

SUGGESTED SOLUTION

PAPER 1

QUESTION 1

BUGATTI SA LTD

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 OCTOBER 2011 (1)

	Notes	R	
Continuing operations			
Revenue (580 000 000 – 6 580 000)		573 420 000	(1½)
Cost of sales [C5]		<u>(377 020 000)</u>	(7)
Gross profit		196 400 000	
Other income (given)		300 000	(½)
Distribution costs (given)		(400 000)	(½)
Administration expenses (4 200 000 + 54 500)			
Other expenses (6 700 000 +		(4 254 500)	(½)
+ 14 400 foreign exchange loss on interest [C1]		(3 589 900)	(7)
+ 900 000 foreign exchange loss on loan [C2]			
+ 4 400 000 foreign exchange loss on creditor [C4]			
– 3 680 000 foreign exchange gain on FEC [C4]			
+110 000 payment to L Sorry [C5]			
– 1 500 000 Transport costs [C5]			
–3 500 000 import duties [C5]			
– 54 500 administrative overheads			
+ 200 000 tax penalty)			
Finance costs (685 000 +			
+ 1 152 000 interest on loan [C1]			
– 25 000 reverse transaction costs [C3]			
+ 203 077 interest on debenture [C3]			
+ 80 000 interest on under provision for tax)		<u>(2 095 077)</u>	(11)
Profit before tax		186 360 523	
Income tax expense [C8]	3	<u>(52 406 146)</u>	(½)
Profit for the year from continuing operations		<u>133 954 377</u>	
Discontinued operations			
Loss for the year from discontinued operations	4	<u>(1 756 952)</u>	(½)
Other comprehensive income for the year			
Fair value adjustment on financial asset		305 300	
- Gains arising during the year [C6]		<u>355 000</u>	(2)
- Tax expense (355 000 x 28% x 50%)		<u>(49 700)</u>	(1)
Total comprehensive income for the year		<u><u>132 502 725</u></u>	
Basic earnings per share			
	5		
Profit from continuing operations attributable to ordinary equity holders (133 954 377 / 58 550 258)		2,29	
Loss from discontinued operations ((1 756 952) / 58 550 258)		<u>(0,03)</u>	
Profit attributable to ordinary shareholders		<u><u>2,26</u></u>	(1)
Diluted earnings per share			
	5		
Profit from continuing operations attributable to ordinary equity holders (134 262 592/59 050 258)		2,27	
Loss from discontinued operations (1 756 952)/59 050 258)		<u>(0,03)</u>	
Profit attributable to ordinary shareholders		<u><u>2,24</u></u>	(1)
One disclosure mark is given for grouping of expenses and income according to function.			<u>(1)</u>

BUGATTI SA LTD

NOTES FOR THE YEAR ENDED 31 OCTOBER 2011

3. Income tax expense

	R	
SA normal tax		
Current taxation		
- Current year	53 844 818	
- Continuing operations [C8]	54 076 546	(4)
- Discontinuing operations [C11]	(231 728)	
- Under provision for prior year		
((3 280 000 – (200 000 – 80 000) – 2 800 000)	200 000	(1½)
Deferred tax		
- Movement in temporary differences	(1 888 320)	
- Continuing operations [C7]	(1 870 400)	(7)
- Discontinuing operations [C10]	(17 920)	
Income tax expense	52 156 498	
<i>Tax rate reconciliation</i>		
Accounting profit (continuing and discontinuing)		
(186 360 523 + (2 006 600))	186 353 923	(½)
Taxation at standard rate	51 619 098	(½)
Taxation effects of:		
Dividends received not taxable (300 000 x 28%)	(84 000)	(½)
Payment – L Sorry not deductible (110 000 x 28%)	30 800	(½)
Interest and penalties not deductible (280 000 x 28%)	78 400	(½)
Termination costs on discontinued operations not deductible		
(850 000 x 28%)	238 000	(½)
Fines on discontinued operations not deductible		
(265 000 x 28%)	74 200	(½)
Under provision of normal tax – prior year	200 000	(½)
Income tax expense	52 406 146	
Income tax expense for continuing and discontinuing operations	52 156 498	
PLUS: Income tax expense for discontinuing operations	249 648	
Income tax expense for continuing operations per statement of comprehensive income	52 406 146	
	Maximum	16½ 15

4. Discontinued operations

	Gross R	Tax R	Net R	
Revenue (1 240 000 + 2 658 000)	3 898 000	-	-	(1)
Expenses	(5 897 600)	-	-	
Cost of sales (868 000 + 1 860 600)	(2 728 600)	-	-	(1)
Other expenses [C9]	(2 891 000)	-	-	(3)
Finance costs (85 500 + 192 500)	(278 000)	-	-	(1)
Loss from discontinued operations	(1 999 600)	247 688 *	(1 751 912)	(1)
Loss on measurement of the disposal group [C10]	(7 000)	1 960	(5 040)	(1½)
	<u>(2 006 600)</u>	<u>249 648</u>	<u>(1 756 952)</u>	<u>(2)</u>
		[C11]		<u>10½</u>
			Maximum	<u>10</u>

* $((1\,999\,600) + 850\,000 + 265\,000) \times 28\%$

5. Earnings per share

Reconciliation of numerators used for basic and diluted earnings per share

	R	
Profit attributable to parent (133 954 377 - 1 756 952)	132 197 425	(½)
Preference dividends	-	
Numerator for basic earnings for profit for the year	<u>132 197 425</u>	
Loss from discontinued operations	1 756 952	(½)
Numerator for basic earnings for profit for continuing operations	<u>133 954 377</u>	
Interest after tax on convertible debentures C12 Option 1 and (428 087 x 72%)	308 216	(7)
Numerator for diluted earnings for profit for continuing operations	<u>134 262 592</u>	
Loss from discontinued operations	(1 756 952)	
Numerator for diluted earnings per share	<u>132 505 640</u>	(½)

Reconciliation of denominators used for basic and diluted earnings per share

	Shares	
Weighted average number of shares for basic EPS (given)	58 550 258	(½)
Convertible debentures (C12 Option 1)	500 000	(½)
Diluted weighted average number of ordinary shares	<u>59 050 258</u>	<u>(½)</u>
		<u>10</u>

CALCULATIONS**C1. Exchange loss on interest paid at 31 October 2011**

Interest recorded in profit or loss	1 152 000	[1]
1 500 000 x 8% x 9,60 (average rate)		
Interest paid (given)	<u>1 166 400</u>	
Foreign exchange loss	<u>(14 400)</u>	[1]

C2. Foreign exchange loss on loan

1 500 000 x (9,12 – 9,72)	(900 000)	[1½]
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C3. Convertible debentures

Present value of liability component:	4 623 119	
FV = -5 000 000 (5 000 x 1 000)		[½]
n = 10 (5 x 2)		[½]
PMT = -225 000 (5 000 000 x 9% x 6/12)		[½]
i = 5,5% (11%/2) OR 11% for HP with setting 2 P/YR		[½]

Equity component	<u>126 881</u>	
Total proceeds (5 000 x 1000 x 0.95)	<u>4 750 000</u>	

Transaction costs to be capitalised against the debenture (deduct from finance costs)	25 000	
- Liability (4 623 119 / 4 750 000) x 25 000	<u>24 332</u>	[1]
- Equity	<u>668</u>	

Liability component	4 623 119	
Minus transaction costs	<u>(24 332)</u>	
PV net of transaction costs	<u>4 598 787</u>	[1]

n = 10 (5 x 2)		
PMT = -225 000 (5 000 000 x 9% x 6/12)		
FV = -5 000 000 (5 000 x 1 000)		
PV = 4 598 787		
comp i = 5,57% or 11,14% per annum		[1]

Interest at 30 June 2011 at effective interest rate (4 598 787 x 5,57%) or ((4 598 787 x (11.14% x 6/12))	256 152	[1]
Interest paid 30 June 2011 (5 000 000 x 9% x 6/12)	<u>225 000</u>	[½]
Additional finance costs at 30 June 2011	<u>31 152</u>	

Interest accrued at effective interest rate at 31 October 2011 ((4 598 787 + 31 152) x 11,14% x 4/12)	<u>171 925</u>	[1½]
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Total interest to be included in finance costs (31 152 + 171 925)	<u>203 077</u>	<u>[8]</u>
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C4. Foreign exchange gains and losses on inventory purchases

FEC fair value (8 000 000 x (9,70 – 9,24) (profit)	3 680 000	[1]
Creditor (Bugatti Automobile S.A.S.) (8 000 000 x (9,15 – 9,70) (loss)	(4 400 000)	[1]

C5. Cost of sales

Opening inventory 1/11/2010 (given)	16 800 000	[1/2]
Cost of sales	399 870 000	
Cost of sales (given)	311 300 000	[1/2]
60 SKD car kits		
- Cost price (8 000 000 x 9,15)	73 200 000	[1]
- Base adjustment (8 000 000 x (9,24 – 9,23))	(80 000)	[1]
- Import duties (reclassify from operating costs to cost of sales)	3 500 000	[1/2]
- Transport costs (reclassify from operating costs to cost of sales)	1 500 000	[1/2]
Other direct and indirect costs		
- Purchases of other small vehicle parts (given)	2 000 000	[1/2]
- Depreciation on plant and machinery (given)	2 850 000	[1/2]
- Salaries assembly technicians	5 200 000	[1/2]
- Salaries assembly technicians October 2011	510 000	[1/2]
Payment to L Sorry excluded from cost of sales (and include in operating costs)	(110 000)	[1/2]
Closing inventory (given)	(39 650 000)	[1/2]
Total cost of sales	<u>377 020 000</u>	[7]

C6. Investment in Auto Electrical Ltd

Cost (150 000 x 24,50)	3 675 000	[1/2]
Transaction costs	20 000	[1/2]
	<u>3 695 000</u>	
Fair value at 31 October 2010 (150 000 x 27)	4 050 000	[1]
Fair value gain (OCI)	<u>355 000</u>	[2]

C7. Deferred tax calculation

	Carrying amount	Tax base	Temporary differences	Deferred tax Cr(Dr)	
Balance 31 October 2010 (1 008 000/28%)			3 600 000	1 008 000	[1]
31 October 2011					
Taxable differences (before adjustments)	xx	xx	3 500 000	980 000	[1]
Revenue received in advance	(6 580 000)	-	(6 580 000)	(1 842 400)	[1]
Investment in equity	4 050 000	3 695 000	355 000	49 700	[2]
Total deductible temporary differences / deferred tax balance			(2 725 000)	(812 700)	
Movement in temporary differences (deductible) / movement in deferred tax			6 325 000	1 820 700	[1]
Adjust for investment in equity through OCI			355 000	49 700	[1]
Movement in temporary differences (deductible) / movement in deferred tax			<u>6 680 000</u>	<u>1 870 400</u>	[7]

C8. Tax calculation

Profit before tax (from SOCI)	186 360 523	[1/2]
Non-deductible expenses/non-taxable income		
Dividends received	(300 000)	[1/2]
SARS interest and penalties (200 000 + 80 000)	280 000	[1]
Payment - L Sorry	110 000	[1/2]
Taxable profit before temporary differences	186 450 523	
Deductible temporary differences (C7)	6 680 000	[1]
Taxable income	193 130 523	
Tax @ 28%	54 076 546	[1/2]

Alternative tax calculation:

Taxable profit before temporary differences (as above)	186 450 523
Tax at 28%	52 206 146
Movement in deferred tax balance	1 870 400
Current tax	54 076 546

Income tax expense:

Current tax for the current year	54 076 546
Under provision of prior year	
((3 280 000 – (200 000 – 80 000) – 2 800 000)	200 000
Movement in deferred tax balance [C8]	(1 870 400)
	52 406 146

[4]**C9. Other expenses - discontinued operations**

Given from trail balance (648 000 + 995 000)	1 643 000	[1]
Termination costs	850 000	[1/2]
Fine	265 000	[1/2]
Direct costs	133 000	
- Actual	76 000	[1/2]
- Estimated	57 000	[1/2]
Total other expenses	2 891 000	[3]

C10. Deferred tax - Discontinued operations

	Carrying amount	Tax base	Temporary differences	
Provision for direct costs	(57 000)	-	(57 000)	
Impairments of buildings	537 000	544 000	(7 000)	[1/2]
Total deductible temporary differences			(64 000)	

C11. Taxation - discontinued operations

Loss before tax (note 4)	(2 006 600)	[1/2]
Non-deductible items	1 115 000	
- Termination costs	850 000	[1/2]
- Fines	265 000	[1/2]
Deductible temporary differences [C10] or (57 000+ 7 000)	64 000	
Tax loss	<u>(827 600)</u>	
Current tax saving @ 28%	(231 728)	
Deferred tax (64 000 x 28%)	(17 920)	
	<u>(249 648)</u>	[1/2]
		<u>[2]</u>

C12. Test which of cash or shares is most dilutive for earnings per share

Basic EPS from continuing operations attributable to ordinary shareholders (133 954 377/58 550 258)	2,29	
Option 1 - Settle in shares		
Basic earnings	133 954 377	
Saving on interest (256 162 + 171 925 =428 087) x 72% [C3]	308 216	[1 1/2]
Diluted earnings	<u>134 262 592</u>	
Number of shares for basic earnings	58 550 258	
Conversion (5000 x 100)	500 000	[1]
Number of shares for diluted earnings	<u>59 050 258</u>	
Diluted earnings per share (134 262 592 / 59 050 258)	<u>2,27</u>	
Option 1 - Settle in cash		
Basic earnings	133 954 377	
Decrease in interest (428 087 [C3] x 72%) – (4 750 000 x 9% x 10/12 x 0,72)	51 716	[3]
Diluted earnings	<u>134 006 093</u>	
Number of shares for basic earnings	<u>58 550 258</u>	
Diluted earnings per share (134 006 093 / 58 550 258)	<u>2,29</u>	
Option 1 is dilutive and Option 2 is anti-dilutive.		
		<u>[5 1/2]</u>
Maximum		<u>[5]</u>

CALCULATIONS**C1. Unimog 4x4 trucks depreciation**

Cost price	8 000 000	[½]
Accumulated depreciation (5 200 000 [8 000 – 2 800] x 6/10)	<u>(3 120 000)</u>	[1]
Carrying value on 1 March 2010	4 880 000	[½]
Residual value (700 000 x 4)	<u>(2 800 000)</u>	[½]
	<u>2 080 000</u>	
Remaining useful life	4 years	
Depreciation for current year (2 080 000 [4 880 – 2 800]/4) [C5]	520 000	[½]

C2. Unimog 4x4 trucks impairment

Value in use	2012	2013	2014	
Revenue	4 100 000	4 050 000	3 900 000	
Operating costs	<u>(3 420 000)</u>	<u>(3 390 000)</u>	<u>(3 330 000)</u>	
	680 000	660 000	570 000	[1½]
	CFj0=0	CFj1	CFj2	CFj3
NPV @15%^[½] = 1 465 143				[½]
Value derived from cash flows	1 465 143			
Value derived from future sale* (700 000 x 4)	<u>2 800 000</u>			[½]
Value in use	<u>4 265 143</u>			
*The value is already at current terms value, therefore no discounting is necessary.				
Fair value less costs to sell (1 000 000 x 4)	4 000 000			[1]
Recoverable amount Higher of fair value less cost to sell and value in use	4 265 143			[½]
Carrying value (4 880 000 – 520 000)	<u>4 360 000</u>			
Impairment loss	<u>94 857</u>			[½]
				<u>[4½]</u>

C3. SUV Bush Cruiser

Cost price (120 000 x 4) + 500 000	<u>980 000</u>	[1/2]
Depreciation charge		
Component tyres (20% x 500 000)	100 000	[1]
Total tyres	20	[1/2]
Cost per tyre (100 000 [500 000 x 20%] / 20)	5 000	
Tyre component depreciation [C5]		
Vehicle 1 (4 x 5 000) x (2 500/50 000)	1 000	[1]
Vehicle 2 (4 x 5 000) x (4 000/50 000)	<u>1 600</u>	[1]
	<u>2 600</u>	
Vehicle component depreciation		
Component (120 000 x 4) + (80% x 500 000)	880 000	[1]
Useful life	10 years	
Depreciation (880 000/10 x 3/12) [C5]	22 000	[1]

C4. Borrowing cost

Building cost		
- 30 June 2010 (4 000 000 x 12% x 8/12)	320 000	[1]
- 31 August 2010 (1 000 000 x 12% x 6/12)	<u>60 000</u>	[1]
	<u>380 000</u>	

OR

Building cost		
- 30 June 2010 (4 000 000 x 12% x 2/12)	80 000	[1]
- 31 August 2010 (5 000 000 x 12% x 6/12)	<u>300 000</u>	[1]
	<u>380 000</u>	

C5. Depreciation vehicles

(520 000 [C1][1½] + 2 600 [C3][3½] + 22 000 [C3][2] = 544 600) [7]

C6. Buildings

Cape Town		
Cost price	900 000	
Accumulated depreciation (900 000 x 1/50)	<u>(18 000)</u>	
Carrying amount 1 March 2009	882 000	
Market value –beginning of year (1 200 000/48 x 49)	1 225 000	[1]
Revaluation surplus	<u>343 000</u>	
Revised depreciation charge (1 225 000/49)	25 000	[1/2]
Depreciation 28 February 2010 (25 000 x 1)	25 000	[1/2]
Depreciation (1 Nov 2010) (25 000 x 8/12)	16 667	[1/2]
Carrying amount 1 Nov 2010 (1 225 000 – 25 000 – 16 667)	1 183 333	[1/2]
Market value	1 150 000	[1/2]
Impairment	<u>33 333</u>	