Part (a)	**Discuss the appropriate accounting treatment of the client claim (note 1.2) in the financial statements of both Cars4Africa and the Valare group for FY2017** • **Do not address presentation and disclosure in your discussion of both the Cars4African and the Valare group** • **Ignore cash flows**	**Marks**
1	A provision shall be recognised when an entity has a present obligation (legal or constructive) as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation.	1
2	In contrast, a contingent liability is a possible obligation that arises from past events; or a present obligation that arises from past events but is not recognised because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.	1
In the financial statements of Cars4Africa –		
3	The past event is the **renting of a vehicle that was not properly maintained as indicated by the vehicle's maintenance history which led to an accident and the law suit**.	1
	An issue here is whether the claim represents a present or possible obligation.	
	Argument in favour of a present obligation	
4	*Cars4Africa is required to have maintained the vehicle, given its* ***contractual obligations with the customer and the nature of its business. In this instance it has a present obligation****.*	*1*
	Argument in favour of a possible obligation	
4A	*There appears to be a dispute as to whether this past event will give rise to a legal obligation in the lawsuit. Based on the opinion of the legal representatives who agree that the vehicle was not properly maintained, but state that it is unlikely that the company will be required to pay for the damages (15%), it appears* ***more likely than not that no present obligation exists*** *for Cars4Africa.*	*1*
	Remaining discussion	
5	Further, according to the legal representatives the **probability of a pay-out for damages is only 15%**; therefore it is **not probable** that there will be an outflow of economic resources.	1
6	But the probability of outflow **is not remote** (15% is more than remote given the Valare group accounting policy threshold of 10%).	1
7	Therefore, the pending law suit should be classified as a *contingent liability*.	1
8	This is because there is a **possible obligation which will be confirmed by the outcome of the court case which is not in the control** of Cars4Africa.	1
In the financial statements of the Valare group –		
9	Valare acquired **control of Cars4Africa, being a business,** effective 30 September 2017 (acquisition date), when Valare acquired 80% of the equity of Cars4Africa.	1
10	The acquisition of the controlling interest in Cars4Africa **is a business combination**, which is accounted for in accordance with IFRS 3.	1
11	The requirements in IAS 37 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the acquirer shall recognise as of the acquisition date **a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably.** Therefore, contrary to IAS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.	1
12	As a **present obligation exists (as proven above)** at 30 September 2017, the contingent liability of Cars4Africa is thus an exception to the recognition principles in IFRS 3 and is recognised as a provision/liability at the acquisition date in the business combination **OR** It is argued as per the above that a **possible obligation exists** in contrast to a present obligation.	1
13	The **fair value of the liability can be determined reliably** at the acquisition date based on the estimated costs provided by the lawyers and the likelihood of settlement.	1
14	Therefore, a **provision should be recognised** pertaining to the pending law suit on the date of the business combination, in the accounting records of the group **OR** Therefore, the **contingent liability of Cars4Africa does not meet the exception to the recognition principle in IFRS 3 and no provision should be recognised** in the accounting records of the group.	1

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15	Provision: The effect is that the net asset value of the subsidiary at acquisition date recognised by the Valare group is reduced, thereby increasing **goodwill** OR Contingent liability: The effect is that the net asset value of the subsidiary at acquisition date recognised by the Valare group will not be reduced by the contingent liability, therefore the **goodwill** amount would be different to if a provision was recognised.	1
	DETERMINING THE AMOUNT FOR THE PROVISION:	
16	The amount should be USD1 500 000 **x 15%** = USD225 000.	1
17	The **spot rate at acquisition date** (i.e. 30 September 2017) should be used in translating the provision (IAS 21 par. 21). Thus USD225 000 x **12** = ZAR2,7 million	1
18	The **subsequent measurement** (year end) in the group will be done with reference to IFRS 3 par. 56, which states that the provision should be measured at the highest of the value as determined by IAS 37 (which would be zero, as explained in the paragraph above referring to the measurement in Cars4Africa's records) and the USD225 000 initially recognised.	1
19	However, importantly, the amount is a monetary amount in terms of IAS 21 and will need to be **translated at the spot rate** (ZAR2,925 million = USD225 000 x **13**) on 31 December 2017.	1
20	Accordingly, ZAR225 000 [(13 – 12) x USD225 000] should be recognised as a foreign exchange loss in profit or loss of the Valare group as it relates to foreign currency movements after the acquisition date.	1
	Available	**21**
	Communication skills – clarity of expression	**1**
	Maximum for part (a)	**14**

Part (b)	Briefly discuss the appropriate measurement of the restructuring provision (note 1.3) in the financial statements of both Cars4Africa and the Valare group for FY2017, assuming that a restructuring provision should be recognised by Cars4Africa on 15 September 2017	Marks
In the financial statements of Cars4Africa –		
1	The **restructuring provisions should not include the ZAR500 000 relocation and retraining costs** and these costs should only be recognised as an expense when actually incurred (which is expected to be in 2018).	1
2	This is because IAS 37 specifically excludes relocation and training costs from the provision as they relate to the **ongoing activities** of the entity.	1
3	The retrenchment packages offered to employees as part of the restructure of R125 000 **are termination benefits** in terms of IAS 19.	1
4	The R125 000 is **directly related to the restructure** and should be recognised in the provision at 15 September 2017.	1
5	Cars4Africa should measure the termination benefit provision at **the best estimate of the amount** it will pay to settle the obligation at the end of the reporting period.	1
6	**No discounting is necessary** as IAS 19 explicitly stipulates that the termination benefits should not be discounted if payable within 12 months, and in this case the year end is six months before expected payment date of 30 June 2018.	1
7	Accordingly, an **amount of ZAR2 250 000 (60 employee's x 30% x R125 000)** should be recognised.	1
8	At the reporting date, the provision should be remeasured for changes in estimates but this is not required as the estimate remained unchanged at 31 December 2017.	1
In the financial statements of the Valare group –		
9	The amount of the provision recognised initially and subsequently should be the same as recognised by Cars4Africa in terms of IAS 19 as IFRS 3 excludes from its measurement scope all employee benefits.	1
	Available	**9**
	Maximum Total for part (b)	**6**

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Part (c) **Calculate the amount of goodwill or gain on bargain purchase recognised within the Valare group arising from its acquisition of Cars4Africa on 30 September 2017**		**Marks**
Element	**R**	
Fair value of consideration transferred		
Fair value of Valare shares given on 30 September 2017	2 500 000	1
Cash payable on 30 September 2019 FV = 2 500 000 I = 8% N = 2 PV = 2 143 347	2 143 347	1 1
Non-controlling interest present ownership interests @ **20%** of identifiable NAV	1 110 000	1C
Total	**5 753 347**	
Fair value of identifiable assets and liabilities	9 000 000	1
Contingent customer claim (from part (a) – alternative 1)	(2 700 000)	
Restructuring provision (from part (b))	(2 250 000)	1C
Customer lists (legally separable, management intention irrelevant)	1 500 000	2
Total	**5 550 000**	
Goodwill	**203 347**	1C
Question indicates tax should be ignored		
Available		**9**
Maximum Total for part (c)		**9**

Part (d)	**Provide all pro forma consolidation and other journal entries required to correctly account for the executive compensation for FY2017 in the consolidated financial statements of Valare. Closing entries are not required**			**Marks**
		Dr.	**Cr.**	
1	**Share-based payment**			
	Share-based payment liability (SFP)	208 333		1C
	Staff costs/share-based payment expense (P/L)		25 000	1C
	Share-based payment equity reserve (equity)		183 333	1C
	Recognition of the share-based payment expense – see calc. C1.1 and C1.2			
2	**Long service award**			
	Staff costs (P/L)	140 070		1C
	Long service liability (SFP)		140 070	
	Recognition of the long service award – see calc. 2			

Calculations for journal 1

Accounted for as cash settled in the books of Cooba as Cooba had to settle but not in its own shares (fair value at year end is chosen because it is a liability). The fair value chosen is one that is adjusted for market condition (share price) but not for non-market condition (EPS)

C1.1 Closing balance liability: R25**(1)** x 5000 x 1/3**(1)** x (7-1-1)**(1)** = R208 334 — 3

Accounted for as equity settled in the consolidated financial statements of the Valare group as this is settled in the own shares of the group. The fair value at grant date is chosen because it is equity settled and the fair value chosen is one that is adjusted for market condition (share price) but not for non-market condition (EPS).

C1.2 Closing balance equity reserve: R22**(1)** x 5 000 x 1/3 x (7-1-1) = R183 333 — 1

Calculations for journal 2

		Marks
Opening balance (31 December 2016 / 1 January 2017)	FV = (50 000 x **1/10**)	1
	I = 8%	
	N = 9	1
	PV =? R2 501	
	Liability: R2 501 x 80 x **70%**: R140 070	1
	Available	**11**
	Communication skills – presentation	**1**
	Maximum Total for part (d)	**12**

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Part (e)	Discuss any ethical concerns that may arise from the events in the scenario, and recommend any actions that should be taken or safeguards that should be implemented to address these concerns	Marks
The SAICA Code of Professional Conduct requires CAs in business to identify threats to compliance with the fundamental principles of professional ethics, evaluate the significance of those threats and apply safeguards to eliminate or reduce such threats. The fundamental principles include integrity and professional behaviour.		
Issue 1: Financial director – EPS target		
1	The financial director is a **CA(SA) and should comply with the SAICA Code of Professional Conduct**.	1
2	It is an **ethical concern** that the financial director sought to increase the **EPS figure artificially** (through deferring losses and not recognising provisions). This contravenes the fundamental principles of **integrity** (as she was not acting honestly).	1
3	It also contravenes the **principles relating to professional behaviour** (as she was not complying with IFRS). The threat here is one of **self-interest**, as she wants to increase her remuneration (annual bonus, which is based on EPS).	1
4	S29 of the Companies Act requires financial statements to be prepared according to accountings standards and should be true and fair reflection of results. It is a **listed company and therefore also constitutes non-compliance with IFRS and therefore non-compliance with the Companies Act**.	1
5	Meryl states: "Your future at this company is at stake if you cannot follow orders". This constitutes an **intimidation threat to integrity**, professional behaviour and objectivity.	1
Issue 2: Financial director – misappropriation of company assets		
6	**The fact that the financial director was using company cars for free for pleasure (holiday) where this is only allowed for business, is a concern**. This contravenes the fundamental principle of **integrity** (as she was not acting honestly).	1
7	This is also non-compliance with the principles of **King IV** which requires directors to act ethically.	1
8	This may be a **fringe benefit** for which tax is not declared and therefore non-compliance with tax legislation.	1
9	Again, the threat is one of **self-interest**/misappropriation of company assets as she is using corporate assets inappropriately (for personal gain).	1
Issue 3: Director of Board – fiduciary duties and due care (acquisition of Cars4Africa)		
10	The director of the Board is bound by s76 of the Companies Act to act in the **best interests of the company with diligence and due care**.	1
11	The fact that the director has indicated his lack of interest/concern in the matter is evidence that the director is not acting with diligence and due care and could be held **liable in terms of** s77 of the Companies Act.	1
12	The director could also be found **liable for reckless trading** in terms of s22 of the Companies Act.	1
Other		
13	Offering services to other entities within the Valare group to Cars4Africa clients, considering that management has indicated that client **confidentiality** is of utmost importance and the issue of spam/unwanted advertising.	1
14	Cars4Africa not properly **maintaining vehicles** that are rented out to the public **(health and safety issue)**.	1
Actions to be taken		
15	Possible safeguards include training regarding ethics (eg. Also internal procedures for whistle-blowing) .	1
16	Consider discussing the matter with the financial director's superior, the Chairman of the Board or the company's legal department.	1
17	Consider reporting responsibilities in terms of NoCLAR (eg. SAICA, authorities, etc) provisions in business.	1
18	Discussions/reporting to the social and ethics committee as the company is listed on ZARX.	1
	Available	**18**
	Maximum Total for part (e)	**6**

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