

Part (d) Provide the journal entries required to account for the information in item 2 in the financial statements of Nama for FY2019.				Marks
<ul style="list-style-type: none"> Do not provide any journal entries for current or deferred tax. Do not provide any closing entries. Journal dates and narrations are not required. Round all calculated amounts to the nearest rand. 				
		Dr	Cr	
		R	R	
Factory buildings (PPE) (SoFP)	12 500 000			1
Bank (SoFP)			12 500 000	
R12 500 000				1
<i>Recognition of new production factory</i>				
Other expenses / Fines and penalties (P/L)	100 000			1
Bank (SoFP)			100 000	
R100 000				1
<i>Recognition of fine incurred (can also be capitalised – facts and circumstances dependent)</i>				
Residential flats (PPE) (SoFP)	16 800 000			1
Bank (SoFP)			16 800 000	
[20 x R840 000 = R16 800 000]				1
<i>Recognition of block of flats</i>				
Depreciation (P/L) [balancing]	93 334			1
Accumulated depreciation (SoFP)			326 667	
[(R16 800 000 / 30) x 7/12 = R326 667]				1C
Factory buildings (PPE) (SoFP)	233 333			1
[(R16 800 000 / 30) x 5/12 = R233 333]				1C
<i>Depreciation on block of flats</i>				
Cost of sales / Depreciation (P/L)	70 741			1
Accumulated depreciation (SoFP)			70 741	
[(R12 500 000 + R233 333) / 30 x 2/12]				1C
<i>Depreciation on factory buildings</i>				
Bank (SoFP)	120 000			1
Rental income (P/L)			120 000	
[20 x R3 000 x 2]				1
<i>Residential accommodation is VAT exempt</i>				
			Available	14
			Maximum	14
			Total for part (d)	14

Part (e) Critically discuss with reference to International Financial Reporting Standards (IFRSs) the statement made by management in item 1.		Marks
1.	<p>IAS 16 clarifies that:</p> <ul style="list-style-type: none"> impairment or losses of items of property, plant and equipment; compensation from third parties for such impairment or loss; and subsequent purchase/ construction of replacement assets <p>are separate economic events and should be accounted for as such (IAS 16.66). Management's appears to have assessed the beef processing factory for impairment as there is an indication of impairment but management's assessment of impairment for the beef processing factory indicates that management has not separately considered these separate economic events and management's assessment is therefore incorrect.</p>	1
		1

2.	Management should consider annually using external sources and internal sources if there is an indication of impairment. On 1 November 2018 there was physical damage to the beef processing factory , resulting in the beef processing factory being obsolete (IAS36.12(e)). Accordingly, there was an indicator of impairment . This appears to have been the trigger for management to have assessed the beef processing factory for impairment for FY2019, though it is not clear when the assessment was done.	1
3.	Because there was an indicator for impairment (being the physical damage), management should make a formal estimate of the recoverable amount (IAS 36.8).	1
4.	The recoverable amount of the beef processing factory (buildings and machinery) will be Rnil , since the factory was completely destroyed (value in use is Rnil since the factory can longer be used and fair value less costs of disposal is Rnil since there is nothing to sell).	1
5.	The asset will be impaired (i.e. an impairment loss recognised) when the carrying amount is higher than the recoverable amount.	
6.	Carrying amount of factory building at date that factory was destroyed: $R13\,300\,000 (1) - (R13\,300\,000 / 360 (\frac{1}{2}) \times 63 (\frac{1}{2})) = R10\,972\,500$	2
7.	The impairment therefore on the factory building to recognise on date of the destruction is R10 972 500 in profit or loss.	1C
8.	Carrying amount of the machinery on date that machinery was destroyed: $(R600\,000 (\frac{1}{2}) \times 100/115 (\frac{1}{2})) - (R521\,739 / 48 (\frac{1}{2}) \times 3 (\frac{1}{2})) = R489\,130$	2
9.	The impairment therefore on the machinery to recognise on date of the destruction is R489 130 in profit or loss.	1C
10.	The carrying amount of the beef processing factory (after impairment is recognised) will be derecognised as there are no future economic benefits after the beef factory was destroyed (IAS16.67(b)).	1
11.	Any resulting gain or loss on the derecognition of the factory will be included in the profit or loss when the item is scrapped (between 1 November 2018 and 1 December 2018) as the cost model is applied.	1
12.	Since the carrying amounts of the factory building and machinery will be Rnil after impairment, no gain or loss on derecognition will be recognised in profit or loss.	1C
13.	Nama will include the insurance claim (i.e. compensation from a third party) for the loss due to the fire in profit or loss when it becomes receivable . (IAS16.65)	1
14.	The insurance claim will become receivable when: <ul style="list-style-type: none"> • Nama has a valid insurance contract under which it can make a claim. Based on the information, Nama has a valid insurance contract; • the loss giving rise to the claim has occurred – being the fire destroying the beef processing factory that has occurred; and • the right to the insurance claim is established, i.e. the insurer is not disputing the claim. No information was provided. • No information is provided about the insurer being unable to settle (and in fact does settle the claim). 	½ ½ ½ ½
15.	Nama will therefore recognise the compensation from the insurer in profit or loss on 1 December 2018 , when the receivable was recognised (an earlier date between 1 November 2018 and 1 December 2018 is acceptable if motivated).	1
Available		18
Maximum		9
<i>Communication skill – logical argument</i>		1
Total for part (e)		10

Part (f) Determine, with reference to IAS 38 <i>Intangible Assets</i> , whether and from which date any expenditure on vMeat would qualify for capitalisation as an intangible asset in the financial statements of Nama.		Marks
Do not discuss the definition of an intangible asset.		
Capitalisation of development costs		
1.1	Expenditure on vMeat would be viewed as an internally generated intangible asset as the expenditure is creating a new product, which is developed in-house by the vMeat team.	1
1.2	In terms of IAS 38.57 , an intangible asset arising from development shall be recognised when an entity is able to demonstrate the following:	1
1.2.1	<i>The technical feasibility of completing the intangible asset so that it will be available for use or sale</i> <ul style="list-style-type: none"> • The vMeat team includes a number of highly skilled individuals who to date have made good progress on the development of vMeat. • Further, the Board is committed to the project and has approved the team's budget on 1 March 2020, which will ensure that the team is fully funded and can secure the technical resources they need to complete the project. 	1 1
1.2.2	<i>Its intention to complete the intangible asset and use or sell it</i> <ul style="list-style-type: none"> • The Board is committed to the project and has approved the team's budget on 1 March 2020, which will ensure that the team is fully funded and can secure the technical resources they need to complete the project. • Taylor and the vMeat team appear to be committed to completing the asset based on the costs incurred to date, hiring of a permanent team and purchase of resources to complete the project since 2017. • The registering of a trademark and copyright on 30 April 2019. • Further, their initial thoughts on bringing Yarnworths on board provides further support that they intent to complete the intangible asset to use it or sell it. 	1 1 1 1
1.2.3	<i>Its ability to use or sell the intangible asset</i> <ul style="list-style-type: none"> • It appears that Nama will be able to use vMeat as similar products are being produced in the United States of America and has been successful to date. By 1 February 2020, the vMeat team is confident that a successful product has been created. • Further, initial market research shows that there is market demand for vegetarian meat that will be profitable, and Nama may be able to sell the meat to Yarnworths given its initial interest in the product. 	1 1
1.2.4	<i>How the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.</i> <ul style="list-style-type: none"> • An external market exists for vMeat as evidenced by the current United States of America market, noted prior to 1 July 2016 already / the interest of Yarnworths in the product. • It is therefore probable that vMeat will generate future economic benefits. 	1 1

1.2.5	<p><i>The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset</i></p> <ul style="list-style-type: none"> • The Board of Nama is committed to the vMeat project and on 1 March 2020 approved the vMeat project budget for the next 10 years thereby ensuring sufficient financial and technical resources to support the vMeat project. • The vMeat team includes a number of highly skilled individuals which demonstrates the availability of adequate technical resources. 	1 1
1.2.6	<p><i>Its ability to measure reliably the expenditure attributable to the intangible asset during its development</i></p> <ul style="list-style-type: none"> • Management decided to dedicate one of the Nama accountants to keeping separate records of the vMeat project so that costs, productions and profits can be reliably measured. • The expenditure attributable to the development of vMeat can therefore be reliably measured. 	1 1
1.3	All of the above criteria are met from 1 March 2020. Expenditure on vMeat should therefore be capitalised as an intangible asset from 1 March 2020.	1
Available		17
Maximum		7
<i>Communication skill – logical argument</i>		1
Total for part (f)		8

Part (g) Calculate, for the trial period only, whether Nama should produce vMeat in-house or outsource production to Yarnworths. Provide a reason for any cash flows that are deemed to be irrelevant. Assume that income tax cash flows arise in the same period as the underlying income or expense.					Marks
Year	0	1	2	3	
In-house production					
Revenue for the vMeat is irrelevant as it does not differ between alternatives					1
Investments					
Machinery and equipment purchased	(3 000 000)				½
Machinery and equipment sold				400 000	½
Machinery and equipment tax allowance (S12C) (R3 mil x 40% x 28%) (Y2 & Y3 = 20%)		336 000	168 000	168 000	1
Machinery and equipment scrapping allowance [(R3 mil – R2.4 mil) – R400 000] x 28%				56 000	1
Working capital investment	(250 000)	(41 500)	(48 389)		1
Working capital recoupment of invested amount				339 889	½
Other expenses					
Repair of the wall	(500 000)				½
Repair of the wall tax deduction (R500 000 x 28%) (Alternative: Tax in Y0)		140 000			½
Lab rental costs (W1)	3 326				
Lab rental costs tax effect (R3 326 – R2 394) (W1)		(931)			
Production expenses					
Mechanical engineer salary (hired 1 January 2020) Growing salary by 6% inflation (Y2 & Y3)		(850 000)	(901 000)	(955 060)	1 ½P
Water and electricity fixed portion (W4) Growing fixed portion by 6% inflation (Y2 & Y3)		(12 720)	(13 483)	(14 292)	½P
Water and electricity variable portion Y1: [144 000 (W2) x R3,18 (W3)] Y2: [158 400 (W2) x R3,37 (R3,18 x 1,06)] Y3: [174 240 (W2) x R3,57 (R3,37 x 1,06)] Growing variable cost per unit by 6% inflation (Y2 & Y3)		(457 920)	(533 935)	(622 568)	½P

Direct materials Y1: [(144 000 (W2) x R108,20) (½) x 1,06 (½)] Y2: [158 400 (W2) x R121,57 (R114,69 x 1,06)] Y3: [174 240 (W2) x R128,87 (R121,57 x 1,06)] <i>Growing direct materials per unit by 6% inflation (Y2 & Y3)</i>		(16 515 648)	(19 257 246)	(22 453 948)	1 ½P
Delivery vehicle non-differential as needed irrespective of decision					1
Market research not relevant as sunk cost					1
Market-related rental not relevant as space is to remain idle (non-differential)					½
Megan and team non-differential					½
Cleaning and delivery staff non-differential					½
Taxation shield					
Tax saving on cost (expenses x 28%)		4 994 161	5 797 586	6 732 843	1
Total net cash flows for in-house production	(3 746 674)	(12 408 558)	(14 788 467)	(16 349 136)	
Net present cost of producing in-house at 14% WACC	(37 045 820)				1
Outsourcing					
Legal fees to draft outsource agreement	(50 000)				½
Legal fees tax deduction (R50 000 x 28%) <i>(Alternative: Tax included in Y0 or exclude since non-deductible)</i>		14 000			½
Lab rental costs non-differential for outsourcing					1
Cost of outsourcing Y1: [144 000 (W2) x R125] Y2: [158 400 (W2) x R125] Y3: [174 240 (W2) x R125]		(18 000 000)	(19 800 000)	(21 780 000)	1
Outsourced cost tax deduction at 28%		5 040 000	5 544 000	6 098 400	1
Total net cash flows for outsourcing	(50 000)	(12 946 000)	(14 256 000)	(15 681 600)	
Net present cost of outsourcing at 14% WACC	(32 960 303)				1
Conclusion: Quantitative outcome suggests Nama should outsource to Yarnworths					1P
Including amounts in incorrect time periods					-1

Workings					
W1 Lab rental cost (Net benefit from early cancellation)	0	1	2	3	
Breakage cost / Cancellation fee	(180 000)				1
Breakage cost tax effect (R180 000 x 28%) <i>(Alternative: Tax included in Y0)</i>		50 400			½
Saved rentals (1 July 2020 to 30 June 2021 i.e. 12 months) <i>(Alternative: As monthly payments made, NPV of net payment is done over a 12 month period and discounted to T0 at 14%)</i>		218 791			1
Saved rentals tax effect (R218 791 x 28%)		(61 262)			½
Cash flows	(180 000)	207 929			
NPV benefit of breaking the lease	2 394				1
Tax gross up of benefit (R2 394 / 72%)	3 326				1
W2 Expected sales volumes	0	1	2	3	
{[(30% x 20 000) + (50% x 10 000) + (20% x 5 000)] (½) x 12 (½)}		144 000	158 400	174 240	1
<i>Correctly growing the sales volume by 10% (principle)</i>					½
W3 Water and electricity – variable portion					
High-low (cost) (R3 500 – R2 000)			R1 500	R3 /unit	1
High-low (volume) (1 000 – 500)			500	(R1 500 / 500)	
Variable cost per unit Y1 [R3,00 x 1,06 (½)]				R3,18	½
W4 Water and electricity – fixed portion					
Fixed portion (on high)		R3 500 – (R3 x 1 000)		R500	1
or Fixed portion (on low)		R2 000 – (R3 x 500)			
Fixed water and electricity Y1 [R500 x 2 (½) x 12 (½) x 1,06 (½)]				R12 720	1½
				Available	32½
				Maximum	29
				<i>Communication skills - presentation</i>	1
				Total for part (g)	30