FINANCIAL ACCOUNTING 700 Seminar RS 3 – Suggested solution *PH Ferreira*	DEPARTMENT OF ACCOUNTING UP

SUGGESTED SOLUTION TO QUESTION 1

1. Financial statements that are intended to meet the needs of those users who are not in a position to demand tailor-made reports that suit their specific information needs [IAS 1.7].

2. The following disclosure is required [IAS 1.25]:

   - the fact that the financial statements are not prepared on a going concern basis;
   - the basis on which the financial statements are prepared; and
   - the reason why the entity is not regarded as a going concern.

3. The effects of transactions and other events are recognised when they occur (and not when cash or its equivalent is received or paid). As a result, transactions are recorded in the accounting records and reported in the financial statements of the periods to which they relate [The Conceptual Framework OB.17]. Furthermore, items are recognised as assets, liabilities, equity, income and expenses when they satisfy the definitions and recognition criteria in The Conceptual Framework [IAS 1.28].

4. Narrative information relating to the prior year should be repeated in the current financial statements only if it is relevant to an understanding of the current period's financial statements [IAS 1.38].

5. If an entity changes the end of its reporting period, the reporting period will be longer/shorter than one year. Consequently the following should be disclosed [IAS 1.36]:

   - the reason for using a longer/shorter period; and
   - the fact that amounts presented in the financial statements are not entirely comparable.

6. As the work in progress is intended for sale in the entity's normal operating cycle, the entire amount (100%) should be classified as a current asset. The amount (20%) that is expected to be recovered after more than 12 months should, however, be disclosed separately [IAS 1.61, .65].

7. The judgements that need to be disclosed relate to accounting policy issues and do not involve estimates, while the sources of estimation uncertainty relate to estimates. An example of the former would be judgement applied in

determining whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue. An example of the latter would be assumptions regarding discount rates used in calculating an asset's value in use [IAS 1.122 - .133].

8. Paragraph 135 of IAS 1 requires disclosure of:

   - an entity's objectives, policies and processes for managing capital;
   - quantitative data about what the entity regards as capital;
   - whether the entity has complied with any capital requirements; and
   - if it has not complied, the consequences of such non-compliance.

9. Dividend per share may **not** be disclosed on the face of the statement of profit or loss and other comprehensive income. According to IAS 1.107 an entity should disclose dividend per share either in the statement of changes in equity or, alternatively, in the notes.

10. Profit or loss is the total of an entity's income less expenses, but excluding gains and losses recognised in other comprehensive income. Other comprehensive income comprises items of income and expenses that are not recognised in profit or loss as required or permitted by other standards, for example:

    - changes in revaluation surplus;
    - translation gains relating to foreign operations;
    - gains/losses on financial assets at fair value through other comprehensive income;
    - gains/losses relating to cash flow hedges.

    Total comprehensive income is the sum total of profit or loss and other comprehensive income. It represents the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.

11. Reclassification adjustments are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods. For example, gains or losses on exchange differences on translating foreign operations are recognised in other comprehensive income when they arise and are then accumulated in equity. When these foreign operations are sold, the amount accumulated in equity should be included in profit or loss. When included in profit or loss, the amount must be deducted from other comprehensive income to avoid including it in total comprehensive income twice.

SUGGESTED SOLUTION TO QUESTION 2

a. A complete set of financial statements comprises (IAS 1.10):

- a statement of financial position;
- a statement of profit or loss and other comprehensive income;
- a statement of changes in equity;
- a statement of cash flows;
- notes;
- a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

b. Inappropriate accounting treatments are not rectified by supplying accounting policy or notes and explanatory information regarding the matter.

When considering whether non-compliance with a specific requirement of a standard is necessary, the following should be taken into account:

- why the objective of financial statements is not achieved in the particular circumstances; and

- the way in which the entity's circumstances differ from those of other entities which follow the requirement. (If other entities in similar circumstances comply, there is a rebuttable presumption that compliance with the requirement will not be misleading).

Should management conclude that departure from the requirement of a standard is necessary (considering that the relevant regulatory framework (ie Companies Act) requires or does not prohibit such a departure), then the entity should depart from the requirement. However, to ensure that users can make an informed judgement on the effect of the departure, it is essential to provide sufficient information.

The following disclosure is therefore necessary:

Refer to IAS 1.20 (a – d).

SUGGESTED SOLUTION TO QUESTION 3

Many accountants are of the opinion that accounting policy should be disclosed only when there is a choice between two different policies.

This approach does however not agree with the definition of accounting policy. In IAS 8.5 the definition is as follows:

Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting financial statements.

This definition is very wide, and its objective is to communicate to the users the policies adopted and applied by the company. Financial statements should not merely report accounting policies only when a choice is made between alternative bases, but should rather inform the users of all material accounting policies applied. (Some Standards however specifically require disclosure of particular accounting policies).

In identifying significant accounting policies, entities should consider the nature of their operations and the policies that the users of financial statements would expect to be disclosed for that type of entity.

An accounting policy may be significant because of the nature of the entity's operations even if amounts for current and prior periods are not material.

Refer IAS 1.117 - 121.

SUGGESTED SOLUTION TO QUESTION 4

SAFARI LTD
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20X7 (function)

	Note	20X7 R	20X6 R
Revenue		900 000	
Cost of sales (cal. 1)		(500 000)	
Gross profit		400 000	
Other income		10 000	
Distribution costs		(100 000)	
Administrative expenses (5 + 15 + 50)		(70 000)	
Other expenses (39 + 2 + 7 + 2 + 20)		(70 000)	
Finance costs		(30 000)	
Profit before tax	4	140 000	
Income tax expense (140 000 x 30%)		(42 000)	
Profit for the year		98 000	
Other comprehensive income for the year, net of tax:		48 700	
Items that will not be reclassified:			
Property revaluation		35 700	
- Revaluation of land		42 000	
- Tax expense (42 000 x 50% x 30%)		(6 300)	
Items that will be reclassified:			
Exchange differences on translating foreign operations		13 000	
- Gain arising during the year		13 000	
- Tax expense		-	
Total comprehensive income for the year		146 700	

OR

SAFARI LTD
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20X7 (nature)

	Note	20X7 R	20X6 R
Revenue		900 000	
Other income		10 000	
Change in inventory finished goods (45 - 75)		30 000	
Raw material & consumables used (20 + 70 - 30)		(60 000)	
Employee benefit expense (175 + 15 + 2 + 7)		(199 000)	
Depreciation (125 + 5)		(130 000)	
Other expenses (170 + 100 + 50 + 39 + 2 + 20)		(381 000)	
Finance costs		(30 000)	
Profit before tax	5	140 000	
Income tax expense		(42 000)	
Profit for the year		98 000	
Other comprehensive income for the year, net of tax:		48 700	
Items that will not be reclassified			
Property revaluation		35 700	
- Revaluation of land		42 000	
- Tax expense (42 000 x 50% x 30%)		(6 300)	
Items that will be reclassified			
Exchange differences on translating foreign operations		13 000	
- Gain arising during the year		13 000	
- Tax expense		-	
Total comprehensive income for the year		146 700	

SAFARI LTD
STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20X7

	Share capital	Foreign currency translation reserve	Revaluation Surplus[4]	Asset replace-ment reserve[4]	Retained earnings	Total
	R	R	R	R	R	R
Balance at 31 December 20X6	100 000	45 000	100 000	-	475 000	720 000
Correction of prior period error	-	-	-	-	(24 500)[1]	(24 500)
Restated balance	100 000	45 000	100 000	-	450 500	695 500
Total comprehensive income for the year	-	13 000	35 700	-	98 000	146 700
- Profit for the year	-	-	-	-	98 000	98 000
- Other comprehensive income for the year	-	13 000	35 700	-	-	48 700
Dividends paid (5 cents per share)[3]	-	-	-	-	(5 000)[2]	(5 000)
Transfer to asset replacement reserve	-	-	-	10 000	(10 000)	-
Balance at 31 December 20X7	100 000	58 000	135 700	10 000	533 500	837 200

1 35 000 – 30% tax = 24 500
2 The amount of dividends proposed must be disclosed by way of a note (refer note 6).
3 Dividend per share should be disclosed either in the statement of changes in equity or in the notes. [5 000/100 000]
4 A description of the nature and purpose of each reserve should be disclosed. This is illustrated in question 5.

SAFARI LTD
NOTES FOR THE YEAR ENDED 31 DECEMBER 20X7

	20X7	20X6
	R	R
4. Profit before tax (if SCI by function)		
Profit before tax is shown after taking into account the following items:		
Depreciation	130 000	
Employee benefit expense (175 + 15 + 2 + 7)	199 000	
Research costs	2 000	
Profit on disposal of plant#	10 000	
Loss of cash due to theft#	20 000	

\# Regarded as a separately disclosable item (IAS 1.97).

	20X7	20X6
	R	R
5. Profit before tax (if SCI by nature)		
Profit before tax is shown after taking into account the following items:		
Research costs	2 000	
Profit on disposal of plant	10 000	
Loss of cash due to theft	20 000	

6. **Dividends**

A final dividend of R4 000 has been proposed (4 cents per share), but is still subject to authorisation at the annual general meeting.

Calculations

1. **Cost of sales**

Opening inventory - finished goods		45 000
Material consumed		60 000
- opening inventory	20 000	
- purchases	70 000	
- closing inventory	(30 000)	
Direct labour costs		175 000
Overheads		
- depreciation		125 000
- other		170 000
Closing inventory – finished goods		(75 000)
Cost of sales		500 000

SUGGESTED SOLUTION TO QUESTION 5

PART A

NEWSOUND LTD GROUP

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20X9

	20X9 R'000	20X8 R'000
ASSETS		
Non-current assets		
Property, plant and equipment	16 069	14 696
Current assets	610 550	373 300
Inventories	192 085	149 002
Receivables	418 465	222 833
Cash and cash equivalents	-	1 465
Total assets	626 619	387 996
EQUITY AND LIABILITIES		
Total equity	223 651	200 209
Equity attributable to owners of the parent	183 526	168 209
Issued capital	147 834	147 834
Revaluation surplus	8 500	-
Asset replacement reserve	5 000	2 000
Retained earnings	22 192	18 375
Non-controlling interests	40 125	32 000
Total liabilities	402 968	187 787
Non-current liabilities	264 875	131 397
Long-term borrowings	236 000	108 297
Deferred taxation	28 875	23 100
Current liabilities	138 093	56 390
Payables	35 990	20 145
Current portion of long-term borrowings	83 042	24 639
Shareholders for dividends	17 409	11 606
Bank overdraft	1 652	-
Total equity and liabilities	626 619	387 996

NEWSOUND LTD GROUP

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20X9

	Note	20X9 R'000	20X8 R'000
Revenue		1 287 052	902 052
Cost of sales		(1 098 187)	(819 939)
Gross profit		188 865	82 113
Distribution costs		(25 741)	(14 010)
Administrative expenses		(28 813)	(10 345)
Other expenses (3 002 + 500 + 45 379); (2 237 + 20 000)		(48 881)	(22 237)
Finance cost		(39 264)	(20 862)
Profit before tax	2	46 166	14 659
Income tax expense	3	(10 927)	(6 148)
Profit for the year		35 239	8 511
Other comprehensive income for the year, net of tax			
Items that will not be reclassified:		10 625	xx
Property revaluation		10 625	-
- Gain on property revaluation (10 625 x 100%/85%)[#]		12 500	-
- Tax expense (12 500 x 15%)[##]		(1 875)	-
Financial assets at FV through OCI[*]		xx	xx
- Gains arising during the year		xx	xx
- Tax expense		(xx)	(xx)
Total comprehensive income for the year		45 864	8 511
Profit attributable to:			
- Owners of the parent		28 039	1 711
- Non-controlling interests (given)		7 200	6 800
		35 239	8 511
Total comprehensive income attributable to:			
- Owners of the parent (28 039 + 10 625 – 2 125)		36 539	1 711
- Non-controlling interests (7 200 + 2 125)		9 325	6 800
		45 864	8 511

\# Eliminating effect of capital gains tax – balance of surplus account represents after-tax effect

\## Capital gains tax charged at 15% (i.e. 30% x 50%)

* Only for illustrative purposes

Note: In this question the tax effect relating to each component of other comprehensive income is disclosed on the face of the statement of profit or loss and other comprehensive income – this disclosure may also be done in a note.

NEWSOUND LTD GROUP

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20X9

	Share capital R'000	Revaluation surplus R'000	Asset replacement reserve R'000	Retained earnings R'000	Total R'000	Non-controlling interest R'000	Total equity R'000
Balance at 31 December 20X7	147 834	-	-	33 802	181 636	26 300[e]	207 936
Total comprehensive income for the year	-	-	-	1 711	1 711	6 800	8 511
- Profit for the year	-	-	-	1 711	1 711	6 800	8 511
- Other comprehensive income for the year	-	-	-	-	-	-	-
Transfer to replacement reserve	-	-	2 000	(2 000)[g]	-	-	-
Dividends	-	-	-	(15 138)[f]	(15 138)	(1 100)[f]	(16 238)
Balance at 31 December 20X8	147 834	-	2 000	18 375	168 209	32 000	200 209
Total comprehensive income for the year	-	8 500[a]	-	28 039	36 539	9 325[b]	45 864
- Profit for the year	-	-	-	28 039	28 039	7 200	35 239
- Other comprehensive income for the year	-	8 500	-		8 500	2 125	10 625
Transfer to replacement reserve	-	-	3 000	(3 000)[g]	-	-	-
Dividends	-	-	-	(21 222)[f]	(21 222)	(1 200)[f]	(22 422)
Balance at 31 December 20X9	147 834	8 500	5 000	22 192	183 526	40 125	223 651

Nature and purpose of reserves:

Revaluation surplus:	a non-distributable reserve for the recognition of revaluation surplusses iro property, plant and equipment.[h]
Asset replacement reserve:	a distributable reserve that provides for the replacement of PPE[h]

[a] 10 625 – 2 125 = 8 500
[b] 2 125 + 7 200 = 9 325
[e] 32 000 + 1 100 - 6 800 = 26 300
[f] The consolidated dividend consists only of the dividend of the parent, while dividends paid to non-controlling interests decrease the non-controlling interests in the statement of financial position.
[g] Transfer to asset replacement reserve is only that of the parent and does not affect the non-controlling interests as the total equity remains the same.
[h] A description of the nature and purpose in respect of each reserve must be given (IAS 1.79). We recommend that this be done at the bottom of the statement of changes in equity. In this question it was assumed that the revaluation surplus is non-distributable, but it can also be distributable depending on the stipulations of the memorandum and articles of the entity.

NEWSOUND LTD GROUP

NOTES FOR THE YEAR ENDED 31 DECEMBER 20X9

1. Accounting policy

1.1 *Basis of preparation*

The financial statements comply in all aspects with IFRS. It has been prepared on the historical cost basis, except for land that is revalued.

[The accounting policy i.r.o. every material transaction type should be disclosed. However, you do not have enough information to do it in this question.]

COMMENT

IAS 1.16 requires disclosure of the fact that IFRShave been complied with.

2. Profit before tax

Included in profit before tax are:

	20X9 R'000	20X8 R'000
Depreciation	3 002	2 237
Loss on scrapping of equipment	500	-
Employee benefit expense	45 379	20 000

COMMENT

1. Note that when expenses are classified according to *function*, the following need to be disclosed in the profit before tax note (IAS 1.104):

   - total depreciation
   - total amortisation
   - total employee benefit expense.

2. The loss on scrapping of equipment qualifies as a separately disclosable item (IAS 1.98(a)). Only the nature thereof and amount should be disclosed.

3. Taxation

	20X9 R'000	20X8 R'000
Major components of tax expense:		
SA normal taxation		
- current	(7 027)	(3 048)
- deferred	(3 900)	(3 100)
	10 927	6 148

SUGGESTED SOLUTION TO QUESTION 6

According to IAS 1.60 a liability should be classified as a current liability when it is expected to be settled in the normal course of the entity's operating cycle, is due to be settled within 12 months from the reporting date, is held primarily for trading purposes, or if the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

The loan (under discussion) originally had a repayment date of 30 April 20X3. This would fall within 12 months after the reporting date. After year-end the directors managed to extend the repayment date to 30 April 20X4 (more than 12 months after year-end).

The agreement that led to the change in repayment terms represents a non-adjusting event after the reporting period date, as it did not influence eFin (Pty) Ltd's solvency and liquidity at the reporting date.

As a result the loan will still be classified as a current liability in the statement of financial position on 30 June 20X2.