



**TOE407V  
ZAC407G  
SECOND PAPER**

October/November 2011

**APPLIED FINANCIAL ACCOUNTING**

Duration : 3 Hours

100 Marks

EXAMINATION PANEL AS APPOINTED BY THE DEPARTMENT.

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Use of a non-programmable pocket calculator is permissible.

This examination question paper remains the property of the University of South Africa and may not be removed from the examination venue.

This paper consists of 8 pages (**QUESTION 3** and **QUESTION 4**).

**YOU HAVE 30 MINUTES TO READ THIS PAPER**

**This is a limited open book examination.**

STUDENTS ARE ALLOWED TO BRING THE FOLLOWING BOOK INTO THE EXAMINATION HALL:

**SAICA HANDBOOK (VOLUMES 1 TO 4) (2010/2011)**

**Departemental Examination Panel:**

**First Examiners:** Mr PC Malemone  
Ms J Sturdy  
Ms C Wright

**Second Examiner:** Prof ZR Koppeschaar

**External Examiner:** Prof C Lambrecht (University of Stellenbosch)

**QUESTION 1**

ABC Ltd is a company listed on the JSE Limited and has interests in various companies. ABC Ltd has a 30 June year-end. ABC Ltd had various corporate activities during the current year and the Chief Financial Officer (CFO) approached you to assist him with the unresolved accounting issues that emerged from the group's corporate activities.

ABC has not performed any consolidation procedures in the current year due to the unresolved accounting issues arising from the corporate activities.

The following extracts from the financial statements are provided:

**EXTRACTS FROM THE STATEMENTS OF FINANCIAL POSITION AS AT 30 JUNE 2011**

	<b>ABC Ltd</b> <b>R'000</b>	<b>X Ltd</b> <b>R'000</b>	<b>Y LLC</b> <b>US\$'000</b>
Share capital	1 000	5 000	780
Retained earnings	8 500	5 000	248
Mark-to-market reserve	1 350	500	-
	<b>10 850</b>	<b>10 500</b>	<b>1 028</b>

**EXTRACTS FROM THE STATEMENTS OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2011**

	<b>ABC Ltd</b> <b>R'000</b>	<b>X Ltd</b> <b>R'000</b>	<b>Y LLC</b> <b>US\$ '000</b>
Profit before taxation	5 000	5 000	40
Income tax expense	(1 200)	(1 500)	(12)
Profit for the year	<b>3 800</b>	<b>3 500</b>	<b>28</b>

Profits for the current year occurred evenly during the year for all the above entities. The mark-to-market reserve of ABC Ltd had a R850 000 opening balance on 1 July 2010. The balance of X Ltd's mark-to-market reserve on 31 December 2010 was R250 000. Ignore secondary tax on companies (STC) and withholding taxes on dividends.

The CFO needs your specific attention for the following accounting issues:

**1. Employee trust**

During the year the board of directors of ABC Ltd launched an incentive program for its employees. In terms of the incentive program three share options will be allocated to each employee. The share options can be exercised at the discretion of the employee when it accrues to the employee in three years time.

In order to ensure that there will be sufficient shares available in future when the share options become exercisable, the directors are thinking of creating an employee trust. The purpose of the trust will be to start buying back shares on the open market.

The trust will obtain a loan from Money Bank to buy back shares. ABC Ltd will guarantee the trust's repayment of the loan to the bank.

Two directors of ABC Ltd will be appointed as trustees of this employee trust. They will be in control of the trust (eg. they will make all decisions on behalf of ABC Ltd) and they will be responsible for buying back shares. The beneficiaries of the trust will be the employees of ABC Ltd.

The CFO is not sure what impact this proposed employee trust will have on the **consolidated financial statements** and whether they will have to account for the trust. He is adamant that the trust is a separate legal entity and that it should not be accounted for.

## 2. Investment in X Ltd

ABC Ltd acquired 10 000 ordinary shares in X Ltd, a South African company, on 1 July 2010 for a total purchase price of R2,5 million, thereby obtaining significant influence over the financial and operating decisions of X Ltd. At this date the net asset value, fairly stated, of X Ltd consisted out of the following:

	R '000
Share capital (25 000 shares)	5 000
Retained earnings	1 500

On 1 July 2010 ABC Ltd signed a contract to purchase 5 000 shares from existing shareholders in X Ltd on 31 December 2010 at the prevailing market price on 31 December 2010 with a long-term investment intention. Since the market price of X Ltd's shares started increasing from 1 July 2010, ABC Ltd decided to purchase future contracts on 1 August 2010 on the South African Futures Exchange (SAFEX) in order to hedge the purchase of the X Ltd shares (500 future contracts were purchased). Each contract represents 10 shares and the value of an index point movement is R10,00. The future contracts end on 31 December 2010. A margin deposit of R3 000 was paid in cash on 1 August 2010. Transaction costs to purchase the shares and future contracts amounted to R3 000 and R350 respectively and were paid in cash.

The market value of the shares and the mark-to-market index for the future contracts (10 shares) were as follows:

	Share price R	Points
1 July 2010	258	210
1 August 2010	263	222
31 December 2010	280	239
30 June 2011	293	

The hedge effectiveness was assessed by ABC Ltd's financial director. You reviewed his calculation and deemed it to be fair. You can therefore assume that the hedge was a 100% effective hedge and no further testing is required on this matter. You can also assume that this transaction was correctly accounted for in the records of ABC Ltd.

ABC Ltd has irrevocably elected to present in other comprehensive income subsequent changes in the fair value of the investment in shares.

On 31 December 2010 all the assets and liabilities of X Ltd were deemed to be fairly stated apart from the following:

- **Customer list**

X Ltd has a unique customer list. It is common practise in the industry that these customer lists are licensed. X Ltd has signed a confidentiality agreement with ABC Ltd which gives ABC Ltd the full right of use (including rights of selling) and access to the detail of the customer list. The fair value of this customer list is deemed to be R500 000 with an indefinite useful life.

- **Preference shares**

X Ltd has 1 000 000 issued cumulative preference shares that earn dividends of 24 cent per share. The preference dividend is payable annually on 30 June. Upon inspection of the trial balances on both 31 December 2010 and 30 June 2011, you noted that no accrual was recognised for any preference dividends for the current year in the separate accounting records of X Ltd. All previous year's preference dividends were paid in full. ABC Ltd does not hold any of these preference shares.

X Ltd did not issue any additional shares in the current year.

### 3. Investment in Y LLC

On 1 July 2009 ABC Ltd acquired a 60% controlling interest in Y LLC, a foreign company, for a purchase consideration of US\$205 000. At this date, the net asset value, fairly stated, of Y LLC consisted out of the following:

	<b>US\$'000</b>
Share capital (20 000 shares)	40
Retained earnings	180

Y LLC had a rights issue on 31 December 2010 to all shareholders, which entitled them to two shares for every one share held at a value of US\$18,50 per share. On this date ABC Ltd sold all its rights to the non-controlling shareholders at US\$18,50 per share. All the rights issue shares were taken up by the non-controlling interests. From this date, ABC Ltd **did not** exercise a significant influence over the financial and operating policies of Y LLC.

The net assets as per the trial balance on 31 December 2010, after taking into consideration the rights issue, consisted out of the following:

	<b>US\$'000</b>
Share capital	780
Retained earnings (1 July 2010)	220
Profit (1 July 2010 – 31 December 2010)	14

The following share prices and exchange rates applied at the respective dates:

Date	Share price US\$	US\$ = R
1 July 2009	13,00	6,80
30 June 2010	17,20	7,50
31 December 2010	18,00	8,20
30 June 2011	19,30	8,55
Average for 2010		7,20
Average for 2011 (1 July 2010 – 31 December 2010)		8,30

You may assume that the investment in Y LLC was the only foreign investment of ABC Ltd.

### Additional information

- ABC Ltd has elected to apply IFRS 3 *Business Combinations* to all business combinations. The valuations and other information needed to apply IFRS 3 to past business combinations were obtained at the time those combinations were initially accounted for.
- The ABC Ltd Group elected to measure all non-controlling interests at fair value at the relevant dates.
- ABC Ltd measures their investments in associates in accordance with IFRS 9 *Financial Instruments*, in terms of IAS 27.38 *Consolidated and Separate Financial Statements* in their separate accounting records.
- ABC Ltd measures their investments in subsidiaries at cost in accordance with IAS 27.38 *Consolidated and Separate Financial Statements* in their separate accounting records.
- ABC Ltd had an early adoption of IFRS 9.5 *Financial Instruments*, and elected to present changes in the fair value of an investment in an equity instrument through other comprehensive income (OCI), and recognise the fair value adjustments in a mark-to-market reserve in equity.
- Assume a normal tax rate of 28% and a capital gains tax rate of 14%.
- ABC Ltd elected in terms of IFRS 9.B5.12, that amounts recognised in OCI are **not** recycled to profit or loss on disposal of the investment and **no** reclassification is made within equity.
- All the entities have a 30 June year-end.

**QUESTION 2****30 marks**

Topwood Ltd ("Topwood") is a proudly South African company that manufactures furniture, mainly for office use. The company purchase the raw timber, leather and other items necessary to manufacture the furniture from various suppliers in South Africa. Topwood's products are very popular through-out South-Africa. Topwood also only uses indigenous wood from forests in South Africa.

Topwood has a 30 June year-end.

**1. Share-based payments**

The following is an extract of the policies and procedures manual of Topwood:

<b>Share-based payment scheme to strategic managers</b>	
Purpose	To retain strategic expertise in the company.
Scope	To each of our 350 managers, employed as at 1 July 2008, we grant 150 share options (one share per option) on the condition that they remain in service of the company for the next four years.
Fair value of option on 1 July 2008	R26
Vesting date	30 June 2012

**Additional information regarding the above mentioned share-based payment scheme**

- On 1 July 2008 Topwood estimated that 130 managers will leave the service of the company over the next four years and therefore forfeit their rights to the share options.
- For the year ended 30 June 2009, 40 managers left the service of the company and Topwood estimated that another 90 will leave over the next three years.
- For the year ended 30 June 2010, 20 managers left the service of the company and Topwood estimated that another 60 will leave over the next two years.
- For the year ended 30 June 2011, 35 managers left the service of the company and Topwood estimated that another 10 will leave during 2012.

The share price of Topwood decreased during the 2010 financial year and the company decided to re-price the share options on 30 June 2010. Vesting will still take place on 30 June 2012. Topwood estimated the fair value of each of the original share options to be R22 at the date of the re-pricing, while the fair value of each re-priced share option was estimated to be R23.

On 30 June 2011 Topwood's directors decided to cancel the share-based payment scheme in exchange for a cash settlement of R30 per option. The market value of Topwood's shares was R28 at 30 June 2011.

**2. Employee benefits**

Topwood has different levels of employees in the company. The accountant is unfamiliar with IAS 19 *Employee benefits* and does not know how to calculate the leave provision at 30 June 2011.

The following information is available on 1 July 2010 (as per employee):

Level of employee	Gross salary per year R	Number of employees	Maximum leave allowed per year (days)	Maximum accumulated leave to carry forward (days)	Leave taken in current year per employee (days)
Directors	570 000	4	28	15	12
Sales personnel	356 500	8	25	15	20
Factory workers	120 500	60	15	5	14

- The company's policy is that unused leave balances may be carried forward for one year.
- Unused leave balances may not be paid out in cash when an employee leaves the service of Topwood.
- When leave is taken, it is first taken out of the previous year's entitlement and then out of the current year's entitlement.
- Topwood expects that directors will take 14 days leave in the 2012 financial year, while sales personnel will take 22 days leave and factory workers 15 days leave.
- There was no unused leave at 30 June 2010.
- On 1 March 2011 two of the sales personnel resigned. No other employees are expected to resign during the 2012 financial year.
- You may assume that there were 260 work days during the current financial year.

### 3. Inventories

Topwood values raw material and work in progress (WIP) on a first-in-first-out (FIFO) basis.

The following are information regarding their manufacturing process:

#### Raw material

Raw material on hand on 30 June 2010 (at cost)	R532 800
Raw material on hand on 30 June 2011	?
Raw material purchased during the year	105 000 kg

The following costs relating to the purchasing of raw material were incurred during the current financial year:

	R
Purchase price	5 728 500
Transport costs	56 000
Handling costs	32 000
Storage (not part of production process)	48 000
Administrative expenses	29 600
	<u>5 894 100</u>

The inventory count at year-end indicated that only 28% of the total raw material purchased was on hand at 30 June 2011.

The normal raw material wastage is 15%, which takes place at the beginning of the production process.

The net realisable value of raw material amounts to R50 per kilogram on 30 June 2011.

### Work in progress

	<b>R</b>
Work in progress on hand on 30 June 2010, at cost	<u>428 400</u>

The cost of work in progress at 30 June 2011 has not yet been calculated. Detailed production records indicate that 15% of this year's allocated production expenditure and material used relate to furniture that were still under production at year-end. The demand for the product is so high that all manufactured furniture is sold as soon as the production process is completed.

### Overhead costs

Topwood uses normal capacity for the allocation of the fixed production overhead during the year.

The following overheads occurred during the year ended 30 June 2011:

	<b>R</b>
Variable production overheads (fully productive)	752 800
Fixed production overheads	1 250 300

Normal capacity equals 15 000 units per year. Due to various problems, Topwood only produced 13 800 units for the year.

### Labour

The following information is available for the year ended 30 June 2011:

Direct labour	R12,60 per hour
Productive hours	125 000 hours
Normal idle hours	3 400 hours

### Finished products

	<b>R</b>
Finished products on hand on 30 June 2010, at cost	<u>1 569 000</u>

Of the finished products, 25% of the units transferred from WIP in the current year was still on hand on 30 June 2011.

The selling price of the finished products was R750 on 30 June 2011. Delivery cost per product amounts to R50, while sales commission amounts to 2,5%.