<u>2 413</u>	[½]
			<u>35 107</u>	<u>[10]</u>

**EXAM TECHNIQUE**

To calculate the foreign currency translation reserve (FCTR) amount that will be disclosed in the consolidated statement of changes in equity, you need to reconstruct the trial balance of the foreign subsidiary and divide all the foreign currency amounts with the specific rates, as per the conversion rules in IAS 21 to rand.

**COMMENT**

Many students multiplied the Thai Baht amount by the different foreign exchange rates, instead of dividing by the rate. The scenario stated that R1 is equal to THB11,95; thus the rand is stronger than the Thai Baht. Therefore, the Thai Baht amount is divided by the given exchange rate to determine the rand amount.

**COMMENT****Goodwill and IFRS 3 adjustments**

IAS 21.47 states that any goodwill arising from the acquisition of a foreign subsidiary and from any IFRS 3 fair value adjustments shall be treated as assets and liabilities of the foreign subsidiary.

The goodwill and IFRS 3 adjustments are not included in the foreign subsidiary trial balance, as these amounts will only be recorded in the consolidated financial statements. Therefore, we are required to separately record the movements as a result of translation to closing rate, in accordance with IAS 21.39.

Remember the IFRS 3 adjustments will first be translated at the exchange rate at acquisition and subsequently remeasured to closing rate at each subsequent year end.

Non-controlling interests

Non-controlling interests are measured at the proportionate share of the acquiree's identifiable net assets for this scenario. This means that NCI will **NOT** share in goodwill or in the FCTR arising from the adjustment of goodwill to the closing rate.

Remember, FCTR is just another type of equity reserve similar to a revaluation reserve and, therefore, the reserve is allocated in accordance to the ownership interests of the parent and NCI.

C8. Goodwill of Phi-Phi

	187 263	
Consideration (1 600 000/11,95)	133 891	[1]
NCI [C11]	53 372	
Net asset value on 1 September 20.17 [C11]	(177 908)	
	<u>9 355</u>	<u>[1]</u>

C9. Non-controlling interest: Total comprehensive income for the year**Profit for the year**

Phi-Phi [C3]	22 616	
Kolkata ordinary shares [C3]	35 464	
Kolkata preference shares [C3]	9 000	
	<u>67 080</u>	[1]

Other comprehensive income for the year

Phi-Phi (46 705 [C7] x 30%)	14 012	[1]
Kolkata (20 000 x 20%)	4 000	[1]
	<u>85 092</u>	<u>[3]</u>

C10. Non-controlling interest: Dividends

Phi-Phi (400 000/10 x 30%)	(12 000)	[½]
Kolkata ordinary shares (30 000 x 20%)	(6 000)	[½]
Kolkata preference shares (18 000 x 50%)	(9 000)	[½]
	<u>(27 000)</u>	<u>[1½]</u>

**COMMENT**

Many students included all dividends declared by the various companies as “dividends paid” in the “retained earnings” column. This effectively means that no elimination of intragroup dividends was done. Some students also included the dividend received by the parent as “dividend paid” in retained earnings.

Remember that only the parent’s dividend paid should be reflected as “dividends paid” in the statement of changes in equity.

C11. Non-controlling interest: Acquisition of interest

	THB	
Share capital	500 000	
Retained earnings	1 850 000	
	2350 000	[1]
Legal claim	(280 000)	
Deferred tax (280 000 x 20%)	56 000	[1]
	<u>2 126 000</u>	
Net asset value in rand (2 126 000/11,95)	177 908	[1]
NCI’s share (177 908 x 30%)	53 372	<u>[1]</u>
		<u>[4]</u>

C12. Change in ownership Phi-Phi

Proceeds (300 000/9,50)	31 579	[1]
NCI adjusted (260 000 [C13] x 10%)	(26 000)	[3]
Before (260 000 [C13] x 30%)	78 000	
After (260 000 [C13] x 40%)	(104 000)	[½]
FCTR (46 705 [C7] x 10%)	4 670	[½]
	<u>10 249</u>	
		<u>[5]</u>
Change in NCI (26 000 – 4 670)	<u>21 330</u>	[1]

C13. Net asset value of Phi-Phi on 31 August 20.18

	THB	
Trade and other payables	(110 000)	
Property, plant and equipment	1 320 000	
Inventory	610 000	
Trade and other receivables	340 000	
Cash and cash equivalents	310 000	
	<u>2 470 000</u>	[2]
Exchange rate	9,50	[½]
Net asset value of Phi-Phi in rand	260 000	<u>[2½]</u>

C14. Analysis of ordinary shares of Phi-Phi (for completeness only)

	THB	Ex- change rate R	Total R	70%-60%		30%-40% NCI R
				At R	Since R	
At acquisition						
Share capital	500 000	11,95	41 841	29 289		12 552
Retained earnings	1 850 000	11,95	154 812	108 368		46 444
Legal claim	(280 000)	11,95	(23 431)	(16 402)		(7 029)
Deferred tax	56 000	11,95	4 686	3 280		1 406
	2 126 000		177 908	124 535		53 373
Goodwill	111 805		9 356	9 356		-
Consideration and NCI	2 237 805	11,95	187 264	133 891		53 373
Current year						
Profit for the year	520 000	9,62	54 054		37 838	16 216
Legal claim	280 000	10,50	26 667		18 667	8 000
Deferred tax	(56 000)	10,50	(5 333)		(3 733)	(1 600)
Dividends paid	(400 000)	10,00	(40 000)		(28 000)	(12 000)
FCTR goodwill			2 413		2 413	-
FCTR			46 704		32 693	14 011
	2 581 805	9,50	271 769		59 878	78 000
Disposal of 10% interest				(12 293)	(5 498)	17 791
Retained earnings					(3 539)	3 539
FCTR					(4 670)	4 670
	2 581 805	9,50	271 769	121 598	46 171	104 000

**COMMENT**

All calculations are marked if used in the answer. The analysis of owners' equity is a very useful calculation method. The drawback is that sometimes it takes a long time to complete, leaving little time to answer the required. Good exam technique is to know which amounts are required for the specific question as not all questions will need a 100% completed analysis. For example, it is not necessary to allocate the equity at acquisition (share capital, retained earnings, etc.) between the parent and NCI as those amounts will not be used. If the NCI column is not required in the statement of changes in equity statement, then the NCI calculation in the analysis can be ignored.

In addition, it is advisable to write your answer as the analysis is completed. For example, if journals are required, write the at-acquisition journal as soon as the goodwill has been calculated on the analysis, and so on.

C15. Analysis of ordinary shares of Kolkata (for completeness only)

	Total	80%		NCI
		At	Since	
Share capital	100 000			
Retained earnings	180 000			
Inventory (16 000 x 73%)	11 680			
Debtors (7 000 x 73%)	(5 110)			
	286 570	229 256		57 314
Goodwill	20 744	20 744		-
Consideration and NCI	307 314	250 000		57 314
Since acquisition				
Retained earnings (195 000 - 180 000)	15 000		12 000	3 000
Debtors reversal	5 110		4 088	1 022
Current period				
Inventory reversal	(11 680)		(9 344)	(2 336)
Profit for the year (207 000 -18 000)	189 000		151 200	37 800
Mark-to-market	20 000		16 000	4 000
Dividend paid	(30 000)		(24 000)	(6 000)
	494 744		149 944	94 800

C16. Analysis of preference shares of Kolkata (for completeness only)

	Total	50%		NCI
		At	Since	
Share capital	20 000	10 000		10 000
Goodwill	7 000	5 000		2 000
Consideration and NCI	27 000	15 000		12 000
Current period				
Preference dividend declared	18 000		9 000	9 000
Dividend paid	(18 000)		(9 000)	(9 000)
	27 000		-	12 000

**COMMENT**

The IFRS 3 fair value adjustments made to debtors and inventory at acquisition must be reversed when the underlying assets are derecognised. Since receivables and inventory are current assets, they are expected to realise within 12 months if no other information is provided in the scenario. However, the scenario stated that the debtors were written down by the subsidiary a month after acquisition and the inventory was only sold in the 20.18 financial year. Therefore, the debtors' reversal will be included in the "since" period and the inventory reversal in the "current" period.

C17. Analysis of ordinary shares of New Delhi (for completeness only)

	Total	25%	
		At	Since
Share capital	100 000		
Retained earnings	750 000		
Profit for the period	193 333		
Mark-to-market reserve	430 000		
Equipment fair value adjustment	65 000		
Deferred tax (65 000 x 27%)	(17 550)		
Net asset value	1 520 783	380 196	
Excess		(30 196)	
Paid		350 000	
Current period			
Profit for the period	96 667		
Depreciation on equipment	(4 333)		
Tax on depreciation	1 170		
	93 504		23 376
Dividends paid	(60 000)		(15 000)
Mark-to-market	70 000		17 500
	<u>103 504</u>		<u>25 876</u>

(b) MUMBAI LTD GROUP**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS OF THE MUMBAI LTD GROUP FOR THE YEAR ENDED 31 AUGUST 20.18****Investment in associate**

On 1 May 20.18 the group acquired a 25% interest in New Delhi Ltd, an associate. New Delhi Ltd is incorporated in South Africa. (1)

The investment in New Delhi Ltd is measured using the equity method. On 31 August 20.18 the fair value of the investment in New Delhi Ltd amounted to R425 000 (25 000 x R17). (1)

Summarised financial information of New Delhi Ltd as at 31 August 20.18:

	Dr/ (Cr)	
Statement of financial position		
Non-current assets (450 000 + 700 000 + 65 000 – 4 333)	1 210 667	(2)
Current assets (125 000 + 285 000 +155 000)	565 000	(1)
Non-current liabilities (17 550 – 1 170)	(16 380)	
Current liabilities (given)	(135 000)	(½)
Net asset value	1 624 287	
Statement of profit or loss and other comprehensive income		
Revenue (1 200 000 x 4/12)	(400 000)	(1)
Profit for the period (290 000 x 4/12 - 3 120 + 30 196)	(123 743)	(1)
Other comprehensive income for the period (given)	(70 000)	(½)
Total comprehensive income for the period (93 547 + 70 000)	(163 547)	(1)
Dividends paid (given)	60 000	(½)
Reconciliation of financial information to investment in associate:		
Opening balance	-	
Acquisition during the year	1 520 783	(½)
Profit for the period	93 504	(½)
Other comprehensive income (given)	70 000	(½)
Dividends paid (given)	(60 000)	(½)
Closing balance	1 624 287	
The group's interest	25%	(½)
Investment in associate	406 072	
	Total	(12)
	Maximum	(10)
	Communication skills: presentation and layout	(1)

**EXAM TECHNIQUE**

Remember that you have the IFRS handbooks in as assessment. This should form the starting point and base for your answer. Always read the required carefully as the reconciliation in terms of IFRS 12.B14(b) was specifically required.

Disclosure in terms of IFRS 12 in the notes to the financial statements relating to associates and joint ventures should include any fair value adjustment at acquisition (IFRS 12.B14(a)).

QUESTION 2

- (a) **Explain, with reasons, which of the persons or entities identified in the information provided are related parties of Planet Active Ltd.**

A related party is a person or entity that is related to the entity that is preparing its financial statements (referred to as the “reporting entity”) (IAS 24.9).

The reporting entity is Planet Active Ltd, as it is entity that is preparing its financial statements.

(1)

Persons or entities that are related to Planet Active Ltd

Healthy Future Holdings Ltd – Entities that are part of the same group (IAS 24.9(b)(i)).

(1)

Mr Bicep – Member of the key management personnel of the reporting entity (IAS 24.9(a)(iii)).

(1)

Mr Hamstring – Member of the key management personnel of the parent of the reporting entity (IAS 24.9(a)(iii)).

(1)(4)

- (b) **Prepare a letter to Mr Hamstring explaining how the proceeds from the two-year contracts should be recognised and measured in the accounting records of Planet Active Ltd, with reference to step 1 to step 5 of revenue recognition in terms of IFRS 15.**

123 Road
Town
0001

5 September 20.18

Dear Mr Hamstring

Please refer to our response below regarding your question on revenue recognition in terms of IFRS 15.

Step 1: Identify the contract(s) with a customer

An entity shall account for a contract with a customer when **all** of the following criteria are met (IFRS 15.9):

- The parties to the contract have approved the contract.
- The entity can identify each party’s rights regarding the goods or services to be transferred.
- The entity can identify the payment terms for the goods or services to be transferred.
- The contract has commercial substance.
- It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

Both PA and the customer signed the contract; therefore, the contract is approved.

(1)

The contract provides that the customer will have access to the health club and, in return, the customer will pay a specified amount to PA. Therefore, each party’s rights can be identified.

(1)

PA will receive a consideration in exchange for the services provided to the customers, i.e., access to the health club facilities, gym bag, towel and four training sessions. Therefore, the contract has a commercial substance. (1)

It also appears probable that PA will collect the consideration, as it is paid upfront. (1)

Although IFRS 15 specifies the accounting of an individual contract, the standard also provides a practical expedient for a portfolio of contracts with similar characteristics. The recognition of revenue will be the same for all two-year contracts, as the contracts are a portfolio of contracts with similar characteristics. (1)

Step 2: Identify the performance obligations in the contract

According to IFRS 15.22, a performance obligation is identified if the goods or service are distinct. A performance obligation is a promise of a good or a service.

For a good or service to be distinct, both criteria of paragraph 27 should be met:

- The customer must gain benefit from the good or service on its own, and
- The good or service should be separately identifiable.

The customer will gain a benefit from using the facilities of the health club and receiving the gym bag, towel and four training sessions with a personal trainer. (1)

For a good or a service to be separately identifiable, the product and services should not be integrated or significantly modified or inter-dependent (IFRS 15.29). (1)

The goods and services are clearly separately identifiable.

The separate performance obligations are as follows: (1)

- access to the facilities of the health club
- goods received: gym bag and towel
- four training sessions with a personal trainer

Step 3: Determine the transaction price

The transaction price is the consideration the entity expects to be entitled to in a contract (IFRS 15.47).

The transaction price in this instance will be R7 200. (1)

IFRS 15.60 states that in determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties in the contract provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer.

In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

In terms of the two-year contract, although not explicitly stated in the contract, it appears to contain a significant financing component. (1)

However, IFRS 15.62 specifically states that a contract with a customer would not have a significant financing component if the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer.

The customer will decide when to use the health club facilities and, therefore, the exception in par 62 will apply. (1)

Step 4: Allocate the transaction price to the performance obligations

In terms of IFRS 15.76 the transaction price shall be allocated to the performance obligation based on their stand-alone prices at contract inception.

Therefore, the stand-alone price of the following performance obligations should be determined: (3)

- access to the facilities of the health club
- goods received: gym bag and towel
- four training sessions with a personal trainer

Furthermore, Planet Active Ltd could be giving a discount for purchasing a bundle of goods or services. (1)

This is evident from the reduced total consideration received for the two-year contract. (1)

The sum of the stand-alone selling prices of the goods and services promised should be compared to the consideration promised to access if a discount is given or not. (1)

Step 5: Recognise revenue as (when) the entity satisfies the performance obligation

The entity shall recognise revenue when the entity satisfies the performance obligation by transferring goods or services to the customer (IFRS 15.31).

An asset is transferred when the customer obtains control of the asset.

At inception of the contract the entity shall determine if the performance obligation is satisfied over a period of time, or at a point in time when control is transferred to the customer (IFRS 15.32).

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (IFRS 15.35 (a)).

Two of the performance obligations fall into this category: (1)

- access to the facilities of the health club, and
- four training sessions with a personal trainer

For the access to the health club facilities and for the four training sessions, Planet Active Ltd shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation. (IFRS 15.39) (1)

An entity shall apply a single method of measuring progress for each performance obligation satisfied over time, and the entity shall apply that method consistently to similar performance obligations and in similar circumstances.

As customers receive access to the health club facilities for two years, an appropriate method of measuring progress will be the lapse of time. Revenue should be recognised in a straight line over two years. (1)

Customers will receive exactly four training sessions; therefore, an appropriate method of measuring progress will be the number of training sessions had. Revenue should be recognised over the four training sessions. (1)

Revenue is recognised at a point in time if the performance obligation is not satisfied over a period of time (IFRS 15.38).

In this instance, the goods that the customer will receive (gym bag and towel) fall into this category; therefore, revenue should be recognised when the goods are given to the customer. (1)

Kind regards,

CTA student

	Total	<u>(22)</u>
	Maximum	<u>(20)</u>
Communication skills: logical flow and format		<u>(1)</u>



EXAM TECHNIQUE

What theory should be used in a discussion question? Even though merely stating the theory does not earn marks, it is very important to identify the theory applicable to the scenario. This is important because the scenario should be applied to the theory, and this assists in the logical structure and layout of the answer.

It is therefore important to have an appropriate knowledge and understanding of each standard in IFRS. Did you know for example that Illustrative example 18 to IFRS 15 deals with: Measuring progress when making goods or services available. The scenario used in the example was also a health club providing access to a member. Even though an example viewed in isolation do not cover all the aspects that might be required in a question, it provides a good reference point to start the discussion.

CASE STUDY 10**100 marks****YOU HAVE 30 MINUTES' READING TIME. SPEND 30 MINUTES READING THE CASE STUDY BEFORE YOU CONTINUE TO THE REQUIRED SECTION.****QUESTION 1****35 marks**

Lowveld Honey Ltd is a company that manufactures honey harvesting equipment. The company supplies this equipment to companies and professional beekeepers across South Africa. Lowveld Honey Ltd is listed on the Johannesburg Stock Exchange.

On 1 February 20.14 Lowveld Honey Ltd acquired a 20% interest in Busy Bees Ltd for a cash consideration of R400 000. Lowveld Honey Ltd did not exercise joint control or significant influence over the financial and operating policy decisions of Busy Bees Ltd at that date.

Lowveld Honey Ltd obtained control, as defined in IFRS 10 *Consolidated Financial Statements*, on 1 January 20.18 when an additional 55% interest was acquired for a cash payment of R1 165 000. Included in the cash payment of R1 165 000 was R35 000 expenses in respect of professional fees.

The purchase agreement also made provision for a highly probable contingent consideration of R880 000 to be settled on 30 June 20.18 if the retained earnings of Busy Bees Ltd increased to R3 000 000 by 30 June 20.19. The fair value of the contingent consideration was correctly calculated as R750 000 on 1 January 20.18 and 30 June 20.18.

At acquisition certain matters were identified and the management of Lowveld Honey Ltd suggested that adjustments to the assets and liabilities of Busy Bees Ltd should be made for the following reasons:

- Busy Bees Ltd has a trademark that is formally registered and relates to an internally generated brand that was developed by Busy Bees Ltd over the past few years. The fair value of the trademark on 1 January 20.18 amounted to R265 000. The trademark has an indefinite useful life.
- Busy Bees Ltd has an internally generated client list. This client list is contingent on a privacy agreement and cannot be sold. The client list had a fair value of R145 000 on 1 January 20.18.
- A contingent liability arose on 30 November 20.17 when Busy Bees Ltd received a claim of R130 000 for damages caused by the company. Should the claim be successful, any amount paid by Busy Bees Ltd will not be deductible for tax purposes. Busy Bees Ltd's legal advisors concluded that Busy Bees Ltd has a present obligation; however, the likelihood of a successful claim is remote. The fair value of the claim was estimated by an independent actuary at R110 500 on 1 January 20.18 and on 30 June 20.18.
- Busy Bees Ltd owns a plant with a carrying amount of R2 455 000 on 1 January 20.18 that is leased to a third party in accordance with an operating lease.

Details of the lease agreement:

Remaining period of lease	5 years
Remaining useful life of plant	12 years
Lease instalments, payable annually in arrears	R250 000
Implicit interest rate	12%

A market-related rental is R190 000 per annum. The estimated fair value of the plant on 1 January 20.18 amounted to R3 235 000.

On 1 March 20.18 Lowveld Honey Ltd sold harvesting equipment to Busy Bees Ltd to the sales value of R350 000. Lowveld Honey Ltd sells the honey harvesting equipment at cost plus 30%. Busy Bees Ltd uses the equipment in the production of inventory and depreciates equipment at 20% per annum on the straight-line method.

Additional information

1. It is the accounting policy of Lowveld Honey Ltd to account for investments in subsidiaries, joint ventures and associates at cost in its separate financial statements, in accordance with IAS 27.10(a).
2. It is the accounting policy of Lowveld Honey Ltd to account for investments in equity instruments other than investments in subsidiaries, joint ventures and associates, in accordance with IFRS 9 *Financial Instruments*. Lowveld Honey Ltd irrevocably elected to present subsequent changes in the fair value of the investments in other comprehensive income in a mark-to-market reserve.
3. All entities in the group account for property, plant and equipment in accordance with the cost model, in terms of IAS 16 *Property, Plant and Equipment*, and depreciation is calculated by using the straight-line method.
4. Lowveld Honey Ltd elected to transfer any cumulative gains or losses within equity in terms of IFRS 9.B5.7.1.
5. Lowveld Honey Ltd elected to measure non-controlling interests at fair value at the acquisition date for all acquisitions.
6. All the companies in the group have a 30 June year end.
7. There were no changes in the issued ordinary share capital of any of the companies in the group.
8. The profit and other comprehensive income of Busy Bees Ltd accrued evenly during the year.
9. Assume a normal income tax rate of 27% and a Capital Gains Tax inclusion rate of 80%. Ignore Value Added Tax (VAT) and Dividend Tax.

10. The following is an extract from the separate trial balances of Lowveld Honey Ltd and Busy Bees Ltd as at 30 June 20.18:

	Lowveld Honey Ltd	Busy Bees Ltd
	R	R
Property, plant and equipment	6 841 115	4 876 300
20% Investment in Busy Bees Ltd at fair value (1 January 20.18)	704 000	-
Investment in Busy Bees Ltd on 1 January 20.18	1 165 000	-
Investments in equity instruments	980 750	720 600
Current assets	1 150 670	480 775
Ordinary share capital (200 000 shares; 100 000 shares)	(600 000)	(200 000)
Retained earnings (1 July 20.17)	(2 881 600)	(1 555 200)
Mark-to-market reserve (1 July 20.17)	(371 050)	(234 200)
Profit after tax	(1 005 100)	(870 120)
Other comprehensive income: mark-to-market reserve	(187 024)	(77 550)
Dividends paid on 31 May 20.18	200 000	150 000
Non-current liabilities	(4 990 511)	(2 899 745)
Current liabilities	(1 006 250)	(390 860)
	<hr/>	<hr/>
	-	-

QUESTION 2**40 marks**

Mageu King Ltd is a company listed on the Johannesburg Stock Exchange. The company was incorporated in 20.15 by Mr Cyril King after the completion of his degree in chemical engineering. Mageu King Ltd is a leading mageu producer in South Africa and has acquired various investments in order to establish and expand their brand in the mageu industry.

AmaizeMeal Ltd

Mageu King Ltd acquired a 70% controlling interest in AmaizeMeal Ltd on 1 September 20.16 for a cash consideration of R195 000. The net assets of AmaizeMeal Ltd were deemed to be fairly valued on 1 September 20.16, with the exception of machinery. The fair value of the machinery was overstated with R55 000 on this date. The machinery had a remaining useful life of three years on 1 September 20.16. No additional assets, liabilities or contingent liabilities were identified on 1 September 20.16.

The equity of AmaizeMeal Ltd consisted of the following on the various dates:

	30 June 20.16	30 June 20.17	30 June 20.18
	R	R	R
Ordinary share capital (100 000 shares)	100 000	100 000	100 000
Retained earnings	133 200	255 780	308 125
Mark-to-market reserve	45 700	45 700	58 800
	<u>278 900</u>	<u>401 480</u>	<u>466 925</u>

AmaizeMeal Ltd declared and paid a dividend amounting to R25 000 on 30 April 20.18. The increase in the mark-to-market reserve balance of AmaizeMeal Ltd arose on 1 March 20.18 when AmaizeMeal Ltd recognised a fair value adjustment on its investments in equity instruments.

On 31 May 20.18 Mageu King Ltd sold 60 000 shares in AmaizeMeal Ltd at the shares' fair value and recognised a loss of R2 143 in its separate financial statements on that date. Mageu King Ltd lost control over AmaizeMeal Ltd on that date.

The assets and liabilities of AmaizeMeal Ltd on 31 May 20.18 were as follows:

	Dr/(Cr)
	R
Property, plant and equipment	?
Investments in equity instruments	107 880
Inventory	140 800
Trade and other receivables	188 000
Bank overdraft	(24 000)
Trade and other payables	(163 880)
Long-term borrowings	(120 000)

Branding4U Ltd

On 1 August 20.17 Mageu King Ltd acquired a 30% interest in Branding4U Ltd for a cash consideration of R185 000. The fairly valued equity of Branding4U Ltd consisted of ordinary share capital of R200 000 and retained earnings of R435 200 on that date. Mageu King Ltd exercised significant influence over the financial and operating policy decisions of Branding4U Ltd from that date.

The profit after tax of Branding4U Ltd for the 11 months ended 30 June 20.18 amounted to R170 400. On 30 June 20.18 Branding4U Ltd's equity also included a mark-to-market reserve balance of R38 300.

LCR Foods Ltd

Mageu King Ltd acquired an 80% controlling interest in LCR Foods Ltd on 30 June 20.17 for a cash consideration of R180 000. The equity of LCR Foods Ltd consisted of share capital amounting to R100 000 and retained earnings amounting to R114 800 on that date. All assets and liabilities of LCR Foods Ltd were deemed to be fairly valued on 30 June 20.17. No additional assets, liabilities or contingent liabilities were identified on the acquisition date.

The profit after tax of LCR Foods Ltd for the current financial year amounted to R80 530. LCR Foods Ltd paid a dividend during the current financial year.

ProudlySA Ltd

On 30 April 20.17 Mageu King Ltd acquired 5 000 of the 100 000 issued ordinary share capital of ProudlySA Ltd for a cash consideration of R51 250. On 30 June 20.18 Mageu King Ltd acquired a further 20 000 of the ordinary share capital of ProudlySA Ltd at a discount. Mageu King Ltd exercises joint control over the relevant activities of ProudlySA Ltd in terms of a joint arrangement. From 30 June 20.18 ProudlySA Ltd is correctly classified as a joint venture, in accordance with IFRS 11 *Joint Arrangements*. All the assets and liabilities of ProudlySA Ltd were deemed to be fairly valued on 30 June 20.18 and no additional assets or liabilities were identified.

ProudlySA Ltd's fairly valued equity amounted to R1 088 000 on 30 June 20.18. An excess of R3 250 arose with the acquisition on 30 June 20.18.

The share price of ProudlySA Ltd on 30 June 20.17 and 30 June 20.18 was R10,59 and R12,75, respectively.

Consolidated financial statements

The following is an extract from the consolidated statement of profit or loss and other comprehensive income of the Mageu King Ltd Group for the year ended 30 June 20.18:

	Note	20.18 R
Other comprehensive income		
Items that will not be reclassified to profit or loss:		
Gain on revaluation of land	1	54 320
Mark-to-market reserve	2	48 020
Share of other comprehensive income of associate		xxx
Other comprehensive income for the year, net of tax		<u>xxx</u>

Notes

1. The revaluation surplus relates to land of LCR Foods Ltd that was revalued during the current financial year.
2. The mark-to-market reserve relates to fair value adjustments to investments in equity instruments of Mageu King Ltd and AmaizeMeal Ltd. Mageu King Ltd received dividends amounting to R30 500 from these investments during the current financial year.

The following movements in balances were extracted from the consolidated statement of financial position of the Mageu King Ltd Group as at 30 June 20.18 (you may assume that these movements were correctly calculated):

Line-item	Movement from 20.17 to 20.18 Dr/(Cr) R
Property, plant and equipment	49 300
Investments in equity instruments	125 000
Investments in associates	258 880
Investment in joint venture	272 000
Non-controlling interests	36 484
Shareholders for dividends	10 500
Long-term borrowings	(563 375)

Additional information

1. It is the accounting policy of Mageu King Ltd to account for investments in subsidiaries, joint ventures and associates at cost in its separate financial statements, in accordance with IAS 27.10(a).
2. It is the accounting policy of all the companies in the group to account for investments in equity instruments other than investments in subsidiaries, joint ventures and associates, in accordance with IFRS 9 *Financial Instruments*. All the companies in the group irrevocably elected to present subsequent changes in the fair value of the investments in other comprehensive income in a mark-to-market reserve.
3. All the companies in the group have a 30 June year end.
4. The profit of AmaizeMeal Ltd accrued evenly during the year.
5. Mageu King Ltd elected to measure non-controlling interests for all acquisitions at the proportionate share of the acquiree's net identifiable assets at acquisition date.
6. There were no changes in the issued ordinary share capital of any of the companies in the group.
7. Mageu King Ltd paid dividends of R75 000 during the current financial year.

8. Included in other expenses in the consolidated statement of profit or loss and other comprehensive income for the year ended 30 June 20.18 is depreciation amounting to R57 600.
9. Cash flows from dividends received are classified as investing activities and cash flows from dividends paid are classified as financing activities.
10. Mageu King Ltd disposed of a partial interest in one of its wholly owned subsidiaries in the current financial year. The equity of the Mageu King Ltd Group, therefore, includes a change in ownership reserve amounting to R5 790 (credit). Non-controlling interests were adjusted by R45 210 as a result of this partial disposal. The profit attributable to non-controlling interests for this subsidiary amounted to R12 200 for the current financial year.
11. The Mageu King Ltd Group did not dispose of or acquire any other associates during the current financial year, unless otherwise stated in the information provided. The Mageu King Ltd Group recognised a share of profit of associates of R20 710 in the current financial year (this amount excludes any profits from associates acquired in the current financial year).
12. There were no repayments of loans during the current financial year.
13. Assume a normal income tax rate of 27% and a Capital Gains Tax inclusion rate of 80%. Ignore Value Added Tax (VAT) and Dividend Tax.

QUESTION 3**25 marks**

AHW Plumbing Ltd was established in 20.1 and has grown from humble beginnings to a well-established business. AHW Plumbing Ltd stocks a wide variety of bathroom and plumbing fittings. Since incorporation in 20.1, AHW Plumbing Ltd has acquired various investments in order to diversify their business. AHW Plumbing Ltd is listed on the Johannesburg Stock Exchange with a June year end.

During the current financial year, AHW Plumbing Ltd entered into negotiations to acquire interests in two companies:

Top Tiles Ltd

Based on current negotiations, AHW Plumbing Ltd will acquire 40% of the ordinary share capital and voting rights of Top Tiles Ltd. Top Tiles Ltd will source scarce and durable tiles and sell these tiles only to AHW Plumbing Ltd. The other 60% of the ordinary share capital and voting rights of Top Tiles Ltd will be held by CMT Ltd. Each share entitles the shareholder to one vote.

AHW Plumbing Ltd will have an option to acquire 30% of CMT Ltd's voting rights. The option will be exercisable for the next three years at a fixed price. The option has no intrinsic value, as it has a strike price that is significantly above the market price. It is expected that the strike price will remain above the market price for the three-year period.

The draft contractual arrangement between AHW Plumbing Ltd and Top Tiles Ltd specifies that AHW Plumbing Ltd will have the right to appoint, reassign or remove members of Top Tiles Ltd's key management personnel. Mrs Bontle, the Chief Executive Officer of AHW Plumbing Ltd, indicated that it is highly unlikely that AHW Plumbing Ltd will exercise this right as she feels Top Tiles Ltd's management is more than capable to make this type of decisions on their own.

Euro Kitchens Ltd

AHW Plumbing Ltd plans to acquire 120 000 ordinary shares in Euro Kitchens Ltd. Euro Kitchens Ltd's equity consists of the following:

	R
Ordinary share capital (150 000 shares)	300 000
12% Preference share capital (40 000 shares)	80 000
Retained earnings	xxx
	<u>xxx</u>

The preference shares give their holders the right to a preferential dividend before the payment of any dividend to the ordinary shareholders. On liquidation of Euro Kitchens Ltd the preference shareholders are entitled to receive their initial investment back before the remainder of the net assets are distributed to the ordinary shareholders. The preference shareholders do not have any further rights on liquidation. Each ordinary share entitles the shareholder to one vote and the preference shareholders do not have any voting rights.

In accordance with the contractual agreement, AHW Plumbing Ltd acquired the ordinary shares on 30 June 20.18 and exercised control, as defined in IFRS 10 *Consolidated Financial Statements*, over Euro Kitchens Ltd from that date. On 30 June 20.18 the fair value of Euro Kitchens Ltd's ordinary shares and preference shares amounted to R12,50 per share and R10 per share respectively.

CASE STUDY 10**REQUIRED**

YOU NOW HAVE 150 MINUTES TO COMPLETE THE CASE STUDY.

QUESTION 1

	Marks
Provide the pro forma consolidation journal entries to account for the investment in Busy Bees Ltd in the consolidated financial statements of the Lowveld Honey Ltd Group for the year ended 30 June 20.18.	34
Communication skills: presentation and layout	1
<p>Please note:</p> <ul style="list-style-type: none"> • The elimination of the intragroup dividends journal is not required. • Journals relating to deferred taxation are required. • Journal narrations are required. • Round off all amounts to the nearest rand. • Your answer must comply with International Financial Reporting Standards (IFRS). 	

QUESTION 2

	Marks
Prepare only the following sections of the consolidated statement of cash flows of the Mageu King Ltd Group for the year ended 30 June 20.18:	39
<ul style="list-style-type: none"> • Cash flows from investing activities • Cash flows from financing activities 	
Communication skills: presentation and layout	1
<p>Please note:</p> <ul style="list-style-type: none"> • Comparative figures are not required. • Round off all amounts to the nearest rand. • Notes to the consolidated statement of cash flows are not required. • Your answer must comply with International Financial Reporting Standards (IFRS). 	

QUESTION 3

	Marks
(a) Discuss, with reasons and by addressing all the information provided, whether Top Tiles Ltd will be consolidated in the consolidated financial statements of the AHW Plumbing Ltd Group.	12
Communication skills: logical flow and conclusion	1
(b) Discuss the measurement of the non-controlling interests in Euro Kitchens Ltd at the acquisition date in the consolidated financial statements of the AHW Plumbing Ltd Group.	12
Please note:	
<ul style="list-style-type: none"> • Your answer must comply with International Financial Reporting Standards (IFRS). 	

CASE STUDY 10**QUESTION 1 - Suggested solution****Pro forma consolidation journals to account for the investment in Busy Bees Ltd in the consolidated financial statements of the Lowveld Honey Ltd Group**

	Dr R	Cr R	
J1	Mark-to-market reserve (SCE) [(704 000 - 400 000) x 0,784]	238 336	(2)
	Retained earnings (SCE)		238 336
	Transfer of fair value adjustments previously recognised in mark-to-market reserve to retained earnings with measurement of equity interest previously held, at group level, in accordance with IFRS 9.B5.7.1		
J2	Ordinary share capital (SCE)	200 000	
	Retained earnings (SCE)	1 555 200	
	Mark-to-market reserve (SCE)	234 200	(1)
	Profit for the year (P/L) (870 120 x 6/12)	435 060	(1)
	Mark-to-market reserve (OCI) (77 550 x 6/12)	38 775	(1)
	Intangible asset (SFP)	265 000	(1)
	Contingent liability (SFP)		110 500 (1)
	Plant (SFP) [(3 235 000 + 216 287 [C1]) - 2 455 000]	996 287	(4)
	Deferred tax (SFP)		
	[(265 000 x 27% x 80%) + (996 287 x 27%)]		326 237 (2)
	Goodwill (SFP) (balancing)	176 215	
	NCI (SFP) [(704 000/20 000) x 25 000]		880 000 (2)
	Investment (SFP) (1 165 000 + 704 000 + 750 000 - 35 000)		2 584 000 (2)
	<u>At acquisition elimination journal</u>		
J3	Depreciation (P/L)		
	[(3 235 000 - 2 455 000)/12 + 216 287/5] x 6/12]	54 129	(3)
	Accumulated depreciation (SFP)		54 129
	<u>Provide depreciation on plant revalued at acquisition</u>		
J4	Deferred tax (SFP) (54 129 x 27%)	14 615	(1)
	Income tax expense (P/L)		14 615 (1)
	<u>Tax effect on depreciation provided</u>		
J5	Revenue (P/L)	350 000	(1)
	Cost of sales (P/L) (350 000 x 100/130)		269 231 (1)
	Equipment (SFP) (350 000 x 30/130)		80 769 (1)
	<u>Elimination of intragroup sales</u>		
J6	Deferred tax (SFP) (80 769 x 27%)	21 808	(1)
	Income tax expense (P/L)		21 808 (1)
	<u>Tax effect on elimination of intragroup sales</u>		
J7	Accumulated depreciation (SFP) (80 769 x 20% x 4/12)	5 385	(1)
	Cost of sales (depreciation) (P/L)		5 385 (1)
	<u>Realisation of unrealised profit in equipment</u>		

	Dr R	Cr R	
J8	Income tax expense (P/L) (5 385 x 27%)	1 454	(1)
	Deferred tax (SFP)		1 454 (1)
	<u>Tax effect on realisation of unrealised profit</u>		
J9	Non-controlling interests (P/L)		
	[[((870 120 x 6/12) - 54 129 + 14 615) x 25%]	98 887	(2)
	Non-controlling interests (OCI) [(77 550 x 6/12) x 25%]	9 694	(1)
	Non-controlling interests (SFP)		108 580 (1)
	<u>Account for NCI's share in profit and OCI</u>		
		Total	<u>(35)</u>
		Maximum	<u>(34)</u>
	Communication skills: presentation and layout (narrations)		<u>(1)</u>

CALCULATIONS

C1. Favourable component of lease contract

HP 10BII		SHARP EL-733A		SHARP EL-738		
1. 2 nd F C	(Clear All)	1. 2 nd F C	(Clear All)	1. 2 nd F C	(Clear All)	
2. (250 000	PMT	2. (250 000	PMT	2. (250 000	PMT	
- 190 000)		- 190 000)		- 190 000)		[1]
3. 12	I/YR	3. 12	I	3. 12	I/Y	[1]
4. 5	N	4. 5	N	4. 5	N	[1]
5. 0	FV	5. 0	FV	5. 0	FV	
6. PV	216 287	6. Comp PV	216 287	6. Comp PV	216 287	<u>[3]</u>

COMMENT

Mark-to-market reserve

Many students are still confused between the reversal of the mark-to-market reserve in Journal 1 and the at acquisition elimination of the mark-to-market reserve in Journal 2.

Journal 1 refers to the investment in Lowveld Honey Ltd's separate financial records. Lowveld Honey Ltd owns 20% shares in Busy Bees Ltd, making it an IFRS 9 investment, as Lowveld Honey Ltd did not exercise joint control or significant influence over the financial and operating policy decisions over Busy Bees Ltd. While Lowveld Honey Ltd held this 20% investment, there were fair value adjustments done through OCI. On 1 January 20.18 Lowveld Honey Ltd bought an additional 55% interest, therefore 75% shareholding in total, resulting in control over Busy Bees Ltd.

Lowveld Honey Ltd has elected to transfer any cumulative gains or losses within equity in accordance with IFRS 9.B5.7.1. This means that Lowveld Honey Ltd (as the separate company and not the group of companies) should transfer the fair value adjustments currently in mark-to-market reserve (only relating to the Busy Bees Ltd investment) to retained earnings. Remember that this amount is already after tax, as the deferred tax was already taken into account in the year that the fair value adjustments arose.

If Lowveld Honey Ltd has not elected to transfer any cumulative gains or losses within equity in accordance with IFRS 9.B5.7.1, then journal 1 would not have been applicable.



COMMENT

Mark-to-market reserve

In our case, Lowveld Honey Ltd bought the 20% interest for a cash consideration of R400 000. On 1 January 20.18 the shares were fairly valued at R704 000. Therefore, there was a fair value increase of R304 000. This is before tax, thus the amount net of tax will be;

At acquisition	=	400 000
At 1 January 20.18	=	<u>704 000</u>
Fair value increase		304 000 x 78,4%

Amount to be transferred from the mark-to-market reserve to retained earnings is R238 336.

The mark-to-market reserve in Journal 2 is the mark-to-market reserve of the subsidiary itself. The subsidiary as an individual company which also has IFRS 9 investments that are carried at fair value through OCI.

Lowveld Honey Ltd, as the parent, will have to eliminate all the reserves at acquisition as part of the consolidation process.

Internally generated client list

Why was the internally generated client list not part of the assets at acquisition?

The privacy agreement prohibits the disposal of the information contained in the client list and, therefore, the list does not meet the separability criterion and cannot be recognised separately from goodwill.

Operating lease

When measuring the fair value of an operating lease at acquisition the terms of the lease contract need to be taken into consideration. In this case the market-related rental is only R190 000 per annum, and Busy Bees Ltd is collecting R250 000 per annum, which means that the lease is favourable to the group and, therefore, needs to be present valued at acquisition. This present value will be depreciated over the remaining term of 5 years.

C2. Analysis of owners' equity of Busy Bees Ltd (for completeness)

	Total	Lowveld Honey Ltd (20% - 75%)		NCI
		At	Since	
At acquisition (1 January 20.18)				
Share capital	200 000			
Retained earnings	1 555 200			
Mark-to-market reserve	234 200			
Profit for 6 months (870 120 x 6/12)	435 060			
OCI for 6 months (77 550 x 6/12)	38 775			
Intangible asset (trademark)	265 000			
Deferred tax (IA) (265 000 x 80% x 27%)	(57 240)			
Contingent liability	(110 500)			
Plant ((3 235 000 + 216 287 [C1]) – 2 455 000)	996 287			
Deferred tax (plant) (996 287 x 27%)	(268 997)			
	3 287 785	2 465 839		821 946
Goodwill	176 215	118 161		58 054
Consideration and NCI [C3]; [(704 000/20 000) x 25 000]	3 464 000	2 584 000		880 000
Current year				
Profit for 6 months (870 120 x 6/12)	435 060			
Depreciation (((3 235 000 – 2 455 000)/12 + 216 287/5) x 6/12)	(54 129)			
Tax (54 129 x 27%)	14 615			
Total current year profit	395 546		296 660	98 886
Mark-to-market (77 550 x 6/12)	38 775		29 081	9 694
Dividend	(150 000)		(112 500)	(37 500)
	3 748 321		213 241	951 080

**EXAM TECHNIQUE**

We receive many e-mails regarding the use of the analysis as a calculation. You may use an analysis of equity for your calculations. Many students only perform the analysis for comfort and then don't use it. Students will also then perform for example C1 to C3 thereby wasting valuable time in the test or exam. If you want to use the analysis for this type of question, remember to reference to the journals, by making use of colour highlighters or symbols, in order to direct the marker to where your specific calculation is.

In certain types of questions an analysis is not necessary, for example the disclosure of the statement of cash flow or the disclosure of the statement of financial position. While preparing for the exams make sure that you know where and where not to use the analysis as a calculation.

C3. Investment in Busy Bees Ltd

Consideration transferred	
Cash	1 165 000
Acquisition-related costs	(35 000)
Contingent consideration	750 000
Plus: fair value of existing interest	<u>704 000</u>
	<u><u>2 584 000</u></u>

QUESTION 2 - Suggested solution**MAGEU KING LTD GROUP****CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 20.18****R****Cash flows from investing activities**

Dividends received (30 500 + 15 000 [C1])	45 500	(7)
Acquisition of property, plant and equipment [C2]	(352 565)	(16)
Acquisition of investments in equity instruments [C4]	(207 880)	(5)
Proceeds from disposal of subsidiary, net of cash relinquished (((195 000 x 60/70) - 2 143) = 165 000 + 24 000)	189 000	(2)
Acquisition of investment in associates	(185 000)	(1)
Acquisition of investment in joint venture [C5]	(205 000)	(2)
Net cash used in investing activities	<u>(715 945)</u>	

Cash flows from financing activities

Proceeds from long-term borrowings (563 375 + 120 000)	683 375	(1)
Proceeds from partial disposal of subsidiary (5 790 + 45 210)	51 000	(1)
Dividends paid [C6]	(102 119)	(9)
Net cash from financing activities	<u>632 256</u>	

Total (44)Maximum (39)Communication skills: presentation and layout (1)**CALCULATIONS****C1. Dividends received**

Increase in investments in associates	(258 880)	[1]
Share of profit of associate (excess) (Branding4U) (((200 000 + 435 200) x 30%) - 185 000)	5 560	[2]
Share of profit of associate (Branding4U) (170 400 x 30%)	51 120	[1]
Share of OCI of associate (Branding4U) (38 300 x 30%)	11 490	[1]
Share of profit of associates (given)	20 710	[1]
Acquisition of associate	185 000	[1]
Dividends received	<u>15 000</u>	<u>[7]</u>

**COMMENT**

Many students did not include the excess of Branding4U. Remember that any excess of the investor's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment will be included in the investment.

Why did we use the "investment in associate" to calculate the dividends received?

When the associate has declared a dividend, the consolidated journal would be:

Dr: Dividend received	xxx
Cr: Investment in associate	xxx

Meaning that the dividend received from the associates are not included in "other income" and therefore the investment in associate account should be reconciled to calculate the dividend received.

It may also happens that the dividends received from associates has been given in the scenario, in that case the balancing figure will indicate either the acquisition of additional associates or disposal of associates.

C2. Acquisition of property, plant and equipment

Increase in property, plant and equipment	(49 300)	
Revaluation of land (54 320/0,784)	69 286	[1]
Depreciation	(57 600)	[1]
PPE of subsidiary disposed Amaizemeal [C3]	<u>(314 951)</u>	[14]
Acquisition of property, plant and equipment	<u>(352 565)</u>	<u>[16]</u>

**COMMENT**

Many students multiplied the revaluation with 80%.

Why is this incorrect?

Remember that we consolidate at 100%. Therefore, we will add 100% of land of the subsidiary. When we revalue that land, we will only allocate 20% of the revaluation surplus to NCI and not 20% of the land's increase.

C3. Disposal of AmaizeMeal Ltd on 31 May 20.18 (PPE derecognised)

NAV on 30 June 20.17	(401 480)	[1]
Profit ((308 125 - 255 780 + 25 000) x 11/12)	(70 900)	[2]
Mark-to-market reserve (OCI) (58 800 – 45 700)	(13 100)	[1]
Dividend	25 000	[1]
Investments in equity instruments	107 880	[1]
Inventory	140 800	[1]
Trade receivables	188 000	[1]
Bank overdraft	(24 000)	[1]
Trade payables	(163 880)	[1]
Long-term borrowings	(120 000)	[1]
Property, plant and equipment (balancing)	331 680	
	<u>-</u>	
PPE of subsidiary on 31 May 20.18	331 680	
Machinery IFRS 3 adjustments at acquisition (55 000 x 73%)	(40 150)	[1]
Depreciation (20.17) (40 150/3 x 10/12)	11 153	[1]
Depreciation (20.18) (40 150/3 x 11/12)	12 268	[1]
	<u>314 951</u>	
		<u>[14]</u>

OR

NAV at acquisition	(278 900)	[1]
Machinery (55 000 x 73%)	40 150	[1]
Retained earnings (30 June 20.17) (255 780 – 133 200)	(122 580)	[1]
Depreciation (20.17) (40 150/3 x 10/12)	(11 153)	[1]
Profit ((308 125 - 255 780 + 25 000) x 11/12)	(70 900)	[1]
Depreciation (20.18) (40 150/3 x 11/12)	(12 268)	[1]
Mark-to-market reserve (58 800 - 45 700)	(13 100)	[1]
Dividend	25 000	[1]
Equity accounted NAV at date of disposal	<u>(443 751)</u>	
Investments in equity instruments	107 880	[1]
Inventory	140 800	[1]
Trade receivables	188 000	[1]
Bank overdraft	(24 000)	[1]
Trade payables	(163 880)	[1]
Long-term borrowings	(120 000)	[1]
PPE derecognised	<u>(314 951)</u>	
		<u>[14]</u>

**COMMENT**

In the scenario the PPE figure was not given, and many students simply ignored this.

Remember assets – liabilities = net asset value (NAV) therefore, if you take NAV and add liabilities less assets, you should end up with the PPE figure.

The total NAV excluding goodwill at disposal date amounted to R443 751 (refer to [C3] alternative calculation). Because non-controlling interests is measured at proportionate share and does not share in goodwill.

C4. Acquisition of investments in equity instruments

Increase in investments in equity instruments	(125 000)	
Fair value adjustment (48 020 / 0,784)	61 250	[1]
Subsidiary becomes IFRS 9 (AmaizeMeal) ((165 000/60 000) x 10 000)	27 500	[2]
IFRS 9 becomes joint venture (ProudlySA) (5 000 x 12,75)	(63 750)	[1]
Disposal of subsidiary	(107 880)	[1]
Acquisition of investments in equity instruments	<u>(207 880)</u>	<u>[5]</u>

**COMMENT**

Students should not forget that the fair value adjustments are always before tax.

C5. Acquisition of investment in joint venture

Increase in investment in joint venture	(272 000)	
Share of profit of joint ventures (excess)	3 250	[1]
IFRS 9 becomes joint venture (ProudlySA) (5 000 x 12,75)	63 750	[1]
Acquisition of investments in joint venture	<u>(205 000)</u>	<u>[3]</u>

C6. Dividends paid

Dividend paid to shareholders of parent [C7]	(85 500)	[1]
Dividend paid to non-controlling interests [C8]	(16 619)	[8]
	<u>(102 119)</u>	<u>[9]</u>

C7. Dividend paid to shareholders of parent

Decrease in shareholders for dividends	(10 500)	
Dividends declared and paid	(75 000)	[1]
	<u>(85 500)</u>	<u>[1]</u>

C8. Dividend paid to non-controlling interests

Decrease in non-controlling interests	(36 484)	
Disposal of subsidiary (AmaizeMeal) (443 751 (NAV ex gw) [C3] x 30%)	133 126	[1]
Partial disposal of subsidiary (given)	(45 210)	
NCI's share in OCI [C9]	(14 794)	[2]
NCI's share in P/L [C10]	(53 257)	[5]
	<u>(16 619)</u>	<u>[8]</u>

C9. NCI's share in OCI

Mark-to-market reserve: AmaizeMeal ((58 800 - 45 700) x 30%) or (13 100 [C3] x 30%)	(3 930)	[1]
Revaluation surplus: LCR Foods (54 320 x 20%)	(10 864)	[1]
	<u>(14 794)</u>	<u>[2]</u>

C10. NCI's share in P/L

Given	(12 200)	[1]
Profit: LCR Foods (80 530 x 20%)	(16 106)	[1]
Profit: AmaizeMeal ((((308 125 - 255 780 + 25 000) x 11/12) + (40 150/3 x 11/12)) x 30% or (70 900 [C3] + 12 268 [C3] x 30%)	(24 951)	[3]
	<u>(53 257)</u>	<u>[5]</u>

QUESTION 3 - Suggested solution**(a) Discuss whether Top Tiles Ltd will be consolidated****Definitions**

An entity that is a parent shall present consolidated financial statements (IFRS 10.4).

AHW Plumbing Ltd shall determine whether it is a parent by assessing whether it controls the investee (IFRS 10.5).

AHW Plumbing Ltd controls Top Tiles Ltd when it is exposed or has rights to variable returns from its involvement with Top Tiles Ltd and has the ability to affect those returns through its power over Top Tiles Ltd (IFRS 10.6). (1)

Application: Power and rights

AHW Plumbing Ltd has power over Top Tiles Ltd when AHW Plumbing Ltd has existing rights that give it the current ability to direct the relevant activities (IFRS 10.10). (1)

Power arises from rights (IFRS 10.11).

When assessing control, AHW Plumbing Ltd considers its potential voting rights as well as potential voting rights held by other parties to determine whether it has power (IFRS 10.B47). (1)

Potential voting rights are considered only if the rights are substantive (IFRS 10.B47).

For a right to be substantive, the holder must have the practical ability to exercise that right (IFRS 10.B22).

AHW Plumbing Ltd has the option to acquire another 30% of the ordinary share capital and voting rights of Top Tiles Ltd, which would result in AHW Plumbing Ltd having the majority of the voting rights. The option is currently exercisable. (2)

As the option has no intrinsic value and the strike price is significantly above the market price, the option is deeply out of the money. Therefore, the option is not considered substantive. (1)

An investor can have power even if it holds less than a majority of the voting rights (IFRS 10.B38).

AHW Plumbing Ltd will have rights to appoint, reassign or remove members of Top Tiles Ltd's key management personnel. The fact that Mrs. Bontle indicated that it is highly unlikely that AHW Plumbing Ltd will exercise this right should not be considered. (2)

Conclusion

AHW Plumbing Ltd has power over Top Tiles Ltd. (1)

Application: Exposure, or rights, to variable returns

AHW Plumbing Ltd will be exposed to variable returns in the form of dividends related to its 40% interest (IFRS 10.B57(a)). (1)

Top Tiles Ltd will source scarce and durable tiles and sell these tiles only to AHW Plumbing Ltd. The revenue that AHW Plumbing Ltd will earn on these tiles is an example of variable returns, seeing that it is a return that is not available to other interest holders (IFRS 10.B57(c)). (2)

AHW Plumbing Ltd is, therefore, exposed to variable returns from its involvement in Top Tiles Ltd. (1)

Link between power and returns

AHW Plumbing Ltd is able to affect these returns (revenue and dividends) through its power over Top Tiles Ltd by means of the contract. (1)

Conclusion

AHW Plumbing Ltd will have to consolidate Top Tiles Ltd in its consolidated financial statements, as it has control over Top Tiles Ltd. (1)

Total (15)
Maximum (12)
Communication skills: logical flow and conclusion (1)

(b) Measurement of non-controlling interests at acquisition**Definitions**

For each business combination, the acquirer shall measure at the acquisition date components of non-controlling interests in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:

- (a) fair value, or
- (b) the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets (IFRS 3.19)

All other components of non-controlling interests shall be measured at their acquisition date fair values, unless another measurement basis is required by IFRSs (IFRS 3.19).

Application

The non-controlling interests in Euro Kitchens Ltd consists of two components, namely ordinary share capital and preference share capital that should be measured separately. Both components will be recognised in a one line-item in equity, namely non-controlling interests. (2)

The measurement choice can be applied on a subsidiary-by-subsidary basis; thus, for each business combination, as it is not part of the accounting policy of the acquirer. (1)

Conclusion

AHW Plumbing Ltd will acquire 120 000 of the 150 000 shares; therefore, the remaining 30 000 shares (20%) will be allocated to non-controlling interests. (1)

AHW Plumbing Ltd will not take up any of the preference shares; therefore, the entire preference share capital will be allocated to non-controlling interests. (1)

Measurement of ordinary share capital

Euro Kitchens Ltd's ordinary share capital presents an ownership interest, as each share entitles a shareholder to one vote. AHW Plumbing Ltd will also receive a proportionate share of Euro Kitchens Ltd's net assets in the event of liquidation. (1)

AHW Plumbing Ltd will, therefore, have a choice to measure the 20% non-controlling interests in ordinary share capital at the proportionate share of Euro Kitchens Ltd's identifiable net assets, or at fair value at acquisition date. (1)

The fair values of the acquirer's interest in the acquiree and the non-controlling interests on a per-share basis might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree (IFRS 3.B45).

If AHW Plumbing Ltd elects to measure the non-controlling interests in ordinary share capital at fair value, the fair value of R12,50 per share should be used, resulting in non-controlling interests of R375 000 ($150\,000 \times 20\% \times R12,50$) for the ordinary shares. (2)

Measurement of preference share capital

The non-controlling interests that relate to Euro Kitchens Ltd's preference shares do not qualify for the measurement choice in IFRS 3.19, because they do not entitle their holders to a proportionate share of Euro Kitchens Ltd's net assets in the event of liquidation. The preference shareholder also does not have any voting rights and, therefore, do not have a present ownership interest. (2)

AHW Plumbing Ltd will measure the 100% non-controlling interests in the preference shares at their acquisition-date fair value of R10, resulting in non-controlling interests of R400 000 ($40\,000 \times R10$) for the preference shares. (2)

Total	<u>(13)</u>
Maximum	<u>(12)</u>

**EXAM TECHNIQUE**

What theory should be used in a discussion question? Even though merely stating the theory does not earn marks, it is very important to identify the theory applicable to the scenario. This is important because the scenario should be applied to the theory, and this assists in the logical structure and layout of the answer.

The theory used should be based on the information in the scenario and required. If control needs to be discussed, the definition of control, power and rights will be used as a basis. This will be followed by whether information on shareholding is provided (voting rights), the revenue generating activities (relevant activities), and so on. To master the technique, practise, practise, and practise discussion type questions. It is also a good idea to use your IFRS textbook while studying and practising questions. Highlight important paragraphs and know where they are and know how to use your IFRS textbook and the related Illustrative examples.