INSTRUCTIONS

1. This test paper is made up of TWO questions
2. Answer ALL questions in blue or black ink
3. Start each question on a new page in your answer sheet & show all your workings
4. Questions relating to this test may be raised in the initial 30 minutes after the start of the paper. Thereafter, candidates must use their initiative to deal with any perceived error or ambiguities & any assumption made by the candidate should be clearly stated.

REQUIREMENTS

None

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MODERATOR: D Kamotho

This paper consists of 4 pages excluding this cover page
Organic Life Ltd is a company which produces biodegradable washing powders and fabric softeners. The company has been developing a specialized detergent over the past three years. Once clothes have been washed with this detergent, the waste water is clear and can be used to flush toilets.

The marketing manager of Organic Life limited launched an intensive market survey campaign to the amount of N$ 100 000 in February 2017, to ascertain whether consumers are willing to purchase this specialized detergent at an increased price. To his surprise, there was an overwhelmingly positive feedback from the segment of the market surveyed.

N$ 450 000 was spent by the production department for the months of April and May 2017 to produce three samples of detergent. After testing the samples on different types of soiled fabric by 30 June 2018, it was determined that sample 3 will be technically feasible to produce.

The engineers of Organic Life Ltd spent 6 months to design and construct a pilot plant to produce the detergent. The cost of this exercise was N$ 3 800 000. This plant could however only produce small quantities of the detergent and could not be used for full-scale market production.

By February 2018 Organic Life Ltd spent another N$ 600 000 to test a pilot plant which will be able to handle significant production.

The patent was registered on 1 March 2018 and production of the detergent commenced on that date. The lifespan of the patent is 10 years.

Organic Life Ltd’s year end is 31 December.

**Required:**

a) Provide the journal entries for all of the above transactions.

AND State the reason for the treatment of each amount clearly under each journal entry.

(15 marks)

b) The Managing Director of Organic Life Ltd has informed you that the company has invested significant amounts of money in training the laboratory staff. The amount for the training was N$ 2.5 million to date. He has instructed the accountant to capitalize this amount. Explain whether this treatment is correct or not in terms of Accounting Standards.

(3 Marks)
c) Name three criteria which should be present in order for development costs of an intangible asset to be capitalized. (3 Marks)

d) List four internally generated intangible assets which must always be expensed according to IAS 38. (4 Marks)
QUESTION 2  
(17 Marks)

Pro-balance (Pty) Ltd is a manufacturer and distributor of various makes of pet food. The company is in the process of finalizing its accounting records for the year end 31 December 2018. The following assets appear in an extract of the fixed asset register of the company:

<table>
<thead>
<tr>
<th>Asset</th>
<th>Carrying Amount (N$) at 01.01.2018</th>
<th>Additional notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production equipment</td>
<td>50,000</td>
<td>1</td>
</tr>
<tr>
<td>Machinery</td>
<td>530,000</td>
<td>2</td>
</tr>
</tbody>
</table>

Additional notes:

1. At year end, the directors re-assessed the estimates relating to this equipment. The total useful life remained unchanged; however the residual value was re-assessed to N$7,000. The original residual value amounted to N$10,000. Details of the machine are as follows:

<table>
<thead>
<tr>
<th></th>
<th>2018 (Preliminary)</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost (N$)</td>
<td>90,000</td>
<td>90,000</td>
</tr>
<tr>
<td>Accumulated depreciation (N$)</td>
<td>(56,000)</td>
<td>(40,000)</td>
</tr>
</tbody>
</table>

2. At the end of 2017, one item of machinery was damaged, but was still in working order. The machine was acquired on 01 January 2014 at a cost of N$900 000 with nil residual value. Depreciation was calculated on the straight-line method over the expected useful life of 10 years. At the end of 2018, management determined the fair value less costs to sell to be N$560 000 and the value in use of the machine to be N$525 000.
Accounting policies:
All assets are accounted for using the cost model. Any changes in estimates are accounted for by applying the Re-allocation method.

Required:

a) Prepare all the journal entries to record the impairment of the machine for the years ended 31 December 2017 and 2018 in accordance with IFRS.

(17 marks)

END
**MARKING SCHEME**

**QUESTION1**

(25 marks)

a) Journal entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>February 2017</td>
<td>Research expense</td>
<td>100 00</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank</td>
<td></td>
<td>100 00</td>
</tr>
<tr>
<td></td>
<td>(1 Mark for correct double entry)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 2017</td>
<td>Research expense</td>
<td>450 000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank</td>
<td></td>
<td>450 000</td>
</tr>
<tr>
<td></td>
<td>(1 Mark for correct double entry)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Research involves the search for new scientific or technical knowledge. (1)

The cost can be reliably measured. (1)

By the very nature of research, the inflow of future economic benefits cannot be said to be probable (although they may be considered to be possible) since it is merely investigations that are being performed. (1)

For this reason, research costs must be expensed. (1)

<table>
<thead>
<tr>
<th>Date</th>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 2017</td>
<td>Development cost (asset)</td>
<td>3 800 000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank</td>
<td></td>
<td>3 800 000</td>
</tr>
<tr>
<td></td>
<td>(1 Mark for correct double entry)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>February 2018</td>
<td>Development cost (asset)</td>
<td>600 000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank</td>
<td></td>
<td>600 000</td>
</tr>
<tr>
<td></td>
<td>(1 Mark for correct double entry)</td>
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<td></td>
</tr>
</tbody>
</table>

Development costs, on the other hand, may result in a resource where the expected inflow of future economic benefits is probable. (1)

The cost should be reliably measured (1)
The inflow of future economic benefits is considered to be probable when all of the 6 criteria per IAS 38.57 can be demonstrated. If just one of these criteria is not demonstrable then the development costs must be expensed. (1)

At the end of June 2018, the sample is chosen and Organic Life Ltd determines that is technically feasible to develop sample 3. The research stage therefore concludes at that point. (1)

<table>
<thead>
<tr>
<th>Date</th>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 2018</td>
<td>Amortisation of intangible asset</td>
<td>366 667</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accumulated amortization on intangible</td>
<td></td>
<td>366 667</td>
</tr>
<tr>
<td></td>
<td>asset</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(1 Mark for correct double entry)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(1 Mark for correct calculation of amortization)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The intangible asset must be amortized as of the date which is taken into use, which is 1 March 2018. (1)

b) Treatment of staff training as an intangible asset

To capitalize staff training is not correct. (1)

An asset is a resource, which arose due to a past event that leads to future economic benefits. The asset should be controlled by the entity. (1)

Staff cannot be controlled by the entity as they are free to leave the employ of the entity at any time. (1) Therefore training should be expensed.

c) Criteria to capitalize development expenditure

In order for development expenditure (that meets the definition of an intangible asset) to be capitalized, the entity must demonstrate all of the following criteria:

- the technical feasibility of completing the asset;
- the intention to complete the asset and to either use or sell it;
- the ability to use or sell the asset;
- how the asset will generate probable future economic benefits;
- the adequate availability of necessary resources (technical, financial or otherwise) to complete the development and to sell or use the asset; and
- the ability to reliably measure the cost of the development of the asset. IAS 38.57

Any 3 of the above criteria - 3 marks

d) Internally generated intangibles which should always be expensed
Question 2 (25 Marks)

a)  
Cost (given)  900 000  
Accumulated depreciation- 31 December 2016  -270 000✓  
900 000/10 x 3 years = N$270 000  
Carrying amount- 31 December 2016  630 000✓  

LESS:  
CA at end 2017 = Recoverable amount (given) (530 000)✓  

= Impairment loss in 2017  100 000✓  

CA at end of 2018  530 000  
Dep: CA/RUL= 530 000/7 years (75 714)✓  
CA before considering RA  454 286✓  

FVLCOD (given)  560 000  
VIU (given)  525 000  
RA (higher of the two)  560 000✓  
Less CA above  454 286  
Thus possible reversal  105 714✓  
BUT LIMIT OF HCA (900 x 6/10) = 540 000✓  
540 000 – 454 286✓  
THUS actual reversal allowed  85 714✓  

2017  
Impairment loss (P&L)  100 000✓  
Accumulated impairment losses  100 000✓  

2018  
Depreciation  75 714✓  
Accumulated depreciation  75 714✓  
Accumulated impairment loss  85 714✓
Reversal of impairment loss (P&L)  

85 714 ✓

Plus 1 mark for narrations.