

SENIOR SECONDARY INTERVENTION PROGRAMME 2013



GRADE 12

ACCOUNTING

LEARNER NOTES

The SSIP is supported by



TABLE OF CONTENTS

LEARNER NOTES

| SESSION | TOPIC | PAGE |
|---------|---|-----------|
| 1 | Topic 1: Companies Ledger Accounts Topic 2: Companies Accounting Equation | 3 – 16 |
| 2 | Companies Financial Statements | 17 – 27 |
| 3 | Companies Financial Statements | 28 – 53 |
| 4 | Consolidation | 54 – 59 |
| 5 | Part I: Companies – interpretation of financial statements Part II: Companies – interpretation of financial statements | 60 – 108 |
| 6 | Cash Budgets | 109 – 131 |
| 7 | Topic 1: VAT Topic 2: Stock Inventory and non-current assets | 132 - 164 |

TOPIC 1: COMPANIES LEDGER ACCOUNTS**SECTION A: TYPICAL EXAM QUESTIONS****HINTS**

- Remember the new ledger accounts
- Income tax only comes about as an adjustment at the end of the year
- All provisional payments to SARS affect the bank account

QUESTION 1: 50 marks 30 minutes

COMPANY LEDGER ACCOUNTS

You are provided with information relating to Parboo Ltd for the year ended 29 February 2008. The company has an authorised share capital of 1 000 000 ordinary shares of R4,00 par value each. The Chief Executive Officer (CEO) is Ben Bhengu.

REQUIRED

- 1.1 Briefly explain what is meant by:
- Share capital (2)
 - Share premium (2)
 - Retained income (2)
- 1.2 Refer to information 6. Calculate the correct net profit before tax for the year. (6)
- 1.3 Prepare the following accounts in the ledger (the accounts must be properly closed off or balanced).
- SARS (Income tax) (11)
 - Appropriation account (15)
- 1.4 Consider information 4 regarding the permission granted to the directors to issue shares at their discretion. You are a shareholder but not a director. Provide one point in favour of granting the directors this permission and one point against. (4)
- 1.5 Refer to the extract from the newspaper article provided.
- Consider the complaint by Mary Moosa regarding Bhengu's director's fees. Do you agree with her? Explain. (4)
 - Consider the complaint by Ken Kelly. Is Bhengu's response acceptable? What else could he have said? (4)

INFORMATION

- 1 The following balances appeared in the ledger at the beginning and end of the financial year:

| | Beginning 1 Mar 2007 | End 29 Feb 2008 |
|--|---------------------------------|----------------------------|
| Ordinary share capital (par value R4 each) | R2 400 000 | R ? |
| Share premium | R 330 000 | R 505 000 |
| Retained income | R 454 000 | R ? |
| SARS (Income tax) | R 38 600 (Credit) | R 11 500 (Debit) |
| Shareholders for dividends | R 270 000 | R ? |

2. Amounts owing in respect of the previous financial year to SARS and the shareholders (for dividends) were paid on 10 June 2007.
3. Amounts paid on 31 August 2007:
- The first provisional tax payment of R187 500 for the 2008 financial year.
 - Interim dividend of 84 cents per share (the new shares issued on 1 Sept 2007 do not qualify for these interim dividends, but will receive final dividends. Refer to information note no 4 below).
4. The directors have been granted permission by the shareholders to issue new shares as and when required.
- The directors decided to issue new shares at a premium of 125 cents during the year. The transactions were handled by New Bank and the relevant amount was received from Star Bank on 1 September 2007.
5. The second provisional tax payment of R220 000 was made on 29 Feb 2008.
6. At the year-end, the accountant calculated the net profit before tax to be R1 475 000 but thereafter he discovered that the following had not yet been taken into account:
- A donation of stock to the Chatsworth Youth Development programme, R70 000.
 - According to his contract, Ben Bhengu's directors fees are R110 000 per month. His fees for February had not been paid.
 - Although rent paid of R175 000 had been correctly recorded, it was discovered that these payments included rent for March and April 2008.
7. At the year-end, 29 February 2008, the directors recommended a final dividend of 110 cents per share. An entry must also be made for income tax for the year.
8. The following article appeared in the newspaper after the AGM:

Parboo Ltd shareholders take CEO to task

By Harry Digger, 10 June 2008

There was certainly a lot of argument at the AGM of Parboo Ltd last week. The company distributes sports equipment and has built up a fine reputation amongst the public in recent years, and has delivered impressive returns to shareholders over the past five years. However, this counted for nothing last night as CEO **Ben Bhengu** was called upon to answer a number of very direct questions.

One of the minority shareholders, **Mary Moosa**, questioned Bhengu’s exorbitant directors’ fees, saying these could not be justified. Bhengu responded by saying these had been approved by the remunerations committee and were based on the past and current performance of the company.

Another shareholder, **Ken Kelly**, also questioned the ‘unnecessary waste of funds’ that have been donated to the Chatsworth Youth Development programme, saying these funds could have been used to boost dividends to shareholders. Bhengu’s response was that such expenditure was in line with the company’s social responsibility objectives which had been unanimously approved by the entire board of directors.

The share price dropped 15% on the JSE yesterday.

[50]

SECTION B: ADDITIONAL CONTENT NOTES

Ordinary share capital

| | | | | | | | |
|--|---------|-----|------|--|---------|-----|------|
| | Balance | C/d | xxxx | | Balance | b/d | xxxx |
| | | | | | Bank | CRJ | xxxx |
| | | | xxxx | | | | xxxx |
| | | | | | Balance | B/d | xxxx |
| | | | | | | | |

Additional shares issued at par

Opening balance

- Use the par value of shares when recording information in this account.

Ordinary share premium

| | | | | | | | |
|--|---------|-----|------|--|---------|-----|------|
| | Balance | C/d | xxxx | | Balance | b/d | xxxx |
| | | | | | Bank | CRJ | xxxx |
| | | | xxxx | | | | xxxx |
| | | | | | Balance | B/d | xxxx |

Additional shares issued at a premium
Opening balance

- Use only the premium portion of the share price to record into this account.

SARS: Income tax

| | | | | | | | |
|--|---------|-----|------|--|------------|-----|------|
| | Bank | CPJ | xxxx | | Balance | b/d | xxxx |
| | Bank | CPJ | xxxx | | Income tax | GJ | xxxx |
| | Balance | C/d | xxxx | | | | xxxx |
| | | | xxxx | | Balance | B/d | xxxx |

Provisional tax payments Payment of amount due to SARS Opening balance
(This could be a CR or a DR balance)

Tax assessment for the year
(Calculated as a % of the net income)

Income tax

| | | | | | | | |
|--|------------------|----|------|--|---------------|----|------|
| | SARS: Income tax | GJ | xxxx | | Appropriation | GJ | xxxx |
| | | | xxxx | | | | Xxxx |

Tax for the year

Closing transfer

Shareholders for dividends

| | | | | | | | |
|--|---------|-----|------|--|--------------------------|-----|------|
| | Bank | CPJ | xxxx | | Balance | b/d | xxxx |
| | | | | | Ordinary share dividends | GJ | xxxx |
| | Balance | C/d | xxxx | | | | xxxx |
| | | | xxxx | | | | xxxx |
| | | | | | Balance | B/d | xxxx |
| | | | | | | | |

Payment of amount due to shareholders

Final dividend declared at the year-end

Opening balance

- If an interim dividend is declared, but paid later, then it will be entered in the same way as the final dividend. The entry for the payment thereafter will be reflected on the debit side of the shareholders for dividend account.

Ordinary share dividends

| | | | | | | | |
|--|----------------------------|-----|------|--|---------------|----|------|
| | Bank | CPJ | xxxx | | Appropriation | GJ | xxxx |
| | Shareholders for dividends | GJ | xxxx | | | | |
| | | | xxxx | | | | xxxx |
| | | | | | | | |

Interim dividend declared and paid on the same day

Closing transfer of total dividends

Final dividend

Appropriation account

| | | | | | | | |
|--|--------------------------|----|------|--|-----------------|----|------|
| | Income tax | GJ | xxxx | | Profit and loss | GJ | xxxx |
| | Ordinary share dividends | GJ | xxxx | | Retained income | GJ | xxxx |
| | Retained income | GJ | xxxx | | | | xxxx |
| | | | xxxx | | | | xxxx |
| | | | | | | | |

Income tax for the year

Retained income at the beginning of the year

Net income for the year

Total dividends for the year

Retained income at the year-end (This is the balancing figure)

- If the retained income at the beginning and the end of the year is given, then this account may be used to find a missing amount such as the net income for the year as the balancing figure.

Learner Note: As you attempt the homework, you need to ensure that you are able to answer the questions in the allocated time frames. If you get stuck, you should refer either to the additional notes or your class teacher.

SECTION C: HOMEWORK

QUESTION 1

37 marks**25 minutes***(Taken from own question bank)*

You are provided with information relating to Phoenix Ltd for the year ended 28 February 2010.

REQUIRED

1. Post the relevant information to the ledger. Balance/close off the accounts.

Phoenix Ltd. began trading on 1 July 2010 with issued share capital of 300 000 ordinary shares of R2 each, at par value. The authorised share capital is 400 000 ordinary shares. In the first year of trading the after-tax income was R40 000. However, no dividends were declared in the first year.

On 31 December 2012 after six months of trading in the second financial year, the accountant calculated that the company had to pay R15 000 provisional income tax to the South African Revenue Services. On 31 December 2012, cheque no. 92 was issued to the South African Revenue Services (SARS).

On the same date, the directors declared and paid an interim dividend of 10 cents per share. The dividends were paid by cheque to the 30 shareholders listed in the share register.

On 30 June 2013, the last day of the accounting period, a second provisional tax payment of R35 000 was made to the SARS (cheque no. 210). After the completion of the audit, the following was determined:

- (a) The net income for the year amounted to R150 000.
- (b) The total income tax liability for the entire accounting period was R60 000.
- (c) The final dividend declared by the directors amounted to 15 cents per share.

[37]

SECTION D: SOLUTIONS AND HINTS TO SECTION A

QUESTION 1

1.1

- **Share capital**

The capital provided by the shareholders at par value ✓✓

- **Share premium**

The amount above the par value paid by shareholders for their shares ✓✓

- **Retained income**

The amount of profit not distributed by the company to shareholders ✓✓

(6)

1.2

Calculate the correct net profit for the year

$$\begin{array}{cccccc}
 \checkmark & & \checkmark & & \checkmark & & \checkmark\checkmark & & \checkmark \\
 1\ 475\ 000 & - & 70\ 000 & - & 110\ 000 & + & 25\ 000 & = & 1\ 320\ 000
 \end{array}$$

(6)

1.3

B4. SARS (INCOME TAX)

| | | | | | | | |
|----------------|---------|-----|-----------|----------------|-----------------|-----|-----------|
| 2007 Jun 10 | Bank ✓ | | ✓ 38 600 | 2007 Mar 1 | Balance | b/d | ✓ 38 600 |
| 2007 Aug 31 | Bank ✓ | | ✓ 187 500 | 2008 Feb 29 | Income tax ✓ | | ☑ 396 000 |
| 2008 Feb 29 | Bank ✓ | | ✓ 220 000 | | Balance | c/d | ✓ 11 500 |
| | | | 446 100 | | | | 446 100 |
| | | | | | | | |
| 2008 Mar 1 | Balance | b/d | ☑ 11 500 | | | | |

(11)

F3. APPROPRIATION ACCOUNT

| | | | | | | |
|-------------------|---|--|-------------|-------------------|-----------------|------------|
| 2008 Feb 29 | Income tax ✓ | | ☑☑ 396 000 | 2008 Feb 29 | Profit & loss ✓ | ☑1 320 000 |
| | Dividends ✓ 504 000 ✓✓ + 814 000 ✓✓ | | ☑ 1 318 000 | | Retained inc ✓ | ✓ 454 000 |
| | Retained income ✓ | | ☑ 60 000 | | | |
| | | | 1 774 000 | | | 1 774 000 |
| | | | | | | |

1.4 **Point in favour:** Any valid explanation, e.g. ✓✓

.If the company needs funds urgently then this should not be delayed. It takes a while to convene a meeting of shareholders. Notice period required.

Point against: Any valid explanation, e.g. ✓✓

If the directors cannot be trusted to make the right decision, the issue of shares will affect the dividends to the existing shareholders and hence this could affect the share price.

(4)

1.5 Any valid explanation, e.g.

Yes / No with explanation ✓

Bhengu's fees are R1,32 m per year. This is equal to the net profit and seems unreasonable;

OR

Bhengu's fees have been transparently determined by the committee, goodwill and past performance has been taken into account. Dividends are good. ✓✓✓

Consider the complaint by Ken Kelly. Is Bhengu's response acceptable? What else could he have said?

Yes / No with explanation ✓

Corporate social investment is the responsible thing to do. They are in the business of selling sports equipment. The goodwill generated will lead to better chances of a sustainable business. ✓✓✓

(8)

[50]

Learner Note: It is important to show all calculations to earn part marks.

TOPIC 2: COMPANIES ACCOUNTING EQUATION

Learner Note: Make sure you are able to answer theory type of questions.

SECTION A: TYPICAL EXAM QUESTIONS**HINTS**

- Adapted from new era study guide
- Always answer in point form
- Make sure you learn your theory on companies
- Open ended questions do not have one correct answer

QUESTION 1**30 marks****30 minutes****CASE STUDY – COMPANIES****BLUE LABEL DIRECTORS GUILTY OF DODGY SALES***THABISO MOCHIKO**Daily News, Monday 14 April 2008*

Three directors of listed firm, Blue Label Telecoms, were yesterday found guilty by the JSE of trading shares without permission. Selwyn Diamond was fined R100 000 while Sean Kaplan and Graeme Prosser were “privately censured.”

Prosser bought shares last November while Diamond and his spouse, and Kaplan’s wife sold millions of rands worth of stock in February. The dealings occurred in an open period but prior clearance from Blue Label’s designated director was not obtained, and the trades were not announced on the JSE’s Stock Exchange News Service (Sens) within 48 hours.

Prosser, Diamond and Kaplan work for a Blue Label subsidiary, the Prepaid Company. Diamond was fined R100 000 with R60 000 suspended for a year. If he breaches listing requirements again, he will have to pay the suspended fine and face further action, the JSE said. Diamond and Kaplan were found guilty of not telling their wives that the directors needed to be informed about trades.

The JSE said it viewed any breach of listings requirements in a very serious light and had informed Diamond of its “disappointment” at his conduct.

Prosser paid R2 million for 227 000 shares on November 14 at R8.81 each. The shares closed at R7 yesterday, so he has lost R410 000 on his investment.

While Blue Label said the directors’ conduct had caused it “damage and embarrassment”, their actions did not justify their dismissal or termination of their directorships.

“It is unfortunate that these share dealings have attracted so much adverse publicity,” said Blue Label’s joint chief executives, Mark and Brett Levy. “We are confident that lessons have been learnt.”

To prevent a recurrence, all the company's directors will attend a JSE workshop on the listing requirements this week.

Although director's associates did not need to get clearance to trade, the JSE said the directors had to be told when their associates dealt so the facts could be released on Sens.

QUESTIONS:

- 1.1 What is the role of directors in a company? Discuss at least 2. (4)
 - 1.2 Explain the 2 different prices that are quoted for the shares i.e. R8.81 and R7. Why is there a difference? (4)
 - 1.3 Why do they say that Prosser has lost R410 000 on his investment? Explain fully. (4)
 - 1.4 What did the 3 directors do that involved them being charged? Why is this wrong? (4)
 - 1.5 What is the role of the JSE in the country? Discuss at least 2 roles using the above article as a guide. (4)
 - 1.6 Why do you think the directors did not lose their directorships? (4)
 - 1.7 The chief executives expressed their unhappiness concerning the adverse publicity. Do you agree with them and should incidents like this not be published? (6)
- [30]

SECTION B: ADDITIONAL CONTENT NOTES

A company is a form of business enterprise which is created by an association of persons with a common profit motive with its own legal personality, under the Companies Act No. 61 of 1973 (as amended).

Legal personality

A company registered in terms of the Companies Act, has a legal personality of its own. This means that, in the eyes of the law, a company is regarded as a person. It can own assets, enter into contracts in its own name, institute legal proceedings in its own name, sue and be sued. The directors, in effect, serve as the "ears, eyes, arms and legs" of a company. They act on behalf of the company.

This legal personality does not apply to sole proprietorships. The owners of these enterprises enter into contracts in their own names, i.e. in the event of legal proceedings, the sole proprietors or the partners are sued in their own names, and each is jointly and severally liable for the debts of the business.

The legal personality of companies has the following implications:

- (a) A company has the capacity to have its **own rights and duties** and an indefinite existence apart from its owners, i.e. shareholders or members. As far as sole proprietorships or partnerships are concerned, continuity ends when an owner withdraws from the business or dies.
- (b) A company **acquires assets under its own right** and they are its exclusive property. The members share in the division of its assets only on liquidation. In the case of sole proprietorships, the proprietor is the sole owner of the assets of his business, while in the case of partnerships, the partners are the joint owners of the partnership assets.
- (c) The company is **liable for its own debts** and its members can in no way be held liable for them.

Consider the following example: Mr Khumalo owes R100 000 to Mrs Jabu. If Mr Khumalo cannot settle his debt, one cannot ask Mr Khumalo's brother to take responsibility for the debt. In the eyes of the law, Mr Khumalo and his brother are regarded as separate legal personalities.

Similarly, the shareholders and the company are regarded as separate personalities. The shareholders cannot be held responsible for the debts of the company. In the case of a sole proprietorship or partnership, these enterprises do not have legal personalities of their own; hence the owners will be jointly and severally liable for the debts.

- (d) A company has an **independent contractual ability** which means that it can do business with other legal personalities, including business with its members (the shareholders). Only the directors can act on behalf of the company. There is complete **segregation of management from ownership**.
- (e) The profits or losses that a company makes, are for its **own account**. They belong to itself, not to its members. The shareholders are entitled to the dividends that the company declares. In the case of sole proprietorship or partnerships, the profits accrue to the owners who are then responsible for income tax thereon.
- (f) Because of its legal personality, a company must have a unique name which must be registered with the Registrar of Companies. The last word of the name must be "LIMITED", which may be abbreviated to "LTD" This is discussed further below.

The concept of limited liability

- (a) We have seen above that, because a company is a separate legal person distinct from its owners, the shareholders cannot be held liable for the debts of the company. In the event of insolvency, the shareholders cannot be asked to settle amounts owed by the company. In the event of insolvency, the shareholders will lose **only the capital** invested by them. The liability of the members is, therefore, limited to the amount of capital invested.
- (b) The protection offered to shareholders by way of the concept of limited liability, is, therefore, vitally important in stimulating investment in businesses in a country.

Statutory control

One can imagine that, without strict control, the privilege of separate legal personality and limited liability could be open to abuse. In the case of companies, there is a separation of ownership from control. The shareholders are the owners and they provide the capital. The directors are entrusted with the use of that capital.

Certain controls are necessary to ensure that, as far as possible, the capital provided by the shareholders is appropriately handled by the directors. The shareholders need to receive adequate information on how their funds have been utilised by the directors, Also, because of limited liability, certain disreputable directors could be negligent or even fraudulent in the dealings with other businesses or individuals, knowing that their private assets are protected in the event of legal proceedings.

The Companies Act, therefore, provides for the protection of a company's shareholders by way of:

- Proper incorporation and registration with the Registrar of Companies.
- The maintenance of proper and complete accounting and other records.
- A fair presentation and disclosure of the financial position and financial results of the company in the prescribed annual financial statements.
- A proper audit of the financial statements, accounting records and securities of the company by suitably qualified public accountants and auditors.
- Proper management of the company by its directors and other office bearers.

SECTION C: HOMEWORK**QUESTION 1****30 Marks****30 Minutes***(DoE Nov. 2008)***COMPANY CONCEPTS, RECORDS AND VAT**

You are provided with information relating to Garland Limited for the financial year ended 30 June 2008.

REQUIRED

- 1.1 Briefly explain why a company has to have 'Limited' or 'Ltd' in its name. (2)
- 1.2 Briefly explain why Garland Ltd has to make special entries for VAT in its books. (2)
- 1.3 Analyse the transactions for the current financial year in the table provided. Show the account debited, account credited and the missing amounts. (25)
- 1.4 The company plans to issue the remaining unissued shares next year.
 - 1.4.1 How many shares will the company issue? (3)
 - 1.4.2 Gary Garland, the managing director, currently owns 230 000 shares in this company. What is the minimum number of shares Gary will have to buy to keep control of the company? (3)

BACKGROUND INFORMATION AND OPENING BALANCES:

- The business was started in 2004 with an authorised share capital of 500 000 ordinary shares of R2,00 par value each.
- By 1 July 2007, the start of the current financial year, the business had issued 300 000 of these shares at par.

TRANSACTIONS FOR THE YEAR ENDED 30 JUNE 2008

Example: Directors' fees of R150 000 were paid.

1. Credit purchases of trading stock for the year amounted to R350 000, excluding VAT. The VAT amount is R49 000.
2. Cash sales for the year were R684 000 including VAT of 14%. The cost price of these goods was R400 000. The business uses the perpetual (continuous) inventory system.
3. Provisional tax payments totalling R143 550 were made to SARS.
4. Interim dividends of R24 000 were paid to the shareholders.
5. Further 120 000 shares were issued at a premium of 60 cents each.
6. The tax assessment for income tax for the year amounted to R154 356.
7. A final dividend of 17 cents per share was declared.

[35]

SECTION D: SOLUTIONS AND HINTS TO SECTION A**QUESTION 1****COMPANY****30 marks****30 minutes**

| | | |
|-----|--|-----|
| 1.1 | <p>What is the role of directors in a company? Discuss at least 2.</p> <ul style="list-style-type: none"> • To run the day-to-day activities of the company. ✓✓ • To report and be answerable to the shareholders. ✓✓ • To manage the capital of the shareholders in accordance with good business principles. • Etc. | (4) |
| 1.2 | <p>Explain the 2 different prices that are quoted for the shares i.e. R8.81 and R7. Why is there a difference?</p> <ul style="list-style-type: none"> • R8.81 was the price Prosser bought the shares for. ✓ • R7 is the present market price. ✓ • The demand for shares has fallen so the price has decreased. ✓✓ | (4) |

| | | |
|-----|---|-----|
| 1.3 | <p>Why do they say that Prosser has lost R410 000 on his investment? Explain fully.</p> <p>His investment on paper is worth less as the shares will be valued at the present market price. ✓✓ However, as he has not sold these shares, he has not physically lost the money yet. ✓✓</p> | (4) |
| 1.4 | <p>What did the 3 directors do that involved them being charged? Why is this wrong?</p> <ul style="list-style-type: none"> • They engaged in buying and selling shares without obtaining permission from the directors concerned and then notifying the JSE of this transaction. ✓✓ • For transparency and to ensure that directors are not trading due to privileged information (Inside Information). ✓✓ Also known as insider trading | (4) |
| 1.5 | <p>What is the role of the JSE in the country? Discuss at least 2 roles using the above article as a guide.</p> <ul style="list-style-type: none"> • The JSE is a market place from where shares can be bought and sold. ✓✓ • The JSE controls trading and transactions to ensure that brokers and companies operate within the boundaries of the regulations. ✓✓ | (4) |
| 1.6 | <p>Why do you think the directors did not lose their directorships?</p> <p>While it was unethical to have entered into these transactions, nobody but themselves was affected. ✓✓ Probably also their first offence. ✓✓</p> | (4) |
| 1.7 | <p>The chief executives expressed their unhappiness concerning the adverse publicity. Do you agree with them and should incidents like this not be published?</p> <p>Learners to give their own opinions. We operate in a country of free press ✓✓ where people are entitled to report on what they hear and also to read what goes on. ✓✓ Press reports control the ethics of people as they realize there are consequences to their actions, and that there is the possibility that it will be made public knowledge. ✓✓ (Any reasonable explanation.)</p> | (6) |

[30]

Learner Note: From the above you can see the importance of understanding your concepts of companies. As you attempt the homework, you need to ensure that you are able to answer the questions in the allocated time frames. If you get stuck, you should refer either to the additional notes or your class teacher.

COMPANIES FINANCIAL STATEMENTS**SECTION A: TYPICAL EXAM QUESTIONS****HINTS**

- Always answer in point form
- Make sure you learn your theory on companies
- Open ended questions do not only have one correct answer

QUESTION 1:**55 marks***(Adapted from New Era Study Guide)***FINANCIAL STATEMENTS****1.1 SIMPHIWE LIMITED**

You are provided with the Pre-Adjustment Trial Balance of Simphiwe Limited. The company buys and sells uniforms, and they also repair uniforms for their customers, for which they charge a fee. These fees are credited to the Fee Income Account in the General Ledger.

REQUIRED

- 1.1.1 Refer to Information 2J below.
Calculate the profit or loss on disposal of the computer. Show workings. You may prepare an Asset Disposal Account to identify the figure. (8)
- 1.1.2 Complete the Income Statement for the year ended 30 September 2009. The notes to the financial statements are NOT required. (47)
- [55]

INFORMATION**1. SIMPHIWE LTD****PRE-ADJUSTMENT TRIAL BALANCE AS AT 30 SEPTEMBER 2009**

| | DEBIT | CREDIT |
|--|--------------|---------------|
| Balance Sheet Accounts Section | R | R |
| Ordinary share capital | | 1 300 000 |
| Share premium | | 170 730 |
| Retained income (1 October 2008) | | 170 000 |
| Loan from Stay Bank | | 90 000 |
| Land and buildings at cost | 1 628 520 | |
| Vehicles at cost | 220 000 | |
| Equipment at cost | 190 000 | |
| Accumulated depreciation on vehicles (1 October 2008) | | 41 000 |
| Accumulated depreciation on equipment (1 October 2008) | | 37 000 |
| Debtors' control | 36 600 | |

| | | |
|-------------------------|---------|--------|
| Creditors' control | | 17 960 |
| Trading stock | 479 000 | |
| Bank | | 13 500 |
| Petty cash | 2 200 | |
| SARS – Income tax | 83 500 | |
| Provision for bad debts | | 1 440 |

| Nominal Accounts Section | R | R |
|---------------------------------|-----------|-----------|
| Sales | | 2 720 000 |
| Cost of sales | 1 310 000 | |
| Debtors' allowances | 6 200 | |
| Salaries and wages | 162 000 | |
| Discount allowed | 905 | |
| Fee income | | 104 750 |
| Rent income | | 56 000 |
| Insurance | 11 000 | |
| Sundry expenses | 39 250 | |
| Directors' fees | 390 000 | |
| Audit fees | 53 705 | |
| Consumable stores | 24 000 | |
| Interest income | | 2 500 |
| Ordinary share dividends | 88 000 | |

2. ADJUSTMENTS

- A. Prepaid expenses in respect of sundry expenses at the year- end, R3 200, have not been taken into account.
- B. On 30 September 2009, R580 was received from A Ethic whose account had previously been written off as irrecoverable. The amount was entered in the Debtors' Control column in the Cash Journal.
- C. The provision for bad debts must be adjusted to R1 830.
- D. There were two directors at the start of the accounting period. Directors' fees have been paid for the first half of the accounting period. On 1 April 2009, a third director was appointed. All three directors earn the same monthly fee. Provide for the outstanding fees owed to the directors.
- E. Rent has been received for 14 months.
- F. The following credit note was left out of the Debtors' Allowances Journal for September in error. The mark-up on goods sold was 50% on cost.

| SIMPHIWE LTD | | CREDIT NOTE 4533 | |
|---|---|--------------------------|----------------|
| | | 28 Sept. 2009 | |
| Credit: Supaclean Ltd PO Box 340, Westmead, 3610 | | Unit price | Total |
| 24 | Uniforms returned | R400 | R9 600 |
| | Reduction on fee charged for repair of uniforms | | R 750 |
| | | | <u>R10 350</u> |

G. A physical stock count on 30 September 2009 reflected the stock of uniforms on hand as R490 000.

H. The loan statement from Stay Bank reflected the following:

| | |
|--|-----------|
| Balance at beginning of financial year | R 150 000 |
| Repayments during the year | R 78 000 |
| Interest capitalised | R ? |
| Balance at end of financial year | R 90 000 |

I. Depreciation on vehicles is calculated at 20% p.a. on the diminishing-balance method.

J. Depreciation on equipment is calculated at 10% p.a. on the cost price. Note that an item of equipment was taken over by one of the directors, Ivor Steele, on 30 June 2009 for personal use for R800 cash. The relevant page from the Fixed Asset Register is provided below. No entries have been made in respect of the disposal of this asset.

FIXED ASSET REGISTER

Page 12

Item: VYE Computer

Ledger Account: Equipment

Date Purchased: 1 April 2006

Cost Price: R22 000

Depreciation Policy: 10% p.a. on cost price

| Date | Depreciation calculations | Current Depreciation | Accumulated Depreciation |
|----------------------|-------------------------------------|----------------------|--------------------------|
| 2006 30 September | $R22\ 000 \times 10\% \times 6/12$ | R1 100 | R1 100 |
| 2007 30 September | $R22\ 000 \times 10\% \times 12/12$ | R2 200 | R3 300 |
| 2008 30 September | $R22\ 000 \times 10\% \times 12/12$ | R2 200 | R5 500 |
| 2009 30 June | ? | R ? | R ? |

K. Income tax for the year amounts to R63 280.



Learner Note: From the above, you can see the importance of understanding your concepts of companies. As you attempt the homework, you need to ensure that you are able to answer the questions in the allocated time frames. If you get stuck, you should refer either to the additional notes or your class teacher.

SECTION B: ADDITIONAL CONTENT NOTES**INTRODUCTION**

A company essentially has three different sets of financial statements.

The first set is the most comprehensive, and shows all items of income, expenditure, assets and liabilities. This set of financial statements is set up for use by management and other internal users. **We will be focusing on this particular set of financial statements.**

The second set has less information, and is set up for use by shareholders.

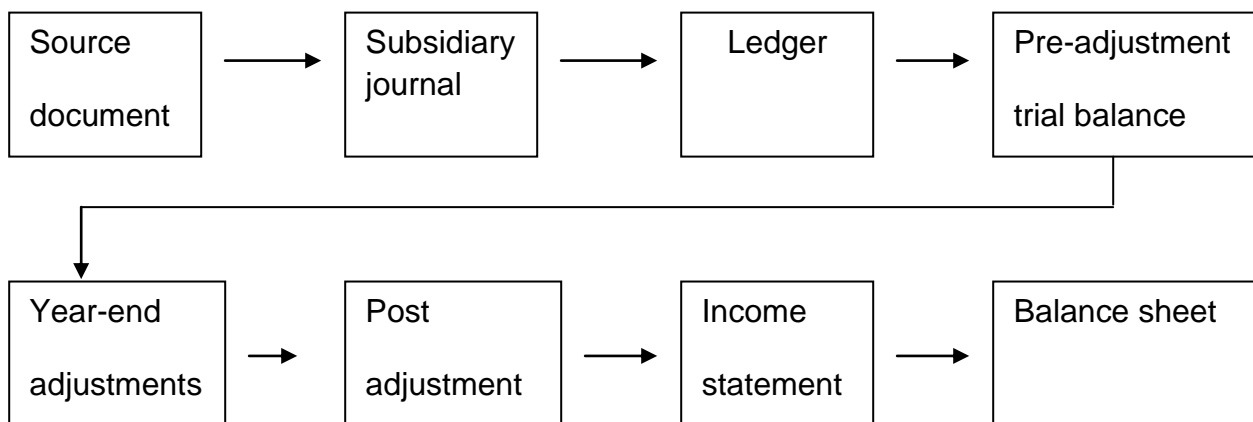
The third set is set up according to the express requirements of the Companies Act, and displays the least information of the three sets of statements. This is the version of the annual financial statements that should be published. (abridged financial statements)

Some users of financial statements:

- Shareholders
- Prospective shareholders or investors
- Banks and other financial institutions
- Creditors
- Directors
- SARS:
- The **Income statement**, which gives an indication of the operating activities of the enterprise during the year (**result of operations**)
- The **Balance sheet**, which indicates the enterprises' financial position at the end of the year (**state of affairs**)

In terms of the recording of transactions of an enterprise, financial statements form the last step in this process. All transactions are recorded as they occur and at the end of the financial year the financial statements are prepared.

The following diagram illustrates the cycle followed when recording transactions:



INCOME STATEMENT

The Income Statement should reflect all incomes and expenses, which apply to the financial period under review. Therefore, this statement would only include income and expense accounts. The purpose of preparing this statement is to determine the net profit / loss for the period.

The income statement is prepared in keeping with the GAAP principals, especially the matching principal where incomes and expenses for the same period must be reflected.

The following table illustrates some income and expense accounts:

| Incomes | Expenses |
|--|--|
| Sales | Cost of sales |
| Rent income | Rent expense |
| Discount received | Discount allowed |
| Interest on fixed deposit / investment | Interest on loan |
| Commission income | All operating expenses (e.g., telephone, wages etc.) |
| Bad debts recovered | Bad debts |
| Provision for bad debts (decrease) | Provision for bad debts (increase) |
| Trading inventory surplus | Trading inventory deficit |
| Profit on sale of asset | Loss on sale of asset |
| | Depreciation |
| | Directors fees |
| | Audit fees |

Format of the company Income Statement:

| |
|--|
| LIMITED LIABILITY COMPANIES |
| INCOME STATEMENT – TRADING BUSINESS (Continuous inventory system) |

Name of Company _____

Income statement for the year ended _____

| | Notes | R | R |
|--|----------|---|--------------|
| Turnover (sales – debtors allowances) | | | Xxxx |
| Cost of sales | | | (xxx) |
| Gross profit | | | Xxxx |
| Other operating income | | | Xxxx |
| (Incomes as illustrated in the table above, excluding interest) | | | Xxxx |
| Gross operating income | | | Xxxxx |
| (Operating expenses as illustrated in the table above, excluding interest) | | | (xxxx) |
| Operating profit / (loss) | | | Xxxxx |
| Interest income | 1 | | Xx |
| Profit (loss) before interest expense | | | Xxxxx |
| Interest expense | 2 | | (xx) |
| Profit / (loss) before tax | | | Xxxx |
| Taxation | | | (xxx) |
| Net profit / (loss) after tax for the year / period | 9 | | Xxxxx |

| |
|----------------------------|
| SECTION C: HOMEWORK |
|----------------------------|

QUESTION 1**69 marks****42 minutes**

You are provided with information relating to Ruma Carpets. The business is owned by R. Rugg. They sell, fit and repair carpets. Installation and repair fees are reflected as fee income. You are required to prepare the financial statements on 28 February 2009. The bookkeeper has entered the pre-adjustment figures but does not know how to process the adjustments.

REQUIRED

1.1 Income Statement for year ended 28 February 2009.

(69)

INFORMATION**RUMA CARPETS: PRE-ADJUSTMENT TRIAL BALANCE ON 28 FEBRUARY 2009**

| Balance Sheet section | Debit | Credit |
|---|--------------|---------------|
| Capital | | 991 000 |
| Drawings | 360 000 | |
| Bank | 66 162 | |
| Vehicles - at cost | 666 000 | |
| Accumulated depreciation on vehicles | | 299 700 |
| Equipment - at cost | 230 000 | |
| Accumulated depreciation on equipment | | 95 000 |
| Loan from Trusty Finance | | 210 000 |
| Fixed deposits: Richnet Bank | 160 000 | |
| Trading stock | 677 000 | |
| Debtors control | 255 000 | |
| Provision for bad debts | | 16 000 |
| Cash float | 3 000 | |
| Petty cash | 2 000 | |
| Creditors control | | 282 000 |
| SARS (PAYE) | | 19 300 |
| Medical Aid Fund | | 6 600 |
| UIF | | 800 |
| Nominal section | | |
| Sales | | 3 060 000 |
| Debtors allowances | 510 000 | |
| Cost of sales | 1 800 000 | |
| Fee income | | 1 045 000 |
| Rent expense | 90 400 | |
| Salaries & wages | 765 000 | |
| Employer's contributions to UIF & Medical Aid | 79 000 | |
| Vehicle expenses | 95 600 | |
| Bank charges | 28 000 | |
| Bad debts | 5 400 | |

| | | |
|---|------------------|------------------|
| Electricity & water | 17 000 | |
| Discount allowed | 4 000 | |
| Telephone | 19 300 | |
| Insurance | 28 600 | |
| Printing & stationery | 17 700 | |
| Consumable stores | 132 000 | |
| Interest income (on current bank account) | | 1 100 |
| Sundry expenses | 33 338 | |
| | 6 026 500 | 6 026 500 |

Adjustments and additional information:

- The water and electricity account for February has not yet been paid, R1 350.
- A cash customer, N Nokwe, paid R3 000 for installation fees in February, but the job will be done only in March 2009.
- The rent has been paid up to 30 April 2009. Note that the rent was increased by R900 per month on 1 January 2009.
- During a burglary in February the following items were stolen:
 - Carpeting worth R60 000 (trading stock)
 - Consumable stores of R3 000.
 The insurance company has agreed to pay out 80% of the loss, but this has not yet been received.
- A debtor, K Krumm, complained that the carpets that were fitted in his house in his absence were defective. Ruma Carpets issued a credit note for the following but this has not yet been recorded in the books:
 - Selling price of carpeting R22 000 (the cost price was R13 600)
 - Installation fee R2 600.
 On closer inspection it was found that the entire batch of carpeting which had cost R48 000 was defective. This was returned to the manufacturer Carplex Ltd but no entry has been made. Mr Krumm is now using another carpet company.
- The following items appeared in the bank statement for February 2009. These have not been entered in the books:
 - Bank charges R2 100
 - Interest on current bank account R220
 - Dishonoured cheque R4 700 (this was originally received from a debtor H Hill in settlement of his debt of R5 000)
 - Stop-order for insurance premium for February 2009, R2 600.
- Further bad debts of R4 000 are to be written off and the provision for bad debts is to be adjusted to 5% of trade debtors.
- A physical count at the year-end reflects the following on hand at cost price:
 - Trading stock R560 000
 - Consumable stores R18 500.

9. The business owned three identical vehicles which were all purchased on the same date. Depreciation is at 20% p.a. on cost. On 30 November 2008 one of the vehicles was taken over by partner M Matt at a market value of R96 300. No entry has been made to record depreciation or the sale of the vehicle.
10. New equipment costing R54 000 was bought on 1 January 2009. This has been properly recorded. Depreciation is to be calculated at 10% p.a. on the diminishing balance method.
11. The loan statement from Trusty Finance reflects the following:
- Balance on 1 March 2008 R284 000
 - Interest capitalised R ?
 - Repayments during the year including interest R74 000
 - Balance on 28 February 2009 R239 400

All repayments have been debited to the loan account in the ledger but no entry has been made to record interest. According to the loan agreement the loan will be reduced by R54 000 over the next 12 months.

12. Interest of R8 800 has been earned on the fixed deposits but no entry has been made. The interest is capitalised. One of the fixed deposits valued at R32 000 will mature on 31 March 2009.
13. One employee has been left out of the Salaries Journal in error. He has not yet been paid. His details are:

| GROSS SALARY | DEDUCTIONS | | | NET SALARY |
|--------------|------------|-------------|-----|------------|
| | PAYE | Medical Aid | UIF | |
| R6 200 | R1 018 | R800 | R62 | R4 320 |

The business contributes on a Rand-for-Rand basis to Medical Aid and UIF.

SECTION D: SOLUTIONS AND HINTS TO SECTION A

QUESTION 1: INCOME STATEMENT

57 marks

36 minutes

1.1.1 Calculate the profit or loss on disposal of the computer:

No part marks

$$\begin{array}{r r r r r r} \checkmark & & \checkmark & & \checkmark\checkmark\checkmark & & \checkmark & & \checkmark\checkmark \\ 22\ 000 & - & 5\ 500 & - & 1\ 650 & - & 800 & = & R14\ 050 \end{array}$$

OR

$$\begin{array}{r r r r r r} \checkmark & & \checkmark & & \checkmark\checkmark\checkmark & & \checkmark & & \checkmark\checkmark \\ 22\ 000 & - & (5\ 500 & + & 1\ 650) & - & 800 & = & R14\ 050 \end{array}$$

OR

| | | |
|---------------------------------|----------------------|----|
| Cost price | 22 000 | ✓ |
| Accu depr (5 500 ✓ + 1 650 ✓✓✓) | <u>7 150</u> | |
| Carrying value | 14 850 | |
| Disposal/Bank | <u>800</u> | ✓ |
| Loss on sale of asset | <u><u>14 050</u></u> | ✓✓ |

Asset disposal

| | | | |
|---------------------|---------------|---|---------------|
| <i>Equipment</i> | ✓22 000 | <i>Accu depr</i> (5 500 ✓ + 1 650 ✓✓✓) | 7 150 |
| Ignore details here | | <i>Bank</i> | ✓800 |
| | | <i>Loss on sale of asset</i> | ✓✓14 050 |
| | <u>22 000</u> | | <u>22 000</u> |

(8)

1.1.2 SIMPHIWE LTD

INCOME STATEMENT FOR THE YEAR ENDED 30 SEPTEMBER 2009

| | | | |
|----|--|---|-------------|
| | Sales (2 720 000 ✓ – 6 200 ✓ – 9 600 ✓) –R15 800: 2 marks | ✓ | 2 704 200 |
| | Cost of Sales (1 310 000 ✓ – 6 400 ✓) <i>Mark figures only</i> | ✓ | (1 303 600) |
| 8 | Gross Profit <i>Check operation, COS must be deducted</i> | <input checked="" type="checkbox"/> | 1 400 600 |
| | Other operating income <i>Check operation</i> | <input checked="" type="checkbox"/> | 157 180 |
| | Fee income (104 750 ✓ – 750 ✓) | ✓ | 104 000 |
| | Rent income (56 000 ✓ – 8 000 ✓) | ✓ | 48 000 |
| | Bad debts recovered | ✓✓ | 580 |
| 12 | Trading stock surplus (490 000 – [479 000 + 6 400]) <i>Ignore workings, 1 method mark for any figure</i> | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> | 4 600 |
| | Gross operating income | | 1 557 780 |
| | Operating Expense <i>Check operation, mark figure only</i> | <input checked="" type="checkbox"/> | (1 331 350) |
| | Salaries and wages | ✓ | 162 000 |
| | Discount allowed | ✓ | 905 |
| | Insurance | ✓ | 11 000 |
| | Sundry expenses (39 250 ✓ – 3 200 ✓) | ✓ | 36 050 |
| | 585 000 | | |
| | Directors fees (390 000 ✓ + 390 000 ✓ + 195 000 ✓) | ✓ | 975 000 |
| | Audit fees | ✓ | 53 705 |
| | Consumable stores | ✓ | 24 000 |
| | Provision for bad debts adjustment <i>No part marks</i> | ✓✓ | 390 |
| | Depreciation (1 650 <input checked="" type="checkbox"/> + 16 800 ✓✓ + 35 800 ✓✓) See 4.1.1 <i>@Any figure</i> | @ <input checked="" type="checkbox"/> | 54 250 |
| 22 | Loss on sale of asset <i>See 4.1.1</i> | <input checked="" type="checkbox"/> | 14 050 |
| | Operating profit | | 226 430 |
| | Interest Income | ✓ | 2 500 |
| | Profit before interest expense/finance cost | | 228 930 |
| | Interest expense / Finance cost <i>If no brackets accept the figure</i> | ✓✓ | (18 000) |
| | Profit before tax | | 210 930 |
| | Income Tax <i>If no brackets accept the figure</i> | ✓ | (63 280) |
| 5 | Net Profit after tax <i>Check operation, tax and interest expense must be deducted</i> | <input checked="" type="checkbox"/> | 147 650 |

(47)

TOTAL MARKS: 55

COMPANIES FINANCIAL STATEMENTS**SECTION A: TYPICAL EXAM QUESTIONS****Learner Note:**

- Always answer in point form
- Make sure you learn your theory on companies
- Open ended questions do not have one correct answer

QUESTION 1: 79 marks 48 minutes *(Adapted from New Era Study Guide)*

COMPANY FINANCIAL STATEMENTS**1.1 BOTSO-BOTSO STORES LTD**

The financial year-end is 30 June. Their inexperienced accountant prepared the final accounts and the Post-closing Trial Balance of the business on 30 June 2009 without taking certain adjustments into account.

REQUIRED

- | | | |
|-------|--|--------------|
| 1.1.1 | Calculate the correct net income after tax after taking all the adjustments into account. | (21) |
| 1.1.2 | Complete the following notes to the Balance Sheet on 30 June 2009: | |
| | • Retained income (Accumulated profits) | (7) |
| | • Trade and other receivables | (15) |
| | • Trade and other payables | (14) |
| 1.1.3 | Complete the Balance Sheet on 30 June 2009. (Show calculations in brackets where the notes are not required.) | (22) [79] |

| FIGURES OBTAINED FROM THE POST-CLOSING TRIAL BALANCE ON 30 JUNE 2009 | Debit R | Credit R |
|---|----------------|-----------------|
| Ordinary share capital R2 per share | | 500 000 |
| Retained income (1 July 2008) | | 85 000 |
| Ordinary share premium | | 30 000 |
| Fixed assets at book value | 780 540 | |
| Loan MAP Bank | | 140 200 |
| Fixed deposit :Heeda Investments | 30 000 | |
| Trading stock | 104 000 | |
| Debtors' control | 28 450 | |
| Provision for bad debts | | 1 250 |
| Bank | | 23 000 |
| SARS: PAYE | | 3 200 |
| SARS: Income tax | 46 000 | |
| Cash float | 1 000 | |
| Creditors' control | | 67 340 |
| Net income before tax and additional adjustments | | 140 000 |
| | 989 990 | 989 990 |

ADDITIONAL INFORMATION

The accountant calculated the **net income before tax** to be R140 000. The following adjustments and other information were not taken into account:

- The amount due by debtor G.Galu, R700, must be written off as irrecoverable and the provision for bad debts must be adjusted to R1 105.
- A credit note from creditor Ngele Suppliers for merchandise returned on 28 June 2009 had not been entered, R820.
- A physical stocktaking on 30 June 2009 showed that the following were on hand:

| | |
|-------------------|----------------|
| Trading stock | R98 000 |
| Consumable stores | <u>R 540</u> |
| | <u>R98 540</u> |
- 50% of the fixed deposit at Heeda Investments will mature on 31 March 2010

5. The loan from MAP Bank has been debited with R44 400 that is 12 payments of R3 700 per month including the interest. The accountant has calculated that the following:

| | |
|--------------------------------------|----------|
| Beginning of the year (1 July 2008): | R184 600 |
| End of the year (30 June 2009): | R162 124 |

An adjustment for interest must be made.

Over the next financial year this loan will reduce by R26 000.

6. Advertisements include an amount of R6 240 for a billboard advertisement at the Garwa High School for a period of two years commencing on 1 September 2008.
7. The salary of one employee Kala Hoendier was not taken into account in June 2009. His salary and all the amounts owing for salary deductions will be paid on 2 July 2009.

| GROSS SALARY | DEDUCTIONS | | | NET SALARY |
|--------------|------------|--------------|------|------------|
| | SARS: PAYE | Pension Fund | UIF | |
| R10 000 | R3 000 | R900 | R100 | R6 000 |

The business contributes on a rand-for-rand basis to the Pension Fund and UIF. These contributions are not included in the totals above.

8. Income tax for the financial year has been calculated to be R42 500.
9. The directors declared a final dividend of 7½ cents per share

[79]

ACTIVITY 2

Instructions:

1. Read through the question 2, taking careful note of the marks allocated for each question and the time you should spend on each question
2. Use your notes from the previous sessions to assist you to answer these questions
3. After 10 minutes you will be asked to stop working by your tutor, so that you can ask questions and to confirm you are on the right track
4. Complete the activity for homework and bring your answer to the next session

CASE STUDY: 20 marks 20 minutes

ESKOM BONUSES 'NOT ON'
Daily News, Monday 14 April 2008

Johannesburg: The Democratic Alliance said a comment by public enterprises minister Alec Erwin that Eskom executives deserved performance bonuses was laughable.

DA Spokesman Manie van Dyk said the executives did not deserve any bonus.

“Given the frequency with which power cuts have occurred and the 14% price hike of electricity, bonuses are not warranted,” Van Dyk said.

Speaking at a conference in Rustenburg last week, Erwin had said a decision to give the bonuses had been made and was supported because Eskom executives had done well in the past financial year.

“If we treat our senior executives badly, we will struggle to keep them. We must treat people fairly,” he said.

Van Dyk said Erwin’s comments showed that Eskom’s inability to supply power would have no bearing when bonuses were paid. – SAPA

QUESTIONS

- 2.1 Bonuses to executives are paid in many businesses. Why then is the DA arguing that the Eskom directors should not be receiving theirs? Discuss fully by referring to the current situation in the country. (6)
- 2.2 What do you understand by the term ‘performance bonuses’? Why do you think Eskom have decided to pay their directors performance bonuses? (4)
- 2.3 In view of your answer to no. 1 and 2 above do you believe it is unethical to pay the bonuses to the directors? Why? (4)
- 2.4 Why do businesses pay performance bonuses in lieu of salary increases? Discuss fully. (2)
- 2.5 From an internal control point of view how would the accountant keep track of what bonuses to pay out? Discuss fully. (4)
- [20]

QUESTION 3: 55 marks*(Adapted from New Era Study Guide)***COMPANY BALANCE SHEET, AUDITING AND STOCK**

You are provided with information relating to Topical Ltd at their year-end 30 June 2008.

REQUIRED

- 1.1 Use the information provided to prepare the Balance Sheet of Topical Ltd on 30 June 2008. Show workings in brackets to earn part-marks. (43)
- 1.2 Auditing:
- 1.2.1 Briefly explain the difference in the work done by the internal auditor and the independent (external) auditor. (3)
- 1.2.2 Briefly explain how an auditor should check that the figures shown for equipment and stock in the financial statements are reasonable. (3)
- 1.2.3 What should the independent auditor do if he feels that the value for equipment is not reasonable? (3)
- 1.2.4 The independent auditor is aware that a new model of TV is now on the market. He knows that the TVs in stock at Topical Ltd cannot be sold at their normal selling price, and they probably would not be sold at their cost price either. What advice do you have for the auditor? Explain. (3)

INFORMATION

1. The following information appeared in the books for fixed/tangible assets on 30 June 2008:
- Land and buildings (cost) R198 000
 - Vehicles (cost) 234 000
 - Equipment (book/carrying value) 269 801
 - Accumulated depreciation on vehicles 233 999
 - Accumulated depreciation on equipment 52 200
2. The investment comprises a fixed deposit at Pretoria Bank, R347 548.
3. Inventories comprise trading stock only. There are no consumable stores on hand. The business sells only one type of TV set. During the year they sold 258 TV sets at a mark-up of 60%. The business uses the WEIGHTED AVERAGE method of valuing stock (round off to the nearest rand). Purchases from the manufacturers were in bulk as follows:

| Date | Unit cost | Quantity | Total purchases |
|------------------|-----------|----------|-----------------|
| 10 July 2007 | R4 000 | 120 | R480 000 |
| 24 November 2008 | R4 800 | 160 | R768 000 |
| 18 April 2008 | R5 300 | 50 | R265 000 |

4. The authorised share capital comprises 400 000 ordinary shares of R2 par value. To

date, 300 000 of these ordinary shares have been issued. Half of the issued shares were issued at a premium of 60 cents per share.

5. The following figures were obtained from the Retained Income note to the financial statements:

| | |
|--|--------------------|
| Retained income at the beginning of the year | R 114 000 |
| Net income after tax | R 262 000 |
| Interim dividends paid | R 51 000 |
| Final dividends declared | 22 cents per share |

6. The loan statement from Sabie Bank reflected the following:

| | |
|--|-----------|
| Balance at the beginning of the financial year | R 275 000 |
| 12 monthly payments of R6 100 each | R 73 200 |
| Interest capitalised | R 32 500 |

Over the next financial year, the capital value of the loan will be reduced by R45 600.

7. The provision for bad debts is 5% of book debts. The following balances appeared in the ledger on 30 June 2008:

| | |
|---------------------------------------|-----------|
| Debtors control | R 185 000 |
| Creditors control | R 108 000 |
| Income receivable (accrued) | R 3 800 |
| Deferred income (received in advance) | R 6 400 |
| Expenses payable (accrued) | R 7 300 |

8. No money is owed to SARS or owing by SARS for Income Tax at the end of the year.
9. The missing figure represents cash & cash equivalents.

[55]

QUESTION 4: COMPANY REPORTING 65 marks 39 minutes

4.1 SEBENZA LIMITED

You are provided with information relating to Sebenza Limited. The company sells entertainment equipment.

REQUIRED

- 4.1.1 Answer the following questions:

- 4.1.1.1 Explain the following concept in relation to companies:

- Separate legal entity (2)
- Limited liability (2)

- 4.1.2 Calculate the correct net profit before tax (12)

4.1.3 The following note to the financial statements:

- Tangible Assets (10)

4.1.4 Complete the balance sheet on 31 December 2008
(Where the notes are not required show workings in brackets.)

NB. Certain figures have been provided. (27)

INFORMATION

1. **Figures extracted from the Ledger accounts on 31 December 2008:**

| | |
|---------------------------------------|-----------|
| Ordinary share capital (R5 par value) | R 800 000 |
| Fixed deposit: Slamo Bank | 30 000 |
| Fixed deposit: Jigzo Bank | 95 000 |
| Creditors control | 18 600 |
| Petty cash | 7 000 |
| Ordinary Share Premium | 80 000 |
| Equipment | 575 000 |
| Accumulated depreciation on equipment | 86 000 |
| Mortgage loan from Palmbank | ? |
| Bank | 6 000(cr) |
| Depreciation | 27 000 |
| Directors fees | 38 000 |

2. **Adjustments and additional information:**

The figures in the Pre-Adjustment Trial balance indicated that the net profit before tax amounted to R343 500 but the following adjustments have not been taken into account:

- 2.1 The company purchased additional equipment on credit for R170 000 on 31 December 2008. The equipment was delivered but no entry has been made.
- 2.2 Depreciation on equipment, R27 000 was entered in the books. On investigation it was found that the amount should have been R22 000.
- 2.3 The figure for Trade and other Receivables is **correct**. The bookkeeper, however, omitted the Trading Stock Deficit, R19 000 and the decrease in the provision for bad debts from R5 000 to R4 500 from the profit and loss account.
- 2.4 In terms of their contracts, the directors are entitled to the following fees for the year:
Snow R30 000 and White R23 000. White's fees have been paid in full. Snow has only been paid 50% of the amount due to her. Provide for Snow's outstanding amount.

- 2.5 Interest on the loan is capitalised. The loan statement from Palmbank on 31 December 2008 reflects the following:

| | |
|---|---------|
| Balance on 1 January 2008 | 320 000 |
| Interest charged | 47 600 |
| Monthly payments including interest to Palmbank in terms of the loan agreement (12 months x R6 000) | 72 000 |
| Balance on 31 December 2008 | ? |

- The interest for the year has not yet been entered in the books.
 - Capital repayments on the loan will amount to R8 500 per month in the next financial year.
- 2.6 The Fixed Deposit at Jigzo Bank will mature on 1 April 2009.
- 2.7 No amounts are due to SARS for income tax or VAT. Both these accounts have debit balances.
- 2.8 According to the bank statement, Cheque no. 786 for R2 000 issued to a creditor has not been presented for payment because it was post dated.
- 2.9 Sebenza Limited did not declare a final dividend due to poor economic conditions which impacted on profits for the year
- 2.10 The lease agreement with the new tenant included the following clause:
The rental of R2 400 per month for the period 1 April 2008 -31 December2008 should be used to upgrade existing equipment of Sebenza Limited. The tenant honoured the agreement and the equipment of Sebenza Limited was upgraded. No entries have been processed as yet.

4.2 CORPORATE GOVERNANCE & AUDITING

Study the statement below and then answer the questions, which follow.

DIFFERENCE BETWEEN AUDITING AND ACCOUNTING

Generally, accounting is the writing up of books and the preparation of financial statements, while auditing involves the verifying of incomes and expenditure and also the verification of assets and liabilities in order to enable the auditor to compile a report

- 4.2.1 Why are auditors referred to as 'independent' auditors? (2)
- 4.2.2 In the annual report a shortened Income Statement is presented. This is also referred to as the 'statutory' Income Statement. Explain why it is accepted accounting practice that a short form is provided instead of the full Income Statement. List two points. (4)
- 4.2.3 Mention one consequence for an independent auditor if he/she were negligent in performing his/her duties. (3)

- 4.2.4 The King Code, developed in South Africa, lists **seven important** characteristics for good governance: Discipline, independence, social issues and responsible management to name a few. Choose any **one characteristic not mentioned above** and briefly explain what is meant by it.

(3)
[65]

SECTION B: ADDITIONAL CONTENT NOTES

THE BALANCE SHEET

The balance sheet should include all assets, liabilities and equity information, thus reflecting the financial status of the enterprise as at a particular date.

The following are among the items included in the balance sheet:

| Assets | Equity and Liabilities |
|---|---|
| Fixed assets <ul style="list-style-type: none"> Land & Buildings Vehicles Equipment | Shareholders equity <ul style="list-style-type: none"> Ordinary share capital Ordinary share premium Retained income |
| Financial assets <ul style="list-style-type: none"> Fixed deposits > than 12 months Investments | Non current liabilities <ul style="list-style-type: none"> Mortgage loans > than 12 months |
| Current assets <ul style="list-style-type: none"> Inventory Receivables Cash on hand and at the bank (includes fixed deposits < than 12 months) | Current liabilities <ul style="list-style-type: none"> Payables Bank overdraft Short term loans i.e. loans < than 12 months |

Distinctive features in the format of the Balance sheet of a company and the notes to the financial statements:

| 1. COMPANIES | | | |
|--|-------|---|--------------|
| BALANCE SHEET – TRADING BUSINESS (Continuous inventory system) | | | |
| Name of company _____ | | | |
| BALANCE SHEET AT _____ | | | |
| | Notes | R | R |
| ASSETS | | | |
| (This section is the same as in a sole proprietor) | | | |
| | | | |
| Total assets | | | XXXXX |

| | | | |
|---|----|--|-------|
| EQUITY AND LIABILITIES | | | |
| Equity and reserves | | | XXXXX |
| Ordinary share capital / equity | 7 | | XXXX |
| Share premium | 8 | | XXXX |
| Retained income | 9 | | XXXX |
| Non-current liabilities | | | XXXXX |
| Mortgage bond (> 12 months) | | | |
| | | | |
| Current liabilities | | | XXXXX |
| Trade and other payables (creditors) | 10 | | XXXX |
| Bank overdraft (if any) | | | XXXX |
| Short term loans (loans payable within 12 months) | | | XXXX |
| Total equity and liabilities | | | XXXXX |

Note: This is not the full balance sheet. It only illustrates the distinctive features of a company balance sheet.

Pay special attention to the Equity and reserves section

| |
|--|
| COMPANIES 2. NOTES TO THE FINANCIAL STATEMENTS TRADING BUSINESS (Continuous inventory system) |
|--|

| | |
|---|-----|
| 5. Trade and other receivables (debtors) | |
| Trade debtors | XXX |
| Provision for bad debts (new amount calculated) | XXX |
| Net trade debtors | XXX |
| Prepaid expenses | XXX |
| Accrued income | XXX |
| Insurance claim | XXX |
| Deposit for water and electricity | XXX |
| *South African Revenue Services: Income tax (if SARS has been overpaid) | XXX |
| | XXX |

***Compare the SARS: Income tax amount in the trial balance to the tax for the year as reflected in the adjustments. If the amount in the trial balance is higher than the tax for the year, then the difference between the two amounts will appear as above.**

| | |
|---|-------|
| 7. Ordinary Share capital | |
| AUTHORISED | |
| xxxx ordinary shares of Rx each | XXXXX |
| ISSUED | |
| xxxx shares issued at Rx on the last day of the previous year | XXXX |
| xxxx shares at Rx each issued during the financial year | XXXX |
| xxxx shares at Rx on closing date | XXXX |

- **State number of shares and the par value.**

| | | |
|---|--|------|
| 8. Share premium | | |
| Balance on the last date of the previous year | | XXXX |
| xxx shares issued during the financial year at a premium of x cents | | XXX |
| Balance on the last day of the current year | | XXXX |

- State the number of shares issued at a premium and the premium amount.

| | | |
|--|--|-------|
| 9. Accumulated profits / Retained Income | | |
| Balance on the last day of previous year | | xxx |
| Net profit (loss) after tax for the year / period | | xxx |
| Ordinary dividends | | (xxx) |
| Paid (interim) | | (xx) |
| Recommended (final) | | (xx) |
| Balance on the last day of the current year | | xxxx |

- The amount for the recommended or the final dividend will always be the same as the balance of the shareholders for dividend account

| | | |
|---|--|-----|
| 10. Trade and other payables (creditors) | | |
| Trade creditors | | xxx |
| Accrued expenses | | xxx |
| Income received in advance | | xxx |
| Creditors for salaries (net salaries) | | xxx |
| Pension fund (deduction + contribution) | | xxx |
| Medical fund (deduction + contribution) | | xxx |
| Shareholders for dividends (amount of final dividend) | | xxx |
| South African Revenue Services | | xxx |
| - *Income tax (if an amount is still owed to SARS) | | xxx |
| - PAYE | | xxx |
| - Vat Control | | xxx |
| | | xxx |

***Compare the SARS: Income tax amount in the trial balance to the tax for the year as reflected in the adjustments. If the amount in the trial balance is less than the tax for the year, then the difference between the two amounts will appear as above.**

Note:

- These are not all the notes to the financial statements, but only those that are different in a company.
- The information in brackets is used to show the amounts that make up a particular item.

| |
|----------------------------|
| SECTION C: HOMEWORK |
|----------------------------|

QUESTION 1: COMPANY REPORTING 70 marks 40 minutes**1.1 SABUSO LTD.**

You are provided with information relating to Sabuso Ltd.

REQUIRED

- 1.1.1 Calculate the correct net profit before tax. (12)
- 1.1.2 The following note to the financial statements. (8)
- Tangible Assets
- 1.1.3 Complete the Balance Sheet on 28 February 2008. (25)
- (Where notes are not required show workings in brackets.)
- NB:** Certain figures have been provided.
- 1.1.4 Answer the following questions:
- 1.1.4.1 (a) What is meant by a 'Statutory Income Statement'? (2)
- (b) Why is the Statutory Income Statement published by a company instead of the detailed Income Statement. (2 points) (4)
- 1.1.4.2 Briefly explain one of the concepts that constitute GAAP and give a practical example of its application. (4)
- 1.1.4.3 Certain individuals are of the opinion that the published financial statements are not an accurate representation of the affairs of a business. List 2 main points that could lead to this conclusion. (4)
- [59]

INFORMATION

- The following figures were identified from the ledger on 28 February 2008.

| | R |
|---------------------------------------|----------|
| Equipment | 275 000 |
| Accumulated Depreciation on Equipment | 86 000 |
| Loan : ABSA | ? |
| Fixed Deposit : FNB | 10 000 |
| Fixed Deposit : Barclays | 65 000 |
| Retained Income (1 March 2007) | 30 000 |
| Ordinary Share Premium | 27 500 |
| Petty Cash | 5 000 |
| Creditors Control | 16 600 |
| Ordinary Share Capital | 300 000 |
| Bank | 6 000 Cr |
| Depreciation | 22 000 |
| Director's Fees | 18 000 |

• **ADJUSTMENTS AND ADDITIONAL INFORMATION**

The figures in the Pre-Adjustment Trial Balance indicated the next profit before tax to be R377 200 but the following adjustments have not yet been taken into account:

1. The company purchased additional equipment on credit for R70 000 on 28 February 2008. The equipment was received but no entry was made.
2. Depreciation on equipment, R22 000 was recorded. On investigation it was revealed that the amount should have been R25 000.
3. The bookkeeper has correctly calculated the Inventories and Trade and Other Receivables figures for the Balance Sheet. He, however, omitted the Trading Stock surplus, R9 000 and an increase in the provision for bad debts R1 500 from the profit and loss account.
4. In terms of their contracts, the directors are entitled to the following amounts each year:
5. **The loan account from ABSA is reflected below.**

Loan : ABSA

| | | | | | | | | | | |
|------|----|---------|-----|---------|--|-------|----|------------------|-----|---------|
| 2008 | | | | | | 2007 | | | | |
| Feb | 28 | Bank | CPJ | 72 000 | | March | 1 | Balance | b/d | 320 000 |
| | | | | | | | | | | |
| | | Balance | c/d | ? | | Feb | 28 | Interest on loan | GJ | 51 200 |
| | | | | | | | | | | |
| | | | | 371 200 | | | | | | 371 200 |
| | | | | | | | | Balance | b/d | ? |

- The interest on the loan was omitted from the profit and loss account.
 - Repayments including interest amounted to R6 000 per month.
 - Capital repayments on the loan will amount to R5 500 per month in the next financial year.
6. The Fixed Deposit at Barclays will fall due on 1 April 2008.
 7. No amounts are due to SARS for Income Tax or VAT. Both accounts have debit balances.
 8. No final dividends were declared payable due to poor profits.

1.2 CORPORATE GOVERNANCE AND ETHICS: 11 marks

Study the information provided and then answers the questions that follow:

QUESTIONS**1.2.1 Refer to Example A.**

- (a) To which interested party is this report aimed? (1)
- (b) Who prepared this statement? (1)

1.2.2 Assume that you are a shareholder (of the company in **Example A**) and are dissatisfied with the company's performance. Shareholders have proposed a vote of no confidence in the Directors. What characteristics should shareholders look for in appointing the directors? List two points. (4)

1.2.3 Refer to example B

- (a) Give one reason why 'successful businesses build strong relationships with many stakeholders and social partners.' (2)
- (b) Explain why 'adherence by both employees and employers to given rules is good for business'. (Explain one good point) (3)

[11]

INFORMATION

| | |
|----------------------|---|
| EXAMPLE A | The financial performance is expected to improve during the year but additional cash and working capital will be required. The year-end cash balances are expected to increase and would facilitate a further return of cash to shareholders. |
|----------------------|---|

| | |
|----------------------|---|
| EXAMPLE B | Successful businesses need to build strong and vibrant relationships with many stakeholders and social partners. Adherence by both employees and employers to given rules is good for business. Ethics is a form of corporate advertising for the private as well as the public sector. <i>Dr Engelo Nicolaides (Senior Lecturer - University of Johannesburg)</i> |
|----------------------|---|

QUESTION 2: COMPANY REPORTING**75 marks 40 minutes****2.1 KAMBULO LTD**

You are provided with information relating to Kambulo Ltd.

REQUIRED

- 2.1.1 Complete the Balance Sheet on 30 June 2008. (35)
- 2.1.2 Joan Kambo currently owns 65% of the issued shares. The directors have decided to issue all the unissued shares on 10 January 2009. What is the minimum number of new shares Joan Kambo must buy in order to keep control of the company? (5)

INFORMATION

1. The authorised share capital comprises 800 000 ordinary shares of R4 par value each. By 30 June 2008, 500 000 shares had been issued as follows:
 - 200 000 of these shares were issued at par
 - 300 000 were issued at R5,40 each.
2. The mortgage loan statement from Kwezi Bank reflected the following:
 - Balance on 1 July 2007, R830 000
 - Interest capitalised for the year, R94 200
 - Repayments of R12 600 per month (this is to cover interest and loan repayments)
 The capital sum of the loan is expected to reduce by R60 000 over the next financial year.
3. The following balances were extracted from the post-adjustment trial balance on 30 June 2008:
 - Fixed assets at carrying value, R3 408 000
 - Creditors control, R280 000
 - Bank overdraft, R170 000
 - Cash float and petty cash, R8 000.
4. There are two fixed deposits at the KZN Bank.
 - One, valued at R360 000, matures on 30 June 2009
 - The other, valued at R80 000, matures on 31 December 2007.
5. The following financial indicators apply on the Balance Sheet date:
 - The debt / equity ratio is 0,2 : 1
 - The current ratio is 2 : 1
 - The acid-test ratio is 0,8 : 1.

2.2 CORPORATE GOVERNANCE & AUDITING

- 2.2.1 The following audit report was issued by the auditors of Kambulo Ltd:

Audit opinion – To the shareholders:

In our opinion, the financial statements fairly present, in all material respects, the financial position of the company and the group at 30 June 2008 and the results of their operations and cash flows for the year then ended in accordance with International Financial Reporting Standards, and in the manner required by the Companies Act in South Africa.

Trew & Frank**Chartered Accountants (SA)****Registered Accountants and Auditors****Durban 25 July 2008**

- (a) Why is this audit report addressed to the shareholders? (3)
- (b) What is the significance of the reference to the CA (SA) qualification? (2)
- (c) Briefly explain how the firm of Trew & Frank arrives at the opinion that they express in this report. Provide two points. (4)
- (d) Should the shareholders be satisfied with this report? Explain. (3)
- (e) What action would be taken by the professional bodies such as SAICA if (4)

Trew and Frank were accused of being negligent in issuing this opinion and what consequences could there be for Trew & Frank?

2.2.2 Consider the following press article (this is based on an actual case):

CEO found guilty of insider-trading charges

Chief Executive Officer of Felon Ltd, YB Goode, will pay about R5-million and cannot serve as the director of a public company for five years under a court order announced on Monday. He had been found guilty of fraud and of contravening the Companies Act and regulations of the JSE.

The amount of R5-million relates to losses which he avoided on the sale of shares in Felon Ltd in December 2007. YB Goode sold Felon Ltd shares a day before the government announced it had declined to approve Felon's new drug for the treatment of cancer, Curex. The share price fell about 80% percent immediately following the government's refusal to approve the Curex drug.

The presiding judge found that YB Goode had been in possession of the privileged information about the government's decision before deciding to sell the shares. He had deliberately not communicated this information to the public, some of whom had consequently lost significant amounts of their retirement funds when the share price subsequently declined.

Felon Ltd announced last week that YB Goode's contract as CEO had been cancelled. Goode was earning R8-million per year in this post.

- (a) In your opinion, has YB Goode been treated fairly by the judge and the company Felon Ltd? Explain your reason briefly. (4)
- (b) If you were a major shareholder of Felon Ltd, what personal characteristics would you look for in appointing the CEO and other directors to prevent a similar problem in future? Provide two points. (4)
- (c) Consider the case of Joan Kambo buying more shares in Kambulo Ltd (see 5.1 above). As CEO, what should she do before buying the new shares? Explain briefly. (4)

2.2.3 South Africa is playing a leading role in promoting good corporate governance. The King Code is often used as a good example of this. One of the recommendations of the King Code is that companies should be required to reflect in their annual reports the contributions that they make to benefit the community at large e.g. social and environmental issues.

- (a) Provide an example of a company that has been complying with this aspect of the King Code. Briefly explain the contribution that this company is making to the community.
- (b) You heard a comment that companies should be primarily concerned about the interests of the shareholders, not the greater community. Explain why this opinion would not be supported in modern times.

(3)

(4)

[40]

[75]

SECTION D: SOLUTIONS AND HINTS TO SECTION A

QUESTION 1

| 1.1.1 CALCULATION OF CORRECT NET INCOME | | | |
|--|--------------|---------------------------------|-----------------|
| | | | |
| Net income before adjustments | | 140 000 | |
| <i>Do not mark details One mark for operation (+ or –) & one mark for figure in each case. If figure cannot be identified then no marks. Use of brackets for negatives is acceptable. If no bracket or no sign, assume it is positive.</i> | | Pluses R 34 325 8 marks | |
| | | Minuses R 81 304 12 marks | |
| | + / - | | Amount / |
| Bad debts | ✓ | - 700 | ✓ |
| Provision for bad debts | ✓ | +145 | ✓ |
| Trading stock deficit | ✓ | - 5 180 | ✓ |
| Consumable stores on hand | ✓ | + 540 | ✓ |
| Interest on loan | ☑ | - 21 924 | ✓✓ |
| Advertising | ✓ | + 3 640 | ✓ |
| *Salary total * May be split or combined R11 000: 4 marks in total | ✓ | - 10 000 | ✓ |
| *Pension & UIF contributions | ✓ | - 1 000 | ✓ |

| | | | |
|------------|---|----------|--|
| Income tax | ✓ | - 42 500 | ✓ |
| | | | |
| | | 63 021 | ✓ <input checked="" type="checkbox"/> <i>Inspection</i> |

(21)

| | | | |
|---|-------------------|---------|--|
| 1.1.2 BOTSO-BOTSO STORES LTD | | | |
| NOTES TO THE FINANCIAL STATEMENTS – 30 JUNE 2009 | | | |
| RETAINED INCOME | | | |
| Balance at beginning of year | | 85 000 | ✓ |
| Net profit after tax the year | | 63 021 | <input checked="" type="checkbox"/> 5.1.1 |
| | | | |
| <i>Ordinary share dividends</i> ✓ | | 18 750 | ✓ ✓ |
| Balance at end of year | <i>Inspection</i> | 129 271 | ✓ <input checked="" type="checkbox"/> |

(7)

| | |
|---|---|
| TRADE AND OTHER RECEIVABLES/ | |
| Trade debtors (28 450 ✓ - 700✓) | 27 750 ✓ |
| Provision for bad debts (1250 – 145) | (1 105) ✓✓ |
| | 26 645 <input checked="" type="checkbox"/> <i>Inspection</i> |
| | |
| SARS: Income tax (46 000✓ – 42 500✓) | 3 500 ✓ |
| Prepaid expenses | 3 640 ✓✓ |
| \$\$\$ <i>May be directly in BS or as Cash & cash equivalents</i> | <input checked="" type="checkbox"/> 33 785 <i>Inspection</i> |
| | |

(15)

| TRADE AND OTHER PAYABLES/ | | |
|--|--------|---|
| Trade creditors (67 340✓ - 820✓) | 66 520 | ✓ |
| Creditors for salaries | 6 000 | ✓✓ |
| SARS: PAYE/ (3 200✓ + 3 000✓) | 6 200 | ✓ |
| Pension fund | 1 800 | <input checked="" type="checkbox"/> ✓ If/ R900 |
| UIF | 200 | <input checked="" type="checkbox"/> ✓ If R100 |
| Shareholders for dividends / \$\$\$ | 18 750 | ✓ |
| \$\$\$ May be directly in BS | 99 470 | <input checked="" type="checkbox"/> Inspection |
| ** Current portion of loan – alternative | | |

(14)

| 1.1.3 BOTSE-BOTSE STORES LTD BALANCE SHEET AT 30 JUNE 2009 | | |
|---|--|---|
| ASSETS | | |
| NON-CURRENT ASSETS | | 780 540 ✓ |
| FINANCIAL ASSETS | | |
| Fixed deposit Heeda Bank (30 000-15 000) | | 15 000 ✓ |
| CURRENT ASSETS | | <input checked="" type="checkbox"/> 148 325 Inspection |
| <i>Inventories</i> | | 98 540 ✓✓ |
| Trade and other receivables/ | | <input checked="" type="checkbox"/> 33 785 See Note |
| Cash and cash equivalents/ (15 000+1000) | | 16 000 ✓ |
| TOTAL ASSETS | | <input checked="" type="checkbox"/> 943 865 Inspection |

| | | |
|--|--|---|
| EQUITY AND LIABILITIES | | |
| SHAREHOLDERS EQUITY | | 659 271 <input checked="" type="checkbox"/> <i>Inspection</i> |
| Ordinary shareholders equity | | 500 000 ✓ |
| Ordinary share premium | | 30 000 ✓ |
| Retained income | | 129 271 <input checked="" type="checkbox"/> <i>See Note</i> |
| NON-CURRENT LIABILITIES | | 136 124 <i>Any figure</i> |
| Loan MAP Bank (162 124 – 26 000) | | 136 124 <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> |
| CURRENT LIABILITIES | | 148 470 <input checked="" type="checkbox"/> <i>Inspection</i> |
| Trade and other creditors/ | | 99 470 <input checked="" type="checkbox"/> <i>See Note</i> |
| Current portion of loan ** | | 26 000 ✓✓ |
| Bank overdraft/ (23 000 ✓ ✓) | | 23 000 ✓ |
| ** <i>Current portion of loan may be in the Note</i> | | 943 865 <input checked="" type="checkbox"/> <i>Inspection</i> |

(22)
[79]

ACTIVITY 2: 20 marks 20 minutes**CASE STUDY – COMPANIES**

| | | |
|-----|---|-----|
| 2.1 | At present the country is experiencing an electricity shortage due to mismanagement and not keeping up with power supplies. ✓ ✓ Electricity charges have also increased considerably due to this mismanagement ✓ ✓ Therefore, the DA is arguing that the directors have also not performed well and should not receive bonuses. The public and businesses are suffering from the electricity shortage and the directors should not be benefiting at a time like this. Learners to give any reasonable explanation. ✓ ✓ | (6) |
| 2.2 | Performance bonuses are paid for very good work / work achieved above the budget or expectations. ✓ ✓ Eskom feel their directors have performed well, despite the electricity shortage. ✓ ✓ | (4) |
| 2.3 | Learners to give their own opinions but must be substantiated. ✓ ✓ ✓ ✓ | (4) |
| 2.4 | To encourage workers to work extra hard / to give of their best / to go the extra mile, etc. ✓ ✓ | (2) |
| 2.5 | Would have to have budgets with pre-determined criteria of what people should achieve. ✓ ✓ All work must then be monitored according to clear and transparent quarterly review assessment criteria in order to determine if the results were better and who was responsible for this. ✓ ✓ Any feasible answer. | (4) |

[20]

Learner Note: From the above you can see the importance of understanding your concepts of companies. As you attempt the homework, you need to ensure that you are able to answer the questions in the allocated time frames. If you get stuck, you should refer either to the additional notes or your class teacher.

QUESTION 3:

| | | |
|--|--|-------------------|
| 3.1 TOPICAL LTD | | |
| BALANCE SHEET AT 30 JUNE 2008 | | R |
| ASSETS / BATES | | |
| NON-CURRENT ASSETS | | 815 350☑ |
| Fixed / Tangible assets 198 000✓ + 1✓ + 269 801✓ | | 467 802✓ |
| Financial assets | | 347 548✓ |
| CURRENT ASSETS | | 555 650☑ |
| Inventories 72✓ X R4 585✓✓ | | 330 120☑ |
| Trade and other receivables 185 000✓ – 9 250 ✓+ 3 800✓ | | 179 550☑ |
| Cash and cash equivalentents | | 45 980☑☑ |
| TOTAL ASSETS | | 1 371 000☑ |

| | | |
|--|--|-------------------|
| EQUITY & LIABILITIES | | |
| CAPITAL & RESERVES | | 949 000☑ |
| Ordinary share capital 300 000 X R2 | | 600 000✓✓ |
| Ordinary share premium 150 000 X 60cents | | 90 000✓✓ |
| Retained income (114 000✓ + 262 000✓ – 51 000✓)– 66 000✓ | | 259 000☑ |
| NON-CURRENT LIABILITIES | | |
| Loan from Lowveld Bank 275000✓ - 73200✓ + 32500✓ – 45 600✓ | | 188 700☑ |
| CURRENT LIABILITIES | | 233 300☑ |
| Trade and other payables 108 000✓ + 6 400✓ + 7 300✓ | | 121 700✓ |
| Current portion of loan | | 45 600✓✓ |
| Shareholders for dividends | | 66 000☑☑ |
| TOTAL EQUITY & LIABILITIES / | | 1 371 000☑ |

[43]

| | | |
|-------------|---|-------------|
| 3.2.1 | <p>Internal auditor: Is employed by a company to establish and monitor internal control an on on-going basis. Independent auditor: Is appointed by the shareholders to express an opinion on the annual financial statements. ✓✓✓</p> <p><i>MARKS; Excellent = 3 Good = 2 Satisfactory = 2 Poor or wrong = 0</i></p> | (3) |
| 3.2.2 | <p>He should count the stock and the equipment. Control with stock sheets or fixed asset register. Check calculations at cost price. ✓✓✓</p> <p><i>MARKS; Excellent = 3 Good = 2 Satisfactory = 2 Poor or wrong = 0</i></p> | (3) |
| 3.2.3 | <p>He will ask the directors to rectify the matter so that the financial statements fairly present the value. If they do not do this, he must qualify his audit report so that the readers can be aware that there is a problem. ✓✓✓</p> <p><i>MARKS; Excellent = 3 Good = 2 Satisfactory = 2 Poor or wrong = 0</i></p> | (3) |
| 3.2.4 | <p>He should ensure that the directors revalue the stock at below cost price. He should compare the estimated value to market prices to assess reasonableness. A loss will be written off in the Income Statement. He should ensure that a note appears to the financial statements to explain the method of valuation. Rule of prudence applies. ✓✓✓</p> <p><i>.MARKS; Excellent = 3 Good = 2 Satisfactory = 2 Poor or wrong = 0</i></p> | (3) [12] |
| [55] | | |

QUESTION 4

4.1.1

| | | |
|---------|---|-----|
| 4.1.1.1 | <ul style="list-style-type: none"> • Separate legal entity Good answer=2 Satisfactory=1 Incorrect=0 <p>In law a company is regarded as a person separate from its owners- it has its own legal personality and has the same rights and responsibilities as an individual(✓ ✓)</p> | (2) |
| | <ul style="list-style-type: none"> • Limited Liability Good answer=2 Satisfactory=1 Incorrect=0 <p>Shareholders cannot be held liable to pay the debts of the company beyond the amount that they have provided as capital. Their losses are limited to the amount contributed by them ✓✓</p> | (2) |

SEBENZA LIMITED**4.1.2 Calculate the correct net profit**

| | |
|------------------------------------|---|
| Incorrect net profit before tax | ✓ 343 500 |
| Add: | |
| Depreciation | ✓ 5 000 |
| Provision for bad debts adjustment | ✓ 500 |
| Rent income | ✓✓ 21 600 |
| Less: | |
| Trading stock deficit | ✓ (19 000) |
| Director's fees | ✓✓ (15 000) |
| Interest on loan | ✓ (47 600) |
| | <input checked="" type="checkbox"/> 289 000 |

(10)

4.13 Notes to the financial statements on 31 December 2008

| Tangible Assets | Equipment |
|---|--|
| Cost at the beginning year | ✓ 575 000 |
| Accumulated depreciation at beginning of the year (86 000 ✓ -27 000 ✓) | * <input checked="" type="checkbox"/> (59 000) |
| Carrying value at the beginning of the year | <input checked="" type="checkbox"/> 516 000 |
| Movements | |
| Additions at cost (170 000 ✓ +21 600 ✓) | <input checked="" type="checkbox"/> 191 600 |
| Depreciation | ✓ (22 000) |
| | |
| Cost at the end of the year | <input checked="" type="checkbox"/> 766 600 |
| Accumulated depreciation at end of the year | ✓ (81 000) |
| | <input checked="" type="checkbox"/> 685 600 |

*** NO METHOD MARK IF 86 000**

(12)

4.1.4 SEBENZA LIMITED

Balance Sheet on 31 December 2008

| ASSETS | | |
|----------------------------|-----------|---|
| Non-current assets | | <input checked="" type="checkbox"/> 715 600 |
| *Tangible assets | See 4.1.3 | <input checked="" type="checkbox"/> 685 600 |
| *Fixed Deposit: Slamo Bank | | ✓ 30 000 |
| | | |
| Current Assets | | <input checked="" type="checkbox"/> 752 000 |
| Inventories | | 500 000 |

| | |
|--|-------------------|
| Trade and other receivables | 150 000 |
| *Cash and Cash Equivalents(7 000✓+95 000✓) | ✓102 000 |
| TOTAL ASSETS | ✓1 467 600 |

| | |
|---|-------------------|
| EQUITY AND LIABILITIES | |
| Ordinary Shareholders' Equity | ✓962 400 |
| *Ordinary Share Capital | ✓800 000 |
| *Ordinary Share Premium | ✓80 000 |
| Retained Income | 82 400 |
| Non-current liabilities | 193 600 |
| *Loan: Palmbank(295 600 ✓-102 000✓) | ✓193 600 |
| Current Liabilities | ✓311 600 |
| Trade and other payables(18 600✓+170 000✓+15 000✓+2 000✓) | ✓205 600 |
| *Short term Loan(8 500✓x12✓) | ✓✓102 000 |
| *Bank Overdraft(6 000✓-2 000✓) | ✓4 000 |
| TOTAL EQUITY AND LIABILITIES | ✓1 467 600 |

(27)

4.2 CORPORATE GOVERNANCE & AUDITING

| | | |
|-------|---|-----|
| 4.2.1 | <p><i>Any valid point</i>✓✓</p> <p>They cannot be influenced by the company or its directors as their opinion might be called into question. They might be accused of bias if they are not independent. The shareholders do not have access to the books of the company. The auditors do it for them and cannot be biased when they do this</p> | (2) |
| 4.2.2 | <p><i>Any two valid points</i>✓✓ ✓✓</p> <ul style="list-style-type: none"> • Easier to understand • Contains material items only(immaterial items not shown) • Confidential information need not be disclosed | (4) |

| | | |
|-------|---|-----|
| 4.2.3 | <p>Good answer=3 Satisfactory=2 Poor=1 Incorrect=0</p> <ul style="list-style-type: none"> • He/she will not be re-appointed as an auditor • The affected party can lay complaints with professional bodies • He/she will face disciplinary procedures from SAICA AND IRBA✓✓✓ | (3) |
| 4.2.4 | <p><i>Any one valid point</i> Identify ✓ explanation✓✓</p> <ul style="list-style-type: none"> • Transparency-Information should not be hidden from shareholders and other interested stakeholders(e.g. SARS, Registrar of companies) they have legal rights to have the information • Accountability-if errors are made, the person responsible must own up and attempt to correct the matter • Fairness in dealing with stakeholders-The directors must not favour any one stakeholder over another e.g. employees versus shareholders- both have rights | (3) |

[65]

Learner Note: From the above you can see the importance of understanding your concepts of companies.

CONSOLIDATION EXERCISE**SECTION A: TYPICAL EXAM QUESTIONS****QUESTION 1: 30 marks 25 minutes****RECONCILIATIONS & INTERNAL CONTROL**

You are provided with three examples of reconciliations done by employees in the accounting department of Soweto Stationers,

REQUIRED

Inspect the information provided, and then answer the questions that follow.

INFORMATION**EXAMPLE****A**

| BANK RECONCILIATION STATEMENT | |
|--------------------------------------|--------------|
| ON 29 FEB 2008 | |
| | <i>R</i> |
| Balance per bank statement | Credit 8 000 |
| Outstanding deposit | 3 000 |
| Outstanding cheques | |
| No 1040 dated 13 Feb 2008 | 2 200 |
| No 1052 dated 18 Aug 2008 | 8 000 |
| No 1055 dated 28 Feb 2008 | 4 300 |
| Balance per ledger account | ? |

CREDITORS RECONCILIATION STATEMENT**ON 29 FEB 2008****EXAMPLE****B**

| | <i>R</i> |
|---|-------------|
| ACE WHOLESALERS | |
| Balance per creditors statement for Feb | Debit 5 000 |
| Invoices not reflected on statement | |
| Invoice No 225 | 7 200 |
| Invoice No 287 | 3 100 |
| Payments not reflected on statement: | |
| Dated 20 Jan 2008 | 6000 |
| Dated 28 Feb 2008 | 3000 |
| Returns not reflected on statement: | |
| Debit note No. 44 | 1 100 |
| Balance per ledger account | ? |

EXAMPLE**C****RECONCILIATION OF CREDITORS CONTROL
ACCOUNT TO CREDITORS LISTING ON 29 FEB 2005**

| | <i>R</i> |
|---------------------------------------|----------|
| Balance per Creditors Control account | 46 000 |
| Balances per Creditors Ledger | |
| Ace Wholesalers | ? |
| Busta Furnishers | 20 000 |
| Camel Security Services | 22 000 |
| Dumbo CC | ? |
| Difference | ? |

QUESTIONS

- 1.1 Briefly explain what you understand by the term 'internal control' and why it is important to apply this in a business. (3)
- 1.2 Briefly explain the purpose of each of reconciliation examples A, B & C prepared by employees of Soweto Traders. (6)
- 1.3 According to the bank statement, does this business have a favourable bank balance or a bank overdraft? Provide your reason. (2)

- 1.4 Calculate the bank balance in the ledger of Soweto Stationers on 29 February 2008. (2)
- 1.5 List the main instructions you would give to an employee of Soweto Stationers when preparing a bank reconciliation statement. (6)
- 1.6 When preparing the financial statements of Soweto Stationers at the end of February 2008, what bank balance would you reflect under cash & cash equivalents? (2)
- 1.7 Calculate the correct amount owed to Ace Wholesalers by Soweto Stationers. (3)
- 1.8 Consider Example C. What advice would you give to the employee responsible for this reconciliation if a difference is detected at the end of the month? Explain briefly. (6)
- [30]

QUESTION 2**COMPANY REPORTING****53 marks****39 minutes****2.1 SEBENZA LIMITED**

You are provided with information relating to Sebenza Limited. The company sells entertainment equipment.

REQUIRED

2.1.1 Answer the following questions:

2.1.1.1 Explain the following concept in relation to companies:

- Separate legal entity (2)
- Limited liability (2)

2.1.2 Calculate the correct net profit before tax. (10)

2.1.3 The following note to the financial statements:

- Tangible Assets (12)

2.1.4 Complete the Balance Sheet on 31 December 2008

(Where the notes are not required show workings in brackets.)

NB. Certain figures have been provided. (27)

INFORMATION**1. Figures extracted from the Ledger accounts on 31 December 2008:**

| | |
|---------------------------------------|-----------|
| Ordinary share capital (R5 par value) | R 800 000 |
| Fixed deposit: Slamo Bank | 30 000 |
| Fixed deposit: Jigzo Bank | 95 000 |
| Creditors control | 18 600 |
| Petty cash | 7 000 |
| Ordinary Share Premium | 80 000 |
| Equipment | 575 000 |
| Accumulated depreciation on equipment | 86 000 |
| Mortgage loan from Palmbank | ? |
| Bank | 6 000(cr) |
| Depreciation | 27 000 |
| Directors fees | 38 000 |

2. Adjustments and additional information:

The figures in the Pre-Adjustment Trial balance indicated that the net profit before tax amounted to R343 500 but the following adjustments have not been taken into account:

2.1 The company purchased additional equipment on credit for R170 000 on 31 December 2008. The equipment was delivered but no entry has been made.

2.2 Depreciation on equipment, R27 000 was entered in the books. On investigation it was found that the amount should have been R22 000.

2.3 The figure for Trade and other Receivables is **correct**. The bookkeeper, however, omitted the Trading Stock Deficit, R19 000 and the decrease in the provision for bad debts from R5 000 to R4 500 from the profit and loss account.

2.4 In terms of their contracts, the directors are entitled to the following fees for the year:
Snow R30 000 and White R23 000. White's fees have been paid in full. Snow has only been paid 50% of the amount due to her. Provide for Snow's outstanding amount.

2.6 The Fixed Deposit at Jigzo Bank will mature on 1 April 2009.

2.7 No amounts are due to SARS for income tax or VAT. Both these accounts have debit balances.

2.8 According to the bank statement, cheque no. 786 for R2 000 issued to a creditor, has not been presented for payment because it was post dated.

2.9 Sebenza Limited did not declare a final dividend due to poor economic conditions which impacted on profits for the year.

2.10 The lease agreement with the new tenant included the following clause:
The rental of R2 400 per month for the period 1 April 2008 - 31 December 2008 should be used to upgrade existing equipment of Sabena Limited. The tenant honoured the agreement, and the equipment of Sebenza Limited was upgraded. No entries have been processed as yet.

QUESTION 3: 55 marks 35 minutes*(DoE 2010)*

You are provided with information relating to Kanela Limited. The financial year-end is 28 February 2010.

REQUIRED

- 3.1 Use the information below to prepare the Balance Sheet on 28 February 2010. All workings must be shown in brackets – the NOTES to the financial statements are not required. (41)
- 3.2 The Managing Director, Jan Kriel, currently owns 45% of the issued shares. The board of directors has decided to issue the unissued shares to the public. Jan wants to use this opportunity to gain control of the company.
- 3.2.1 How many shares would he have to buy to gain control of the company? (3)
- 3.2.2 Jan plans to purchase the shares himself at par value without advertising the shares to the public. The current market price of a share is R3,10. If you were a shareholder in this company would you be satisfied with this arrangement? Explain. (5)
- 3.3 Kanela Limited has donated funds to build a high school in the community and they have spent considerable amounts in cleaning up a river and a forest area which has been neglected.
- 3.3.1 Explain why large companies like Kanela Ltd are expected to be involved in such projects. (3)
- 3.3.2 Explain how the directors should reflect these projects in the annual report which is published for shareholders. (3)

INFORMATION

- The authorised share capital comprises 1 000 000 ordinary shares of R2,00 par value each. By 28 February 2009, 600 000 ordinary shares had been issued at par. During the current financial year a further 200 000 shares were issued at a premium of R0,70 each.
- The following balances were extracted from the books on 28 February 2010:
 - Land & Buildings at cost, R1 800 000
 - Equipment at cost, R300 000
 - Creditors' control, R720 000
 - Debtors' control, R530 000
 - Creditors for salaries, R36 000
 - Income receivable, R24 000
 - Cash at bank, R66 000

3. One of the fixed deposits, R175 000, matures on 30 September 2010. The rest matures in 2012.
4. A loan from Easi Bank of R1 500 000 was originally received on 1 March 2008. This is to be repaid in equal monthly instalments over 5 years.
5. All the equipment was purchased on the same day, 1 October 2007. Depreciation is written off at 20% p.a. on cost price.
6. The following financial indicators apply at the end of the financial year.
 - The net asset value is R2,58 and the price on the JSE is R3,10
 - The current ratio is 1,5 : 1

[55]

PART I: COMPANIES - INTERPRETATION OF FINANCIAL STATEMENTS**SECTION A: TYPICAL EXAM QUESTIONS****Learner Note:**

- Always answer in point form
- Make sure you learn your theory on companies
- Open ended questions do not have one correct answer

QUESTION 1: 55 marks 35 minutes *(Adapted from New Era Study Guide)*

INTERPRETATION OF FINANCIAL INFORMATION

You are provided with information relating to Bhaga Toys Limited.

REQUIRED

- 1.1 A company's published annual report comprises five main parts. Match the components of the annual report in COLUMN 1 with the description in COLUMN 2. The first one has been done for you. Write only the letter (A – E) next to the question number (1 – 5), for example 6 – C.

| COLUMN 1 | | COLUMN 2 | |
|---------------------------------|------------------------------|-------------|---|
| COMPONENTS OF THE ANNUAL REPORT | | DESCRIPTION | |
| 1 | Income Statement | A | this is a written verbal explanation of the operations of the company during a financial year |
| 2 | Balance Sheet | B | this reflects whether or not the shareholders can rely on the financial statements |
| 3 | Cash-Flow Statement | C | this reflects the profit/loss of the company for the year |
| 4 | Directors' Report | D | this reflects the effect of the operating, financial and investing activities on the cash resources |
| 5 | Independent Auditor's Report | E | this reflects the net worth of the company |

(4)

1.2 Refer to information 1, 2 and 3 at the end of this question.

Calculate the following financial indicators for 2008:

- Acid-test ratio (4)
- Stock turnover rate (4)
- Debt/Equity ratio (3)
- Net asset value per share (4)
- Earnings per share (3)

1.3 Comment on the liquidity situation of the company. Quote THREE relevant financial indicators (actual ratios or percentages) to support your answer. (8)

1.4 The company directors feel that the shareholders should be very happy with the returns, earnings and dividends of the company. Quote THREE relevant financial indicators (actual ratios or percentages) to support their opinion. (6)

1.5 Refer to the market value per share. Many people feel that the market value of the share on the JSE indicates whether or not the directors are doing a good job. (2)

- Explain why the market value is so important in this regard.
If the company issued all its unissued shares next year, how much capital could they expect to raise for the company? Provide a calculation to support your opinion. Note that the authorised share capital comprises 1 000 000 ordinary shares of R2 par value. (4)

1.6 Rather than issue more shares, the directors are considering taking out additional loans. Quote TWO relevant financial indicators (actual ratios or percentages) to support their opinion. (4)

1.7 The auditors have told the directors that Directors' Fees must be shown separately in the financial statements and not as part of Salaries and Wages. The directors do not want to change this. What is your opinion on this problem? Explain. (3)

1.8 Refer to the newspaper article below.

JSE SUSPENDS WOODVIEW LTD OVER NO ANNUAL REPORT

[By Ima Snoop, 12 Feb. 2009]

The trading of shares of furniture company Woodview Ltd were suspended by the JSE Securities Exchange yesterday after the company failed to publish its annual report three months after the end of their financial year-end.

The CEO of Woodview Ltd put out a statement explaining that the auditors had withheld their report and that this was causing a delay.

The company postponed its AGM. The shareholders have not been informed of the reason for the postponement.

Prior to the JSE's action, the share price of Woodview Ltd dropped 30% to 140 cents per share.

The directors of Bhaga Toys Ltd are worried that a similar problem could occur in their company. Briefly explain why this would be a serious problem for the company. Name TWO points. (6)

INFORMATION

1. The following information was extracted from the Income Statement for 2008:

| | |
|--|----------|
| ▪ Cost of sales | R976 000 |
| ▪ Interest on loan (interest 13% p.a.) | 25 000 |
| ▪ Net profit before tax | 750 000 |
| ▪ Net profit after tax | 525 000 |

2. The following **financial indicators** were calculated for the past two years:

| | 2008 | 2007 |
|--|-----------|--------------|
| Current ratio | 4,1:1 | 2,1:1 |
| Acid-test ratio | ? | 1,3:1 |
| Stock turnover rate | ? | 8 times p.a. |
| Debtors collection period | 30 days | 30 days |
| Creditors payment period | 90 days | 60 days |
| Debt/Equity ratio | ? | 0,1:1 |
| % return on average shareholders' equity (after tax) | 33,3% | 25% |
| % return on total capital employed (before tax) | 44,3% | 25,8% |
| Net asset value per share | ? | 213,6 cents |
| Market value per share | 240 cents | 220 cents |
| Dividends per share | 20 cents | 10 cents |
| Earnings per share | ? | 55,2 cents |

3. **BALANCE SHEET AS AT 30 JUNE 2008**

| | 2008 | 2007 |
|---|------------------|------------------|
| ASSETS | | |
| <i>Non-current assets</i> | 1 619 040 | 1 611 000 |
| Fixed assets (carrying value) | 1 619 040 | 1 611 000 |
| | | |
| <i>Current assets</i> | 248 500 | 157 500 |
| Inventory | 99 500 | 62 500 |
| Trade and other receivables | 100 000 | 40 000 |
| Cash and cash equivalents | 49 000 | 55 000 |
| | | |
| TOTAL ASSETS | 1 867 540 | 1 768 500 |
| | | |
| EQUITY AND LIABILITIES | | |
| <i>Ordinary shareholders' equity</i> | 1 657 040 | 1 495 000 |

| | | |
|--|------------------|------------------|
| Ordinary share capital (R2,00 par value) | 1 525 000 | 1 400 000 |
| Share premium | 52 000 | 40 000 |
| Retained income | 80 040 | 55 000 |
| | | |
| Non-current liabilities | 150 000 | 200 000 |
| Mortgage loan: Tshwane Bank (13% p.a.) | 150 000 | 200 000 |
| | | |
| Current liabilities | 60 500 | 73 500 |
| Trade and other payables | 60 500 | 73 500 |
| | | |
| TOTAL EQUITY AND LIABILITIES | 1 867 540 | 1 768 500 |

[55]

QUESTION 2: 70 marks 45 minutes**COMPANIES – CASH FLOW AND RATIOS**

Clarens Ltd has an authorised share capital of 700 000 ordinary shares with a par value of 50 cents per share.

As at 28 February 2007, the end of the previous financial year, they had issued 450 000 ordinary shares all at par value.

REQUIRED: Using the information provided prepare the following:

- 2.1 The Asset Disposal Account on 31 August 2007. Refer to point 7 of the information provided. (9)
- 2.2 Answer the following questions:
 - 2.2.1 Use the EPS (see No. 3 below) in order to calculate the number of new shares issued on 1 March 2007. (5)
 - 2.2.2 Calculate the dividends per share for the year ended 29 February 2008. (4)
 - 2.2.3 Discuss one reason why shareholders would be:
 - happy with the dividend policy of this company, and
 - unhappy with the dividend policy of this company.
 Quote financial indicators to support your answer. (4)

- 2.3 Clarens Ltd shares are currently being traded on the stock exchange at R 0.85 per share and the Net Asset Value is R 0.62 per share. The directors have decided to issue the remainder of the authorised shares at R 0.75 cents each. Would you be willing to purchase additional shares at this price? Justify your answer by providing two reasons. (5)
- 2.4 Prepare the Cash Flow Statement for the year ended 29 February 2008 together with the note for cash generated from operations. Where notes are not required, show workings in brackets. (43)

INFORMATION

1. Figures extracted from the Income Statement of Clarens Ltd on 29 February 2008

| | |
|--|----------|
| Depreciation on Vehicles | R22 392 |
| Depreciation on Equipment | R 5 728 |
| Audit Fees | R38 000 |
| Directors Fees | R90 000 |
| Interest on loan from director (interest is capitalised) | R12 000 |
| Net Income Before Tax | R180 000 |
| Net Income After Tax | R126 000 |

2. New shares were issued on 1 March 2007, at a premium of 20 cents per share.
3. The earnings per share (EPS) for the year ended 29 February 2008 were 20 cents per share.
4. Interim dividends of R 50 400 were **paid** during the current financial year.
5. On 28 February 2007, Clarens Ltd had a loan from a director of R 75 000. The balance of this loan on 29 February 2008 is R 132 000. The loan agreement stipulates that interest is to be capitalized and that repayments of R 1 200 per month are to be made to the director. During the year the loan was also increased.
6. Figures extracted from the Balance Sheet of Clarens Ltd as at the end of February:

| | 2008 | 2007 |
|---|--------------|--------------|
| Retained Income | R ? | R 52 200 |
| Book value of total Tangible (Fixed) Assets | R 322 000 | R 246 200 |
| Creditors Control | R 35 000 | R 28 000 |
| SARS (Income Tax) | R 5 250 (dr) | R 4 000 (cr) |
| Shareholders for Dividends | R 88 200 | R 40 000 |
| Debtors Control | R 63 000 | R 66 000 |
| Inventories | R 116 150 | R 86 200 |
| Cash and cash equivalents | R ? | R 8 000 (cr) |

7. On 30 November 2007, Clarens Ltd sold their only vehicle for cash. The vehicle was sold at book/carrying value. This vehicle was originally bought on 1 March 2005 for R 80 000. A new vehicle was purchased on the same day to replace the vehicle sold. All vehicles are depreciated at 20% p.a. using the cost price method.

These transactions have been recorded. No other tangible assets were bought or sold during the current financial year.

[70]

SECTION B: ADDITIONAL CONTENT NOTES

1. Introduction

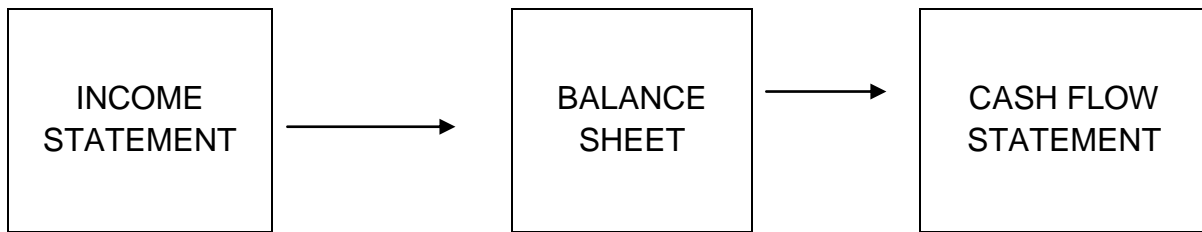
The cash flow statement reflects the movement of cash within an enterprise during a specific period. The Companies Act stipulates that a cash flow statement must be part of the company's financial statements

2. Users of financial statements and its purpose

There are four main financial statements which companies prepare, namely:

- Income statement
- Balance sheet
- Cash flow statement
- Statement of changes in equity

For the purposes of the curriculum we only need to know how to prepare the first three. We first prepare the income statement, then the balance sheet and thereafter the cash flow statement.



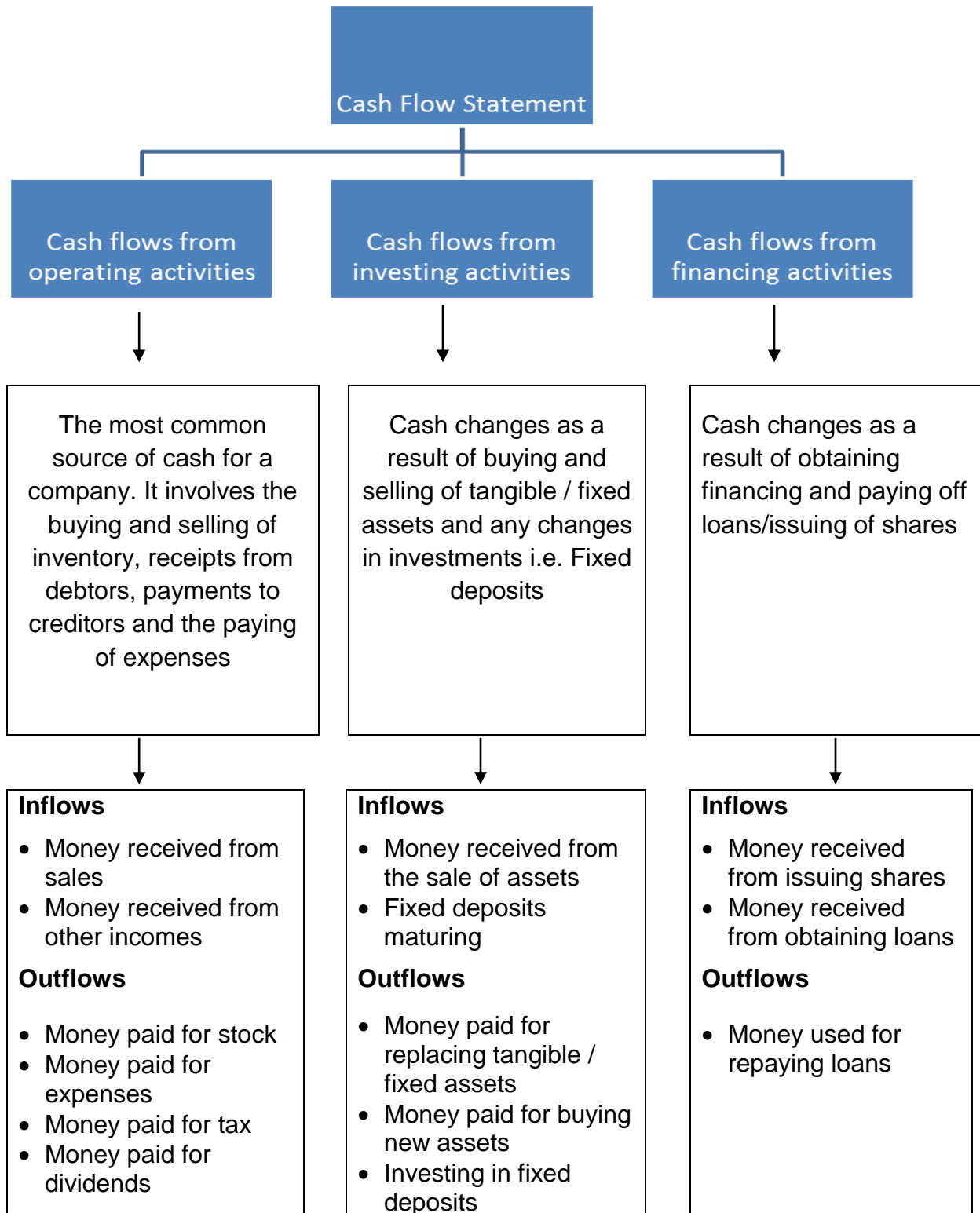
The purpose of doing the cash flow statement is to:

- Determine the cash inflows for the financial period and their sources
- Determine the cash outflows for the financial period and what it was spent on
- Determine the net effect of the changes in cash
- Prepare it as part of the published financial statements of a public company
- Help assess the liquidity of the company
- How were capital developments projects financed?
- Does the company generate sufficient cash from its operations to maintain its current operating capacity

Some users of the Cash Flow Statement:

- Management
- Directors
- Banks
- Investors

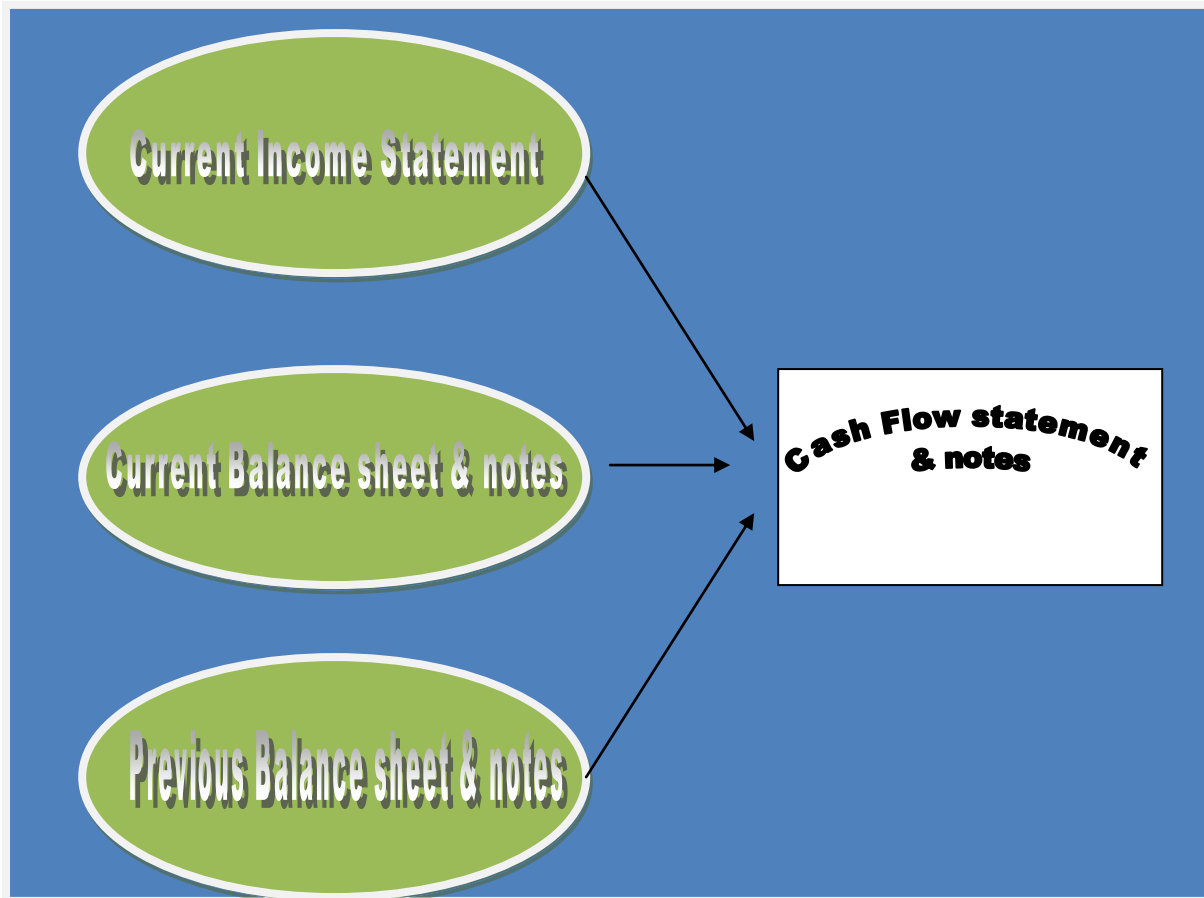
3. Format of the cash flow statement (components)



4. Preparing the cash flow statement

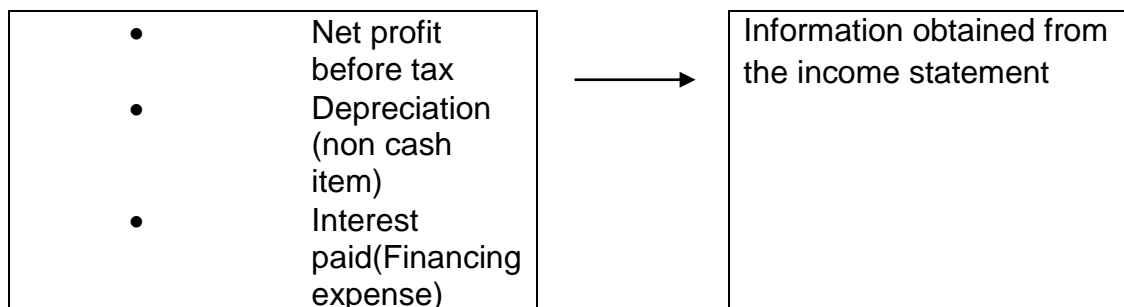
The Cash Flow statement consists of a face and the associated notes. These are prepared after the Income statement and the Balance sheet for the current year have been completed.

The following must be available before a Cash Flow Statement can be prepared:



Steps in preparing the Cash Flow Statement

1. Calculate the cash generated from operations by considering the following:



2. Calculate the changes in working capital by considering the following:

- Changes in inventory. Increase (outflow) , decrease (inflow)
- Changes in trade and other receivables. Increase (outflow) , decrease (inflow)
- Changes in trade and other payables. Increase (inflow) , decrease (outflow)

AIULIG Assets increase utilised/ liabilities increase generated

ADGLDU Assets decreased generated/ liabilities decreased utilised



Information obtained from the Balance sheet / notes of two years

3. Calculate the amount of taxation **paid**.

You may use the logical method as illustrated in the format of the notes to the cash flow statement or you may do the SARS: Income tax account. The **bank** amounts in this account would represent the taxation paid.

4. Calculate the amount of dividend **paid**.

You may use the logical method as illustrated in the format of the notes to the cash flow statement or you may do the Shareholders for dividend and ordinary share dividend accounts. The **bank** amounts in these accounts would represent the dividend paid.

5. Calculate the fixed assets purchased.

You may use the particular asset ledger account or you may use the carrying value method.

Note: The following is the carrying value method

| | |
|--|---------------------------|
| Carrying value of asset at the beginning of the year | xxxx |
| Less: Depreciation | (xxx) |
| Carrying value of asset sold (if any) | (xxx) |
| Add: Asset purchased | ? Amount to be determined |
| = Carrying value at the end of the year | xxxx |

The carrying value at the beginning and the end would be given in the Balance sheet or the notes; therefore the asset purchased would be the missing figure.

6. Calculate the proceeds from the sale of fixed assets.
7. Calculate proceeds from the issue of shares. Remember to include the premium
8. Calculate proceeds from obtaining new loans.
9. Calculate repayment of loans.
10. Calculate the change in cash and cash equivalents.

SECTION C: HOMEWORK

QUESTION 1: 75 marks 45 minutes

CASH FLOW & INTERPRETATION OF A COMPANY

The given information was extracted from the accounting records of Gr8 Xpectations Limited on 30 June 2009, the last day of their financial year. Gr8 Xpectations Limited is a public company listed on the Johannesburg Securities Exchange (JSE). They are based in Pretoria and they sell office equipment and stationery.

REQUIRED

- 1.1 What is the purpose of a cash flow statement? (2)
- 1.2 Calculate the missing figures in the cash flow statement. The missing figures are denoted (a) to (i). (18)
- 1.3 Study the completed cash flow statement and the notes to the cash flow statement and answer the following questions:
 - 1.3.1 Why is depreciation added to the profit before taxation when the cash generated from operations is calculated? (2)
 - 1.3.2 Why was more shares issued when the company made a profit? (2)

- 1.4 Calculate (to one decimal place), unless otherwise stated, the following financial indicators for the year ended 30 June 2009:
- 1.4.1 Mark-up percentage (gross profit percentage) on cost of sales (3)
 - 1.4.2 Percentage return on average shareholders' equity (after tax) (4)
 - 1.4.3 Earnings per share (3)
 - 1.4.4 Net asset value per share (3)
 - 1.4.5 Debt/equity ratio(2 decimal places) (3)
- 1.5 Profitability:
- 1.5.1 The business aims at a mark-up of 70% on cost. Provide THREE possible reasons why Gr8 Xpectations Limited has not achieved the intended mark-up? (3)
 - 1.5.2 Recommend THREE internal control measures on how management can prevent theft of inventory (stock) by customers and employees. (3)
- 1.6 Liquidity:
- 1.6.1 Briefly explain the difference between the current ratio and the acid-test ratio. (2)
 - 1.6.2 Comment on the liquidity of Gr8 Xpectations Limited. Quote any three relevant financial indicators from the question to support your opinion. (9)
- 1.7 You have decided to invest in Gr8 Xpectations Limited. Explain and quote any two financial indicators from the question to support your decision. (6)
- 1.8 Gr8 Xpectations introduced an employees' share scheme on 1 July 2004. The following distributions were made in terms of the scheme to eligible employees:

| | |
|---------------|-------------------------|
| July 2004 | 50 shares per employee |
| December 2006 | 95 shares per employee |
| February 2009 | 165 shares per employee |

One of the employees, I.M. Ntrouble, is experiencing financial difficulties and obtained permission from the directors of Gr8 Xpectations Limited to sell her incentive shares. She has been in the employ of Gr8 Xpectations Limited since January 2003.

- 1.8.1 How many shares would I.M. Ntrouble own on 30 July 2009? (3)
- 1.8.2 Calculate the total dividend she would have received in the 2009 financial year. (3)
- 1.8.3 Taking the market price into account, how much money would she receive if she decided to sell the shares on the JSE on 30 June 2009? (3)
- 1.8.4 During the annual general meeting (AGM) one of the shareholders was questioning the relevance of an employees' share scheme. As managing director of Gr8 Xpectations Limited, explain to the shareholder why this is necessary. (3)

INFORMATION

GR8 XPECTATIONS INCOME STATEMENT FOR THE YEAR ENDED 30 JUNE 2009

| | |
|-------------------------------------|-------------|
| Sales | 7 294 000 |
| Cost of sales | (4 386 400) |
| Gross profit | 2 907 600 |
| Operating expenses | (1 359 640) |
| Depreciation | 356 475 |
| Sundry expenses | 1 003 165 |
| Profit before interest expense | 1 547 960 |
| Interest expense | (276 875) |
| Profit before tax | 1 271 085 |
| Taxation | (355 905) |
| Net profit (after tax) for the year | 915 180 |

**GR8 XPECTATIONS
BALANCE SHEET AS AT 30 JUNE 2009**

| | 2009 | 2008 |
|---------------------------------------|-------------------|-------------------|
| ASSETS | | |
| Non-current assets | 17 354 775 | 16 117 500 |
| Property, plant & equipment | 16 104 775 | 15 117 500 |
| Financial assets | 1 250 000 | 1 000 000 |
| Current assets | 1 716 575 | 1 384 350 |
| Inventories | 733 125 | 609 690 |
| Trade and other receivables | 819 875 | 774 660 |
| Cash & cash equivalents | 163 575 | – |
| TOTAL ASSETS | 19 071 350 | 17 501 850 |
| EQUITY & LIABILITIES | | |
| Ordinary shareholders' equity | 16 941 490 | 14 581 310 |
| Ordinary share capital (R8 par value) | 10 600 000 | 9 540 000 |
| Share premium | 4 125 000 | 3 500 000 |
| Retained income | 2 216 490 | 1 541 310 |
| Non-current liabilities | 1 250 000 | 1 000 000 |
| Mortgage loans | 1 250 000 | 1 000 000 |

| | | | |
|---------------------------------------|--|-------------------|-------------------|
| Current liabilities | | 879 860 | 1 920 540 |
| SARS (Income tax) | | 169 310 | 231 765 |
| Shareholders for dividends | | 530 000 | 500 000 |
| Trade and other payables | | 180 550 | 399 740 |
| Bank overdraft | | – | 789 035 |
| TOTAL EQUITY & LIABILITIES | | 19 071 350 | 17 501 850 |

GR8 XPECTATIONS LIMITED**CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 2009**

| | Notes | R |
|--|-------|-----------|
| Cash flows from operating activities | | (a) |
| Cash generated from operations | 1 | 1 516 595 |
| Interest paid | | (b) |
| Dividends paid | | (c) |
| Taxation paid | | (418 360) |
| Cash flows from investing activities | | (906 250) |
| Purchase of non-current assets | | (d) |
| Proceeds from sale of non-current assets | | (e) |
| Increase in investments | | (250 000) |
| Cash flows from financing activities | | (f) |
| Proceeds from issue of shares | | (g) |
| Proceeds from long-term borrowings | | 250 000 |
| Net change in cash and cash equivalents | | (h) |
| Cash and cash equivalents at beginning of year | | (789 035) |
| Cash and cash equivalents at end of year | | (i) |

NOTES TO THE CASH FLOW STATEMENT

| 1. RECONCILIATION BETWEEN PROFIT BEFORE TAXATION AND CASH GENERATED FROM OPERATIONS | |
|--|-----------|
| Profit before taxation | 1 271 085 |
| Adjustments in respect of: | 633 350 |
| Interest paid | 276 875 |
| Depreciation | 356 475 |
| Operating profit before changes in working capital | 1 904 435 |
| Changes in working capital | (387 840) |
| Increase in inventories | (123 435) |
| Increase in trade and other receivables | (45 215) |
| Decrease in trade and other payables | (219 190) |
| Cash generated from operations | 1 516 595 |
| | |

ADDITIONAL INFORMATION:

1. New shares were issued on the first day of the current financial year.
2. Equipment was sold at carrying value during the year.
3. An additional building was erected at a cost of R1 000 000 during the year.
4. Dividends are as follows:

| Details | Per share | Declared | Paid |
|-----------------------|------------------|------------------|------------------|
| Interim dividend 2009 | 30 cents | 31 December 2008 | 31 December 2008 |
| Final dividend 2009 | 40 cents | 30 June 2009 | 25 August 2009 |

5. The market value of the shares on the JSE is 1100 cents on 30 June 2009. This represents an improvement of 5% from the previous year.
6. The following financial indicators were calculated for the past two years:

| | 2009 | 2008 |
|---|-----------|-------------|
| % increase in sales | 16,3% | 12,5% |
| % mark-up on cost | ? | 68% |
| % operating expenses on sales | 18,7% | 22,5% |
| % net profit on sales | 12,6% | 12,2% |
| Current ratio | 1,95 : 1 | 0,72 : 1 |
| Acid-test ratio | 1,12 : 1 | 0,40 : 1 |
| Inventory (stock) turnover rate | 3,3 times | 5,9 times |
| Average debtors' collection period | 66,5 days | 77,5 days |
| Average creditors' payments period | 60,4 days | 100,7 days |
| % return on shareholders equity (after tax) | ? | 4,6% |
| % return on total capital employed (before tax) | 10,1% | 7,0% |
| Net asset value per share | ? | 1 223 cents |
| Dividends per share | 70 cents | 90 cents |
| Earnings per share | ? | 62,1 cents |
| Debt-equity ratio | ? | 0,07 : 1 |

[75]

SECTION D: SOLUTIONS AND HINTS TO SECTION A

QUESTION 1

1.1

| Column 1 | Column 2 |
|----------|----------|
| 1 | C |
| 2 | E ✓ |
| 3 | D ✓ |
| 4 | A ✓ |
| 5 | B ✓ |

(4)

1.2 **Acid-test ratio**

$$R248\ 500 - R99\ 500 = R149\ 000 \quad \checkmark\checkmark$$

$$R149\ 000 : R60\ 500 \quad \checkmark = 2,46 : 1 \quad \checkmark \quad \text{or } 2,5:1$$

Stock turnover rate

$$R99\ 500 + R62\ 500 / 2 = R81\ 000 \quad \checkmark\checkmark$$

$$R976\ 000 \quad \checkmark / R81\ 000 = 12 \text{ times p.a.} \quad \checkmark$$

Debt/Equity ratio

$$R150\ 000 \quad \checkmark : R1\ 657\ 040 \quad \checkmark = 0,09 : 1 \quad \checkmark \quad \text{or } 0,1:1$$

Net asset value per share

$$R1\ 525\ 000 / 2 = 762\ 500 \text{ shares} \quad \checkmark\checkmark$$

$$R1\ 657\ 040 \quad \checkmark / 762\ 500 \times 100 \text{ cents} = 217,3 \text{ cents} \quad \checkmark$$

Earnings per share

$$R525\ 000 \quad \checkmark / 762\ 500 \quad \checkmark = 68,9 \text{ cents} \quad \checkmark$$

(18)

General comment ✓✓ Good=2 Satisfactory=1 No/invalid comment 0

The liquidity is generally satisfactory although some of the indicators may be considered to be too high, e.g. current ratio should be lower; creditors should be paid in a shorter period.

Any THREE valid indicators named ✓✓✓

Ratios/percentages quoted for each ✓✓✓

Current ratio 2,1:1 → 4,1:1

Acid-test ratio 1,3:1 → 2,46:1

Stock turnover rate 8 times p.a. → 12 times p.a.

Debtors collection period 30 → 30 days

Creditors payment period 60 → 90 days

1.3 *Any THREE valid indicators named ✓✓✓*

Ratios/percentages quoted for each ✓✓✓

Improvement in % return: 25% → 33,3%

Improvement in EPS: 55,2c → 68,9c

Increase in DPS: 10c → 20c

(8)

1.4 *Any THREE valid indicators named ✓✓✓*

Ratios/percentages quoted for each ✓✓✓

Improvement in % return: 25% → 33,3%

Improvement in EPS: 55,2c → 68,9c

Increase in DPS: 10c → 20c

(6)

1.5 *Responses may be expressed differently*

Any valid explanation

Explanation ✓✓

Good = 2 Satisfactory = 1 No/invalid explanation = 0

- The market value is the price at which shares are currently being sold.
- When the market price is higher than the par value, it is an indication to the shareholders that the company is doing well.

If the company issued all its unissued shares next year, how much capital could they expect to raise for the company? Provide a calculation to support your opinion. Note that the authorised share capital comprises 1 000 000 ordinary shares of R2 par value.

Authorised shares = 1 000 000

Issued shares = $1\,525\,000 / 2 = 762\,500$ ✓Available shares = $1\,000\,000 - 762\,500 = 237\,500$ ✓

Capital to be raised by the issue of unissued shares

= $237\,500 \times R2$ ✓ = R475 000 ✓

(6)

1.6 *Any TWO valid indicators named* ✓✓*Ratios/percentages quoted for each* ✓✓

- Return on capital employed for 2008 = 44,3%
- Current interest rate = 13%
- Debt : equity ratio decreased from 0,1:1 to 0,09:1

(4)

1.7 *Any valid comment* ✓✓✓

- Transparency regarding what the directors earn
- Shareholders have a right to know what directors earn

(3)

1.8 *Any TWO valid explanations* ✓✓✓ ✓✓✓

- A delay would cause shareholders to become suspicious
- Shareholders would not vote for these directors next year
- New shareholders will avoid the company and share prices could drop
- The directors would be guilty of a criminal offence. In terms of the Companies Act they have to produce financial statements within three months
- It will affect the ability to raise capital/loans in future as investors will be suspicious

Excellent = 3 Good = 2 Weak = 1 No/invalid explanation = 0

(6)

[55]

QUESTION 2

2.1

General Ledger of Clarens Ltd
ASSET DISPOSAL

| | | | | | | | | | |
|------|----|------------|----|--------|------|----|------------------|-----|--------|
| 2007 | | | | ✓ | 2007 | | Accum Depr | | ✓✓✓ |
| Nov | 30 | Vehicles ✓ | Gj | 80 000 | Nov | 30 | on Vehicles ✓ | Gj | 44 000 |
| | | | | | | | | | ✓ |
| | | | | | | | Bank ✓ | CRJ | 36 000 |
| | | | | ✓ | | | | | |
| | | | | 80 000 | | | | | 80 000 |

(9)

2.2.1 $EPS = N.P \text{ after Tax} / \text{No of shares}$

$$EPS = 126\,000 \checkmark / X = 0.20 \checkmark$$

X = 630 000 Shares

$$630\,000 \checkmark - 450\,000 \checkmark = 180\,000 \text{ new shares issued } \checkmark$$

(5)

2.2.2

$$DPS = (50\,400 + 88\,200) / 630\,000$$

$$DPS = 138\,600 / 630\,000 * 100$$

$$DPS = 22 \text{ cents per share } \checkmark$$

(4)

2.2.3 *One reason with financial indicator* ✓✓

Possible answer:

EPS of 20 c is a return of 40% on par value or 23.5% on current market price of 85 cents. This is much better than current investment rate. Those who are short term investors would be happy with such high dividends and not retaining profits as they will be selling their shares in the short term.

Unhappy with the dividend policy of this company.

Quote financial indicators to support your answer.

One reason with financial indicator ✓✓

Possible answers:

- EPS only 20 cents per share
- DPS is 22 cents per share
- Company has paid out all the earnings and has also used previously retained income for this year's dividend.
- Directors should be retaining some of the profits for future expansion

(4)

2.3 *Yes / No* ✓

Reference to market price ✓✓

Reference to Net Asset Value ✓✓

Any other logical reasons provided.

(5)

2.4 Cash Flow Statement of Clarens Ltd for the year ended 29 February 2008

| | Note | |
|--|------|-------------|
| Cash Flows From Operating Activities: | | 34 520 ✓ |
| Cash Generated from Operations | 1 | 200 170 ✓ |
| Interest Paid | | (12 000) ✓ |
| Dividends Paid (40 000 ✓ + 138 600 ✓ – 88 200 ✓) | | (90 400) ✓ |
| Income Tax Paid (4 000 ✓ + 54 000 ✓ + 5 250 ✓) | | (63 250) ✓ |
| | | |
| Cash Flows From Investing Activities: | | (103 920) ✓ |
| Purchase of Tangible Assets (322 000 ✓ - (246 200 ✓ - 28 120 ✓ - 36 000 ✓)) | | (139 920) ☑ |
| Proceeds from sale of tangible assets | | 36 000 ☑ |
| | | |
| Cash Flows From Financing Activities: | | 171 000 ✓ |
| Increase in Loans (75000 ✓ + 12000 ✓ – 14400 ✓ + X = 132 000 ✓) | | 59 400 ☑ |
| Decrease / Repayment of Loans | | (14 400) ✓ |
| Proceeds from issue of shares (180 000 ✓ x 0,70 [0,50 + 0,20] ✓✓) | | 126 000 ☑ |
| | | |
| Net Change in Cash Equivalents | | 101 600 ✓ |
| Cash & Cash Equivalents at beginning of year | | (8 000) ✓ |
| Cash & Cash Equivalents at End of year | | 93 600 ✓ |

Notes to the Cash Flow Statement:

1. Reconciliation between profit before taxation and cash generated from operations:

| | |
|--|-------------|
| Net profit Before Taxation | 180 000 ✓ |
| Adjust for the following: | 40 120 |
| Depreciation (22 392 + 5 728) | 28 120 ✓✓ |
| Interest on borrowed money | 12 000 ✓ |
| | |
| Operating Profit before changes in working capital | 220 120 |
| Changes in Working Capital: | (19 950) |
| Increase in Inventories | (29 950) ✓✓ |
| Decrease in Debtors | 3 000 ✓✓ |
| Increase in Creditors | 7 000 ✓✓ |
| Cash Generated from Operations | 200 170 ✓ |

(43)

[70]

PART II: COMPANIES - INTERPRETATION OF FINANCIAL STATEMENTS**Learner Note:**

- Always answer in point form
- Make sure you learn your theory on companies
- Open ended questions do not have one correct answer

SECTION A: TYPICAL EXAM QUESTIONS**QUESTION 1: 75 marks 40 minutes****COMPANY INTERPRETATION**

You are provided with information relating to Fatti's Supermarkets Ltd, a public company listed on the JSE Securities Exchange.

REQUIRED

- 1.1 Complete the Cash Flow Statement for the year ended 30 June 2008 (18)
- 1.2 Calculate the following financial indicators for 2008:
- Operating profit on sales
 - Return on average shareholders' equity
 - Net asset value per share
 - Earnings per share
 - Stock turnover rate (23)
- 1.3 The number of directors and employees remained the same for the past two years. You are told that there is problem in this business – the employees feel that they are now working much harder and they are therefore dissatisfied.
- In your opinion, have the employees been treated fairly or not? Explain briefly. Provide two points, supporting your answer by quoting specific figures from the financial statements or the financial indicators.
- What advice would you offer to the directors in solving this problem? (9)
- 1.4 In your opinion, has the company controlled its working capital well, and is it in a good liquidity situation? Explain briefly, quoting specific figures from the financial statements, or the financial indicators. (7)
- 1.5 As a shareholder in this company, you are satisfied with the return, earnings, dividends and share price of the company. Write a brief letter to the Managing Director / Chief Executive Officer (CEO), explaining why you are happy with the performance of the directors, and highlight areas where there could be improvement. Quote specific figures from the financial statements or the financial indicators to support your opinions. (18)

INFORMATION

Information extracted from the published financial statements for the past two years.
Note that figures are expressed in thousands of Rands.

| | 2008 | 2007 |
|--|--------------|--------------|
| | R'000 | R'000 |
| Non-current assets | 1 238 080 | 1 222 000 |
| Fixed assets | 898 080 | 922 000 |
| Financial assets (Investments in shares) | 340 000 | 300 000 |
| Current assets | 178 000 | 168 000 |
| Inventories (all Trading stock) | 59 000 | 125 000 |
| Trade & other receivables | 21 000 | 32 000 |
| Cash & cash equivalents | 98 000 | 11 000 |
| Ordinary shareholders' equity | 1 224 780 | 990 000 |
| Ordinary share capital (R10 par value) | 950 000 | 800 000 |
| Share premium | 140 000 | 80 000 |
| Retained income | 134 780 | 110 000 |
| Non-current liability (Long-term loan, 12% p.a.) | 100 000 | 300 000 |
| Current liabilities | 91 300 | 100 000 |
| SARS (Income tax) | 4 300 | 3 000 |
| Shareholders for dividends | 38 000 | 28 000 |
| Expenses payable | 2 000 | 6 000 |
| Trade creditors & other payables | 47 000 | 63 000 |

Information extracted from the Income Statement for the past two years:

| | 2008 | 2007 |
|------------------------------------|--------------|--------------|
| | R'000 | R'000 |
| Sales | 942 400 | 624 000 |
| Cost of sales | (640 000) | (375 000) |
| Gross profit | 302 400 | 249 000 |
| Operating expenses | (160 000) | (130 000) |
| Salaries & wages (1 120 employees) | 70 000 | 50 000 |
| Directors fees (4 directors) | 16 500 | 15 000 |
| Depreciation | 15 000 | 13 000 |
| Other operating expenses | 58 500 | 52 000 |
| Operating profit | 142 400 | 119 000 |
| Interest on mortgage loan | (12 000) | (36 000) |
| Net profit before tax | 130 400 | 83 000 |
| Income tax | (39 120) | (29 050) |
| Net profit after tax | 91 280 | 53 950 |

Additional information

- New shares were issued on the first day of the financial year.
- Fixed assets were sold at book value during the year for R160 000 000.
- The market value of the shares on the JSE on 30 June 2008 is R11,90. This represents a 15% improvement from the previous year.
- The tax rate for companies declined from 35% in 2007 to 30% in 2008.

The following financial indicators were calculated for the past two years

| | 2008 | 2007 |
|---|----------|------------|
| % Increase in sales | 51% | 2% |
| % Mark-up on cost | 47% | 60% |
| % Operating expenses on sales | 17% | 21,7% |
| % Operating profit on sales | ? | 15,8% |
| % Net profit on sales | 9,7% | 9,0% |
| % Return on shareholders' equity (after tax) | ? | 5,4% |
| % Return on total capital employed (before tax) | 9,4% | 8,5% |
| Net asset value per share | ? | 1238 cents |
| Dividends per share | 70 cents | 60 cents |
| Earnings per share | ? | 67,4 cents |
| Debt/Equity ratio | 0,1 : 1 | 0,3 : 1 |
| Current ratio | 1,9 : 1 | 1,7 : 1 |
| Acid-test ratio | 1,3 : 1 | 0,4 : 1 |
| Stock turnover rate | ? | 3 times |

[75]

QUESTION 2: 75 marks 50 minutes

COMPANIES – CASH FLOW AND RATIOS

Mackie Ltd has an authorised share capital of 900 000 ordinary shares with a par value of R3,00 per share.

As at 28 February 2007, the end of the **previous financial year**, they had issued 500 000 ordinary shares.

REQUIRED

- 2.1 Complete the fixed/tangible asset note in the Balance Sheet of Mackie Ltd as well as the Asset Disposal account by filling in all the missing figures.
- Note that during the year a new vehicle was bought on 31 May 2007 and old equipment was sold at book value on credit. (20)
- 2.2 Complete the following parts of the Cash Flow Statement for the year ended 29 February 2008:
- Note to show the reconciliation between profit before taxation and cash generated from operations. (15)
 - Cash from financing activities (10)
 - Amount of cash paid to SARS (4)
- 2.3 Calculate the price at which the new shares were sold. (4)
- 2.4 Calculate the following to one decimal place on 29 February 2008:
- Net asset value per share (4)
 - Return on average ordinary shareholders equity (4)
 - Return on average total capital employed (4)
- 2.5 Some of the shareholders have issued a vote of no confidence in the directors regarding the performance and financial decisions made in the last year. Do you think they are justified in their decision? Quote at least 3 figures / financial indicators to support your answer. (10)

INFORMATION

1. Depreciation on the assets is as follows:
 - Vehicle at 15% p.a. on diminishing balance method.
 - Equipment R36 375 for the year ended 29 February 2008.
2. The following figures were extracted from the Income Statement:

Interest on loan from director (interest capitalised) R12 000
Income Tax R54 000
Net profit after tax R126 000
3. The new shares were issued on 1 March 2007.
4. On 28 February 2007, Mackie Ltd had a loan from a director of R 75 000 at an interest rate of 14% p.a. The balance of this loan on 29 February 2008 is R 132 000. The loan agreement stipulates that interest is to be capitalized and that repayments of R 1 200 per month are to be made to the director. During the year the loan was also increased.
5. Financial indicators for the year ended 28 February 2007:
 - Net asset value R2,64
 - Return on ordinary shareholders equity 9%
 - Return on total capital employed 12%
6. Current market price of the share on the JSE on 29 February 2008 is R3,20

7. Figures extracted from the Balance Sheet of Mackie Ltd as at the end of February:

| | 2008 | 2007 |
|----------------------------|--------------|--------------|
| Ordinary share capital | R1 800 000 | R1 500 000 |
| Ordinary share premium | R97 500 | R30 000 |
| Retained Income | R 39 600 | R 52 200 |
| Loan from director | R132 000 | R75 000 |
| Creditors Control | R 35 000 | R 28 000 |
| SARS (Income Tax) | R 5 250 (dr) | R 4 000 (cr) |
| Shareholders for Dividends | R 88 200 | R 40 000 |
| Debtors Control | R 63 000 | R 66 000 |
| Inventories | R 116 150 | R 86 200 |

[75]

SECTION B: ADDITIONAL CONTENT NOTES

INTRODUCTION

For our curriculum in Grade 12 we are going to use ratios to analyse the information available in the Income Statement and the Balance Sheet.

The raw information available in these financial statements is of limited value. For example, if we had to say that Company X made a profit after tax of R1 000 000, while Company Y made an after tax profit of R6 000 000. Which one would you say has performed better? Your response initially may be Company Y. But, if I told you that Company X had a turnover of R4 000 000, whilst Company Y had a turnover of R120 000 000, now what would you think?

From this we can see that to make a judgment or decision based purely on raw information could be misleading. Therefore there are a number of ratios that can be used to allow us to interpret financial information more accurately. The ratios one would use would depend on the particular aspect of the business one wishes to analyse or answers to specific questions that one is looking for.

The ratios used can be classified under the following categories:

- Profitability - Indicates how profitable the business is and how well expenses are controlled.
- Return - What the owner/s are getting back in return for their investment.
- Liquidity - The ability of the business to pay its short- term debts.
- Solvency - Can the business settle all its liabilities?
- Operating efficiency - Indicates how well operating activities are carried out.
- Risk - Indicates degree of financial risk

The ratios can help us to:

- Check whether there is growth or stagnation in the business
- Check results with competitors performance
- Compare current results to previous years
- Compare results to general economic indicators in the country or globally
- Compare results to alternative investments
- Determine the degree of financial risk by investors / creditors

Some people interested in measuring the business results:

- Management
- Directors / Owners / Investors / Shareholders
- Banks
- SARS
- Trade Unions
- Competitors

The following ratios are of importance in Grade 12

| No. | Ratio | Category |
|-----|-----------------------------------|---------------|
| 1. | Gross profit on turnover | Profitability |
| 2. | Gross profit on cost of sales | Profitability |
| 3. | Net income before tax on turnover | Profitability |
| 4. | Total expenses on turnover | Profitability |
| 5. | Solvency ratio | Solvency |
| 6. | Current ratio | Liquidity |
| 7. | Acid test ratio | Liquidity |
| 8. | Rate of stock turnover | Liquidity |
| 9. | Number of months of stock on hand | Liquidity |
| 10. | Debtors collection period | Liquidity |
| 11. | Creditors payment period | Liquidity |
| 12. | Gearing ratio / Debt equity ratio | Risk |
| 13. | Return shareholders' equity | Return |
| 14. | Return on capital employed | Return |
| 15. | Earnings per share | Return |
| 16. | Dividends per share | Return |
| 17. | Net asset value per share | Return |
| | | |

The table below describes the ratios, gives their formula and provides guidance on the possible comments to make.

Remember: You have to learn the formula to be able to use the ratio.

Ratio Analysis

| Description | Formula | Guidance to comment |
|------------------------------------|---|--|
| 1. % Gross profit on turnover | $\frac{\text{Gross profit}}{\text{Sales}} \times 100$ | <ul style="list-style-type: none"> • Illustrates mark-up on selling price. • Mark-up achieved may be compared to policy of business. |
| 2. % Gross profit on cost of sales | $\frac{\text{Gross profit}}{\text{Cost of Sales}} \times 100$ | <ul style="list-style-type: none"> • Illustrates mark-up on cost price. • Mark-up achieved may be compared to policy of business. • Possible reasons for difference: <ul style="list-style-type: none"> ➢ Seasonal sales ➢ Cash discounts ➢ Incorrect pricing ➢ Theft |
| 3. % Net income on turnover | $\frac{\text{Net profit}}{\text{Turnover}} \times 100$ | <ul style="list-style-type: none"> • Portion of net income for every Rand of sales. • Compare to previous results |
| 4. % Total expenses on turnover | $\frac{\text{Total expenses}}{\text{Turnover}} \times 100$ | <ul style="list-style-type: none"> • Indicates absorption rate of expenses on turnover. • A lower rate is more favourable. |
| 5. Solvency ratio | Total assets : Total liabilities | <ul style="list-style-type: none"> • The ratio is used to answer the question whether the business is solvent / an indication of its solvency situation. • If assets are more than liabilities the business is solvent. The higher the ratio the better the solvency. • If solvency is close to 1 : 1 there is possible risk of insolvency in the future. |

| | | |
|---------------------------------------|--|--|
| 6. Current ratio | Current assets : Current liabilities | <ul style="list-style-type: none"> • Determines liquidity of business. • Compare to previous results • However if the ratio is very high it can also indicate excessive investment in current assets. Funds could be used for a better return on other investments. |
| 7. Acid-test ratio | Current assets - inventory : Current liabilities | <ul style="list-style-type: none"> • Determines liquidity of business. • Compare to previous results • If current ratio is favourable and acid-test ratio is unfavourable, it shows possibility of too much investment in stock. |
| 8. Rate of stock turnover | <u>Cost of sales</u> Average stock <ul style="list-style-type: none"> • Average stock = stock at beginning + stock at end divide by 2. • Note the answer must be in times per year. | <ul style="list-style-type: none"> • Compare to previous results. • Compare to industry. • Quicker rate is more favourable. |
| 9. Number of months of stock on hand | <u>Average stock</u> x 12 Cost of sales | <ul style="list-style-type: none"> • Gives an indication of how long we can expect the stock on hand to last. • This can help with determining ordering times. • We can also comment on the amount of stock carried by the business. |
| 10. Debtors average collection period | <u>Average debtors</u> x 365 or 12 Credit sales <ul style="list-style-type: none"> • If x 365 answer in days • If x 12 answer in months | <ul style="list-style-type: none"> • Compare to term allowed • If longer, then unfavourable. • How to improve: <ul style="list-style-type: none"> ➤ Send statements more regularly ➤ Charge interest on overdue accounts ➤ Control credit |

| | | |
|--------------------------------------|--|--|
| 11. Creditors average payment period | <p><u>Average creditors</u> x 365 or 12 Credit purchases</p> <ul style="list-style-type: none"> • If x 365 answer in days • If x 12 answer in months | <ul style="list-style-type: none"> • Compare to term allowed • If longer, then unfavourable. • Aim for shorter time: <ul style="list-style-type: none"> ➢ Good relation with suppliers ➢ Negotiate better terms and conditions ➢ Obtain regular supplies |
| 12. Debt / Equity ratio | Non-current liabilities : Shareholders equity | <ul style="list-style-type: none"> • Measures degree of financial risk of the business • A lower ratio is more favourable, the business is less of a financial risk. • Easier to obtain loans • A high ratio indicates that funds have to be obtained by other means, besides borrowing. |
| 13. Return on total capital employed | <p><u>Net profit before tax + interest on loans</u> x 100 Average capital employed</p> <p>Capital employed = Shareholders equity + non-current liabilities. Average therefore will be the above for two years, divided by two.</p> | <ul style="list-style-type: none"> • Compare to previous results. • Compare to other outside investments, such as return on a fixed deposit. |
| 14. Return on shareholders' equity | <p><u>Net profit after tax</u> x 100 Average shareholders' equity</p> <ul style="list-style-type: none"> • Shareholders equity = Share capital + share premium + retained income. • Average therefore would be the above for two years, divide by two. | <ul style="list-style-type: none"> • Compare to previous results. • Compare to other outside investments, such as return on a fixed deposit. • Compare to returns by other companies with a similar share price. |

| | | |
|-------------------------------|--|--|
| 15. Earnings per share | $\frac{\text{Net profit after tax} \times 100}{\text{Number of shares issued}}$ <ul style="list-style-type: none"> Number of shares issued = Share capital divided by par value | <ul style="list-style-type: none"> Compare to previous results. Compare to earnings by other companies with a similar share price. Comment in relation to general economic conditions Comment in relation to JSE performance in general |
| 16. Dividends per share | $\frac{\text{Total dividends} \times 100}{\text{Number of shares issued}}$ | <ul style="list-style-type: none"> Compare to previous results. Compare dividends to earnings per share. If a huge difference exists then it means that a large amount has been kept as retained income. Is there justification for that? Comment in relation to general economic conditions. Comment in relation to JSE performance in general |
| 17. Net asset value per share | $\frac{\text{Shareholders equity} \times 100}{\text{Number of shares issued}}$ | <ul style="list-style-type: none"> Used to determine current value of shares Can influence the decision whether to buy a particular share or not. If the net asset value is more than the par value, one is inclined to buy the share. The difference between dividend per share and earnings per share represents the amount retained by the company and thus increases the net asset value per share |

Learner Note: From the above you can see the importance of understanding your concepts of companies. As you attempt the homework, you need to ensure that you are able to answer the questions in the allocated time frames. If you get stuck, you should refer either to the additional notes or your class teacher.

| |
|----------------------------|
| SECTION C: HOMEWORK |
|----------------------------|

QUESTION 1: **70 marks** **45 minutes**

(DoE Nov. 2008)

CASH FLOW AND INTERPRETATION OF A COMPANY

You are provided with information relating to Glebo Limited for the year ended 30 June 2008. Glebo Limited is a public company listed on the JSE Securities Exchange. They are based in Pretoria and they sell office stationery.

The directors of Glebo Limited decided to open new branches in Bloemfontein and Witbank halfway through the year.



Learner Note:

- Answer the questions below.
- Where you are asked to comment on financial indicators you must quote the name of the relevant indicator as well as the figure, which is provided or calculated in the question for that indicator.

REQUIRED

1.1 Calculate the following financial indicators for 2008:

- | | | |
|-------|--|-----|
| 11.1 | Debt/Equity ratio | (3) |
| 1.1.2 | Acid-test ratio | (4) |
| 1.1.3 | Stock turnover rate | (4) |
| 1.1.4 | % return on average shareholders' equity (after tax) | (4) |
| 1.1.5 | Net asset value per share | (4) |

1.2 Solvency and liquidity:

- | | | |
|-------|--|------|
| 1.2.1 | Briefly explain the difference between <i>solvency</i> and <i>liquidity</i> . | (2) |
| 1.2.2 | Comment on the solvency of this business. Quote a financial indicator from the question to support your opinion. | (3) |
| 1.2.3 | Comment on the liquidity of this business. Quote the financial indicators and the changes (trends) from the previous year to support your opinion. | (10) |

1.3 Returns and share price:

1.3.1 Comment on the earnings, dividends and % return. Quote financial indicators and the changes (trends) from the previous year to support your opinion. (6)

1.3.2 You have been a shareholder since the company started many years ago. The price of the share on the JSE is now 350 cents which is a 6% increase over the past year. Would you be satisfied with the performance of the share price? Comment and compare this to a financial indicator from the question to support your opinion. (4)

1.4 Calculate the missing figures in the Cash Flow Statement. The missing figures are indicated (a) to (e). (12)

1.5 The Cash Flow Statement highlights some significant (important) decisions taken by the directors over the past year. Explain TWO of these significant decisions. Quote figures to support your answer. Also explain how these decisions would benefit the company and the shareholders. (8)

1.6 At the AGM, the directors announce that the company will:

- Conduct training of all employees in terms of morals and ethics
- Donate funds towards cleaning up the environment

Explain why this is necessary although this will cost the company a lot of money each year. State THREE points. (6)

INFORMATION**GLEBO LIMITED****EXTRACT FROM INCOME STATEMENT FOR THE YEAR ENDED 30 JUNE 2008**

| | 2008 | 2007 |
|-------------------------------------|-------------|-------------|
| Sales (70% of sales were on credit) | 9 000 000 | 7 000 000 |
| Cost of sales | 5 625 000 | 4 070 000 |
| Operating profit | 1 423 200 | 947 600 |
| Income tax | 426 000 | 270 000 |
| Net profit after tax | 904 000 | 630 000 |

GLEBO LIMITED
BALANCE SHEET AS AT 30 JUNE 2008

| | 2008 | 2007 |
|---|------------------|------------------|
| ASSETS | | |
| Non-current assets | 4 626 000 | 2 209 000 |
| Fixed assets | 4 326 000 | 1 489 000 |
| Financial assets | 300 000 | 720 000 |
| Current assets | 2 557 000 | 2 508 000 |
| Inventories (all trading stock) | 1 640 000 | 1 510 000 |
| Trade and other receivables (all trade debtors) | 810 000 | 960 000 |
| SARS (Income tax) | 0 | 18 000 |
| Cash and cash equivalents | 107 000 | 20 000 |
| TOTAL ASSETS | 7 183 000 | 4 717 000 |
| EQUITY AND LIABILITIES | | |
| Ordinary shareholders' equity | 4 123 000 | 2 640 000 |
| Ordinary share capital (R2,00 par value) | 2 200 000 | 1 600 000 |
| Share premium | 710 000 | 200 000 |
| Retained income | 1 213 000 | 840 000 |
| Non-current liabilities | 1 980 000 | 700 000 |
| Mortgage loan: Jozi Bank (13% p.a.) | 1 980 000 | 700 000 |

| | | |
|--|------------------|------------------|
| Current liabilities | 1 080 000 | 1 377 000 |
| Trade and other payables (all trade creditors) | 705 000 | 819 000 |
| SARS (Income tax) | 32 000 | 0 |
| Shareholders for dividends | 275 000 | 240 000 |
| Bank overdraft | 0 | 250 000 |
| Current portion of loan | 68 000 | 68 000 |
| TOTAL EQUITY AND LIABILITIES | 7 183 000 | 4 717 000 |

FINANCIAL INDICATORS

The following financial indicators were calculated for the past two years:

| | 2008 | 2007 |
|--|------------|------------|
| Debt/Equity ratio | ? | 0,27:1 |
| Total assets to total liabilities | 2,2:1 | 2,3:1 |
| Current ratio | 2,4:1 | 1,8:1 |
| Acid-test ratio | ? | 0,7:1 |
| Stock-turnover rate | ? | 2,4 times |
| Debtors collection period | 51 days | 72 days |
| Creditors payment period | 49 days | 67 days |
| % return on average shareholders' equity (after tax) | ? | 23,9 % |
| % return on total capital employed (before tax) | 43,3 % | 39,7 % |
| Net asset value per share | ? | 330 cents |
| Dividends per share | 57 cents | 65 cents |
| Earnings per share | 95,2 cents | 78,8 cents |

GLEBO LIMITED
CASH-FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 2008

| | |
|---|-------------|
| | |
| Cash effects of operating activities | 744 000 |
| Cash generated from operations | ? |
| Interest paid | (134 000) |
| Dividends paid | (496 000) |
| Income tax paid | (a) ? |
| | |
| Cash effects of investing activities | (3 217 000) |
| Purchase of fixed assets for new branches | (3 357 000) |
| Proceeds of sale of fixed assets | 140 000 |
| | |
| Cash effects of financing activities | 2 810 000 |
| Proceeds of issue of shares | (b) ? |
| Proceeds of increase in mortgage loan | (c) ? |
| Proceeds of financial assets matured | 420 000 |
| | |
| Net change in cash equivalents | (d) ? |
| Cash equivalents – beginning of year | (230 000) |
| Cash equivalents – end of year | (e) ? |

[70]

| |
|--|
| SECTION D: SOLUTIONS TO SECTION A |
|--|

QUESTION 1**1.1 FATTI'S SUPERMARKET LIMITED****CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 2008**

| | R'000 |
|--|--|
| Cash flow from operating activities | <input checked="" type="checkbox"/> 108 080 |
| Cash generated from operations | 214 400 |
| Interest paid | (12 000) |
| Dividends paid (28 000✓ + 66 500✓✓ – 38 000✓) | ✓ (56 500) |
| Income tax paid | (37 820) |
| Cash effects of investing activities | <input checked="" type="checkbox"/> (31 080) |
| Purchase of fixed assets (922 000 000✓ – 160 000 000✓ – 15 000 000✓ – 898 080 000✓) | ✓ (151 080) |
| Proceeds of sale of fixed assets | 160 000 |
| Increase in investments | (40 000) |
| Cash effects of financing activities | <input checked="" type="checkbox"/> 10 000 |
| Proceeds of shares issued (150 000✓ + 60 000✓) | ✓ 210 000 |
| Loans repaid | 200 000 |
| Net change in cash & cash equivalents | ✓ 87 000 |
| Cash & cash equivalents at beginning of year | 11 000 |
| Cash & cash equivalents at end of year | ✓ 98 000 |

(18)

1.2 CALCULATION OF FINANCIAL INDICATORS

| WORKINGS: | ANSWER: |
|--|---|
| % Operating profit on sales $\frac{142\ 400}{942\ 400} \times 100 =$ | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> 15,1% |
| % Return on shareholders' equity (after tax) $\frac{91\ 280}{1\ 107\ 390} \times 100$ | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> 8,2% |
| Net asset value per share $\frac{1\ 224\ 780}{95\ 000}$ | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> 1289 cents |
| Earnings per share $\frac{91\ 280}{95000} \times 100$ | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> 96,1 cents |
| Stock turnover rate $\frac{640\ 000}{92\ 000}$ | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> 7 times |

(23)

1.3 Candidates should identify:

Assessment increase in salaries & wages

Comparison to directors' fees

Comparison to sales or profits

Figures which should be quoted:

Directors' fees went up by 10% (from R15m to R16,5m)

Salaries and wages went up by 40% (from R50m to R70m)

Sales went up by 51% (from R624m to R942,4m)

Operating profit went up by 19,7% (from R119m to R142,4m)

Possible responses for advice:

Remuneration committee - transparency

Dialogue with staff representatives / union

| | 0 marks | 1-2 marks | 3 marks |
|---|--------------|-------------------------|------------------------|
| Two valid points identified from the question | Non-existent | Incomplete or unclear ✓ | Complete and clear ✓✓✓ |
| Supported by quoted figures | Non-existent | Incomplete ✓ | Complete and valid ✓✓✓ |
| Valid advice provided | Non-existent | Incomplete ✓ | Complete and clear ✓✓✓ |

(9)

1.4 Reasoned opinion expressed – Yes ✓

Quoting of improvement in current ratio from 1.7:1 to 1,79:1 ✓✓

Quoting of improvement in acid test ratio from 0,4:1 to 1,3:1 ✓✓

Quoting of improvement in stock turnover rate from 3 to 7 times ✓\$☑

\$ method mark for transfer of figure from 4.2 – the stock turnover rate

(7)

1.5 Letter to indicate:

Improvement in ROSHE%

Improvement in EPS

Improvement in DPS

Payout rate - possibility of not retaining enough

Improvement in NAV

Undervalued on JSE – reason to be queried

All relevant issues raised for valid global opinion ✓✓✓✓✓✓

Financial indicators appropriately quoted ✓✓✓✓✓✓

Financial indicators correctly interpreted ✓✓✓✓✓✓

(18)

OR

Mention of trend in ROSE ✓ Quoting of ratios ✓

Mention of trend in ROCE ✓ Quoting of ratios ✓

Return on Shareholders' Equity improved from 5,4% to *8,2%

Return on Capital Employed improved from 8,55 to 9,4%

Valid comment made ✓

Shareholders should be happy with the above ratios. Had they invested their money elsewhere it would probably have been at a similar or less interest rate.

Earnings and dividends per share:*Mention of trend in EPS ✓ Quoting of ratios ✓***Mention of trend in DPS ✓ Quoting of ratios ✓**

The EPS increased from 67,4 cents to *96,1 cents per share

The DPS increased from 60 cents to 70 cents per share

Valid comment made ✓

There has been an improvement in both these indicators. It is therefore evident that shareholders have received more in this financial year than they did in the previous financial year.

Share price:*Mention of trend in NAV ✓ Quoting of ratios ✓***Mention of trend in market value of shares ✓ Quoting of ratios ✓**

The NAV improved from 1238 cents to *1289 cents.

The market value of the shares improved by 15% to R11,90.

Valid comment made ✓

There has been an improvement of NAV as well as the market price of shares which is a good indication of the share price.

Possible areas for future improvement:

Any valid suggestion for improvement ✓✓✓

Possible suggestions:

A concern however is that shareholders had paid R14 per share during this financial year which is considerably higher than the market value of R11,90. This means that the shares are undervalued on the JSE and should be investigated.

Although the sales have increased considerably from 2% in the previous financial year to 51% this year, the operating profit on sales indicate a decline from 15,8% to *15,1%.

* award mark for transfer of figure from 4.2

(18)

TOTAL: 75

QUESTION 2

2.1 NOTE TO THE BALANCE SHEET ON 28 FEBRUARY 2008

| Tangible assets / Fixed assets | Vehicles | Equipment |
|---|-------------|-------------|
| Carrying value at beginning of year | 370 000 | 260 000✓ |
| Cost | 480 000 | 390 000 |
| Accumulated depreciation | (110 000)✓ | (130 000) |
| Movements | | |
| Additions at cost | 150 000✓✓ | 0 |
| Disposals at carrying value | 0 | (32 375) |
| Depreciation for the year 55500 + 16875 | (72 375)✓✓✓ | (36 375) |
| Carrying value at end of year | 447 625☑ | 191 250☑ |
| Cost | 630 000 | 310 000✓✓ |
| Accumulated depreciation | 182 375✓✓ | (118 750)✓✓ |

ASSET DISPOSAL

| | | | | | | | |
|------|----|------------------|--------|------|----|------------------------|----------|
| 2007 | | Equipment | | 2007 | | Acc. Dep on equip✓ | |
| Aug | 31 | | 80 000 | Aug | 31 | | 47 625✓☑ |
| | | | | | | Debtors control | 32 375✓✓ |
| | | | 80 000 | | | | 80 000 |
| | | | | | | | |

(20)

2.2 NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 29 FEBRUARY 2008

| | |
|---|------------|
| Profit before taxation 126 000 + 54 000 | 180 000✓✓✓ |
| Adjustment in respect of: | 120 750 |
| Depreciation 72 375☑ + 36 375✓ | 108 750☑ |
| Interest expense | 12 000✓ |
| | 300 750 |
| Changes in working capital | (19 950)☑ |
| Inventories | (29 950)✓✓ |
| Debtors | 3 000✓✓ |
| Creditors | 7 000✓✓ |
| Cash effects of operating activities | 280 800☑ |

(15)

| | |
|--|------------|
| CASH FLOWS FROM FINANCING ACTIVITIES | 412 500☑ |
| Ordinary share capital 300 000 + 67 500 | 367 500✓✓ |
| Loan repayment | (14 400)✓✓ |
| Loan raised 132 000✓ - (75 000✓ + 12 000✓ - 14 400✓) | 59 400☑ |

(10)

| | |
|----------------------------|---------|
| 2.3 INCOME TAX PAID | |
| 54 000✓ + 5 250✓ + 4 000✓ | 63 250☑ |

(4)

$$2.3 \quad 367\,500 \checkmark \div 100\,000 \checkmark \checkmark = R3.68 \checkmark \text{ OR } 367,5 \text{ cents} \quad (4)$$

2.4 • **Net asset value per share** (4)

$$\underline{1\,800\,000 + 97\,500 + 39\,600}$$

$$1\,800\,000 \div 3$$

$$\underline{1\,937\,100 \checkmark \checkmark}$$

$$600\,000 \checkmark$$

$$R3.23 \checkmark$$

• **Return on average ordinary share capital**

$$\underline{126\,000}$$

$$(1\,937\,100 + 1\,582\,200) \div 2$$

$$\underline{126\,000 \checkmark} \quad \times 100$$

$$1\,759\,650 \checkmark \checkmark$$

$$7.2 \% \checkmark$$

• **Return on total capital employed**

$$\underline{180\,000 + 12\,000}$$

$$(2\,069\,100 + 1\,657\,200) \div 2$$

$$\underline{192\,000 \checkmark \checkmark} \quad \times 100$$

$$1\,863\,150 \checkmark$$

$$10.3 \% \checkmark$$

(4)

(4)

2.5 Yes✓ or No (based on learner's figures)

Have raised a lot of capital (R412 500) that is not being utilised effectively in the company.✓✓✓

Net asset value R3.23 is shows an increase from last year of R2.64✓✓✓

The return on the ordinary shareholders equity is 7% which is below alternative investments✓✓✓ and below last year's return of 9%

Negative gearing – return (10.3%) is below the interest rate (14%) and below the return last year of 12%

Market value is R3.20 – below par value.

If NO then it must be qualified to earn the marks

(10)

[75]

CASH BUDGETS**SECTION A: TYPICAL EXAM QUESTIONS****Learner Note:**

- Always answer in point form
- Make sure you learn your theory on budgets
- Open ended questions do not have one correct answer

QUESTION 1: 30 marks 20 minutes*(GDE Preparatory Exam 2008)***CASH BUDGET OF A SOLE TRADER**

You are provided with an incomplete Cash Budget and additional information relating to “The Smart Store”, a popular retail clothing store situated in a busy shopping centre in Wattsville.

The owner, Mrs N. Reddy, is very concerned about the drop in sales over the past months.

REQUIRED

- 1.1 Refer to the proposed Cash Budget, Debtors & Creditors Schedules as well as the additional information provided to calculate the figures labelled to (e). (18)

ADDITIONAL INFORMATION**1. Actual and Budgeted Sales Figures:**

| | Actual | | Budgeted | |
|----------------------|---------|---------|----------|---------|
| | Aug | Sept | Oct | Nov |
| Total Sales | 220 000 | 200 000 | 180 000 | 220 000 |
| Cost Of Sales | 176 000 | 160 000 | 144 000 | 176 000 |

- 20% of total sales are sold on credit each month.
- 65% of all stock is bought on credit.
- A fixed level of trading stock on hand is maintained throughout the year through replacement on a monthly basis.

2. **Debtors are expected to pay their accounts as follows:**

70 % in the month following the month of sale.

28 % in two months following the month of sale.

2 % to be written off in the 3rd month following the month of sale.

3. **Creditors are paid in full** in the month following the month of purchase to qualify for a 5% discount.

1.2

1.2.1 Refer to the item, "Fixed Deposit (1 November)", as shown under the Receipts section of the Cash Budget. Explain what is expected to happen with regards to the Fixed Deposit on 1 November 2008 (2)

1.2.2 The Smart Store plans to purchase equipment during the budget period. Study the Cash Budget in order to calculate the total expected cost price of this equipment. (3)

1.2.3 The sales assistant has complained to Mrs Reddy about her proposed salary increase in November 2008.

- Give one point to support her opinion.
- Give one point against her opinion. (4)

1.2.4 At the end of October 2008, you compare the Actual figures against the Cash Budget figures and you notice differences on certain items. Provide ONE point of advice to Mrs Reddy in respect of **Advertising**:

| | October Budget | October Actual | Difference |
|--------------------|-----------------------|-----------------------|-------------------|
| Advertising | R 2 000 | R 600 | - R1 400 |

(3)

Cash Budget of "The Smart Store" for October & November 2008

| | October | November |
|--|----------|----------|
| RECEIPTS: | | |
| Cash sales | 144 000 | (a) |
| Debtors collections | 40 320 | (c) |
| Fixed deposit (1 November) | - | 20 000 |
| Interest on fixed deposit (12% p.a.) | 500 | 300 |
| Other cash Income | ? | ? |
| PAYMENTS: | | |
| Cash purchase of Trading stock | (b) | 61 600 |
| Payments to creditors | (d) | 88 920 |
| Deposit – purchase of equipment | 3 000 | - |
| Instalment payment – equipment (4 equal instalments) | - | 4 700 |
| Rent expense | 16 000 | 17 440 |
| Salary – shop manager | 12 000 | 13 680 |
| Salary – sales assistant | 5 000 | 5 125 |
| Consumable stores | 11 000 | 12 080 |
| Advertising | 2 000 | 2 000 |
| Interest on overdraft | 315 | - |
| Other cash operating expenses | ? | ? |
| Surplus / (Shortfall) for the month | (21 995) | 18 855 |
| Bank balance at beginning of the month | 14 200 | (e) |
| Bank balance at the end of the month | (7 795) | ? |

[30]

QUESTION 2: 50 marks 30 minutes

(DoE Nov. 2008)

BUDGETING AND CORPORATE GOVERNANCE**2.1 PRESENTATION OF A CASH BUDGET**

You are the accountant of Limpopo Traders and you have prepared the cash budget for the three months ending 31 March 2009, to present to the owner, Thabo Mkhize

REQUIRED

2.1.1 What is the main purpose of preparing a Cash Budget? (2)

2.1.2 At the end of October 2008 you identified the following figures. Explain what you would mention to Thabo about each of the following items at the end of October:

| | October 2008 | |
|-------------------------|--------------|---------|
| | Budgeted | Actual |
| Repairs and maintenance | R23 000 | R18 000 |
| Telephone | R15 000 | R24 000 |
| Rent income | R72 000 | R22 000 |
| Advertising | R25 000 | R25 000 |

(8)

2.1.3 Calculate the total sales that may be expected in February 2009. (4)

2.1.4 Prepare a Debtors Collection Schedule for the period ending 31 March 2009 to check the figures in the Cash Budget. (9)

2.1.5 Thabo is of the opinion that it would be a good idea to start selling on credit, but his shop manager disagrees. Give ONE point from the question to support Thabo's opinion, and ONE point against his opinion. Give figures to support your points. (6)

2.1.6 Refer to the complete Cash Budget for the three months ending 31 March 2009 (see below). Thabo cannot understand what the budget reflects and he asks you to highlight the important aspects.

Explain THREE points other than those mentioned in QUESTIONS 2.1.2 to 2.1.5 above. Give figures (or ratios/percentages) from the question to support your explanations. (9)

INFORMATION

1. **Credit sales:** Thabo decides to start selling on credit from 1 February 2009. Credit sales are expected to comprise 80% of all sales. The business uses a mark-up of 50% on cost at all times. Debtors are expected to pay as follows:
 - 10% pay in the same month as the credit sales transaction
 - 55% pay in the month following the credit sales transaction month
 - 28% pay in the second month following the credit sales transaction month
 - 7% is expected to be irrecoverable (bad debts)
2. **Mortgage loan:** Thabo decides to take out a mortgage loan on the property which the business bought for cash many years ago. Interest of 15% p.a. is capitalised (added to loan).

LIMPOPO TRADERS**CASH BUDGET FOR THREE MONTHS ENDING 31 MARCH 2009**

| | 2009 JANUARY | 2009 FEBRUARY | 2009 MARCH |
|--|-----------------|------------------|---------------|
| RECEIPTS | 675 000 | 1 176 600 | 1 093 600 |
| Cash sales | 600 000 | 144 000 | 162 000 |
| Collection from debtors (see info.1 above) | | 57 600 | 381 600 |
| Mortgage loan from ACE Bank (see info.2 above) | | 900 000 | |
| Rent income | 72 000 | 72 000 | 80 000 |
| Interest on fixed deposit | 3 000 | 3 000 | |
| Fixed deposit maturing | | | 470 000 |

| | | | |
|----------------------------------|----------|----------|-----------|
| PAYMENTS | 771 700 | 960 470 | 1 240 780 |
| Purchase of stock (all for cash) | 400 000 | 480 000 | 540 000 |
| Repayment of loan and interest | | 10 370 | 10 370 |
| Bank charges | 13 000 | 8 000 | 8 000 |
| Insurance | 7 700 | 7 700 | 10 010 |
| Salaries | 140 000 | 140 000 | 168 000 |
| Wages | 60 000 | 62 400 | 62 400 |
| Telephone | 16 000 | 16 000 | 16 000 |
| Advertising | 15 000 | 15 000 | 15 000 |
| Sundry expenses | 20 000 | 21 000 | 22 000 |
| Purchase of vehicles | | | 180 000 |
| Vehicle expenses | | | 9 000 |
| Drawings by Thabo | 100 000 | 200 000 | 200 000 |
| | | | |
| Surplus (Deficit) for the month | (96 700) | 216 130 | (147 180) |
| Cash at beginning of month | 55 000 | (41 700) | 174 430 |
| Cash at the end of the month | (41 700) | 174 430 | 27 250 |

2.2 CASE STUDY: PRESTIGE HOTELS LTD

You are provided with an extract from a newspaper article which is based on an actual case.

REQUIRED

- 2.2.1 If you were a major shareholder in this company, what questions would you ask the managing director at the special meeting? Give TWO questions (6)
- 2.2.2 What should the managing director say at the special meeting to defend the board's decisions about the budget? Briefly explain TWO points. (6)

INFORMATION**PRESTIGE HOTELS LTD SLAMMED FOR INAPPROPRIATE DECISIONS**

[By Helen Brown, Daily Views, 24 Nov. 2007]

The decision by Prestige Hotels Ltd to sponsor the Far East International Soccer tournament to the tune of R5 million at a time when the company is seeking extra loans and finance from investors, has been criticised by some of the major shareholders and trade unions.

One of the major shareholders, Glyn Schroda, said this week that Prestige Hotels made an operating loss of R83 million during the 2006/2007 financial year, and that the budget for the new year shows huge cash shortfalls. She said that the managing director, Brand Schoon, needed to be held accountable and would have to explain the actions of the board at a special meeting called by shareholders next week. Trade union representative, Vally Pradeep, also criticised the company for not looking after its employees.

Prestige Hotels Ltd is the main sponsor and owns hotels in South Africa and the Far East. They will be providing free accommodation for players for the Far East International Soccer Tournament. Spectators will be required to pay for their own rooms.

'We are taking our strong South African brand to the rest of the world with this sponsorship; we are making our presence felt on the world stage,' said Schoon. Siswe Mashala, Chief Accountant of the company, said Prestige Hotels had reduced its sponsorships from more than 40 to only five sporting events, and had budgeted for 8% salary and wage increases.

[50]

QUESTION 3: 45 marks 30 minutes

(DoE March, 2009)

PROJECTED INCOME STATEMENT

You are provided with a Projected Income Statement for Riverside Traders for January and February 2009. The actual figures are also provided. The business is owned by Cheryl Rivers.

She uses a fixed mark-up percentage at all times and credit sales comprise 60% of all sales.

RIVERSIDE TRADERS**PROJECTED INCOME STATEMENT FOR JANUARY AND FEBRUARY 2009**

| | JANUARY BUDGET | JANUARY ACTUAL | FEBRUARY BUDGET | FEBRUARY ACTUAL |
|--------------------------------|---------------------------|---------------------------|----------------------------|----------------------------|
| Sales | 540 000 | 396 000 | 594 000 | 360 000 |
| Cost of sales | 300 000 | 220 000 | 330 000 | 200 000 |
| Gross profit | 240 000 | 176 000 | 264 000 | 160 000 |
| Other income | 47 000 | 34 000 | 53 000 | 44 000 |
| Commission received | 11 000 | 16 000 | 11 000 | 23 000 |
| Rent income | 36 000 | 18 000 | 42 000 | 21 000 |
| Gross operating income | 287 000 | 210 000 | 317 000 | 204 000 |
| Operating expenses | (154 480) | (147 580) | (136 128) | (143 300) |
| Salary of the store manager | 40 000 | 40 000 | 50 000 | 50 000 |
| Wages of shop assistants | 24 000 | 24 000 | 24 000 | 16 800 |
| Sundry operating expenses | 13 000 | 9 000 | 14 000 | 9 000 |
| Motor vehicle expenses | 12 000 | 13 200 | 12 000 | 13 200 |
| Telephone | 1 000 | 3 000 | 1 000 | 5 000 |
| Security expenses | 7 000 | 3 500 | 7 000 | 3 500 |
| Trading stock deficit | 0 | 18 000 | 0 | 12 000 |
| Training of employees | 30 000 | 10 000 | 0 | 0 |
| Advertising | 5 000 | 1 000 | 5 000 | 1 000 |
| Discount allowed | 2 000 | 0 | 2 000 | 0 |
| Bad debts | 6 480 | 11 880 | 7 128 | 10 800 |
| Stationery | 4 000 | 4 000 | 4 000 | 7 000 |
| Depreciation | 10 000 | 10 000 | 10 000 | 15 000 |
| Operating profit | 132 520 | 62 420 | 180 872 | 60 700 |
| Interest income (6% p.a.) | 12 000 | 12 000 | 12 000 | 9 000 |
| Profit before interest expense | 144 520 | 74 420 | 192 872 | 69 700 |
| Interest expense (15% p.a.) | (37 500) | (37 500) | (37 500) | (37 500) |
| Net profit for the year | 107 020 | 36 920 | 155 372 | 32 200 |

REQUIRED

- 3.1 Calculate the mark-up % that Cheryl uses for her business. (4)
- 3.2 Refer to the actual figures for February for Interest income and Depreciation. In each case, give a probable reason why the actual figure is different from the budget for February. (4)
- 3.3 Cheryl is always worried about the internal control over three expenses in particular: stationery, telephone and motor vehicle expenses (especially as the petrol price increased unexpectedly by 25% at the beginning of January). Comment on whether or not these expenses have been well controlled. Quote figures to support your answer. (7)
- 3.4 Cheryl is concerned that she has to keep contributing more capital each month so that the business can settle its debts. Explain why the Projected Income Statement will not help her in identifying the reasons for this problem. (3)
- 3.5 Cheryl has also borrowed money to set up this business. She is not sure if she can afford the loan repayments which start in March. (4)
- Calculate the amount of the loan.
 - What advice would you give her regarding accessing funds in order to repay the loan? Name TWO points. (4)
- 3.6 Cheryl is concerned about the support she is getting from her customers. She is concerned about losing 'goodwill'. (2)
- Quote figures from the questions, which indicate that she appears to be losing customers.
 - Identify THREE points, with appropriate figures from the Projected Income Statement, which indicate that she has made mistakes in dealing with her customers. (6)
- 3.7 The shop assistants earn equal wages. Two of the six shop assistants resigned at the beginning of February. They have not been replaced.
- Calculate the monthly salary earned by each shop assistant in January. (3)
 - Calculate the % salary increase that Cheryl granted the shop assistants in February. (4)
 - Give TWO reasons why they would not be happy with this increase. Quote evidence to support your answer. (4)

[45]

SECTION B: ADDITIONAL CONTENT NOTES

The success of a business is largely dependent on how well it is managed. Management plays a pivotal role in determining the way in which a business is run and the direction it is moving in. People in management are those people who are not only able to think of current issues, but are also able to anticipate and find solutions to problems and situations of the future. The main elements of management are: Planning, Organising, Leading and Control (POLC). Budgets form an important part of planning and control. They can be used as a tool for future planning as well as a tool for exercising control over cash receipts and payments.

For the scope of our curriculum in grade 12, our emphasis will be on the analysis of the monthly cash budget.

Users of budgets:

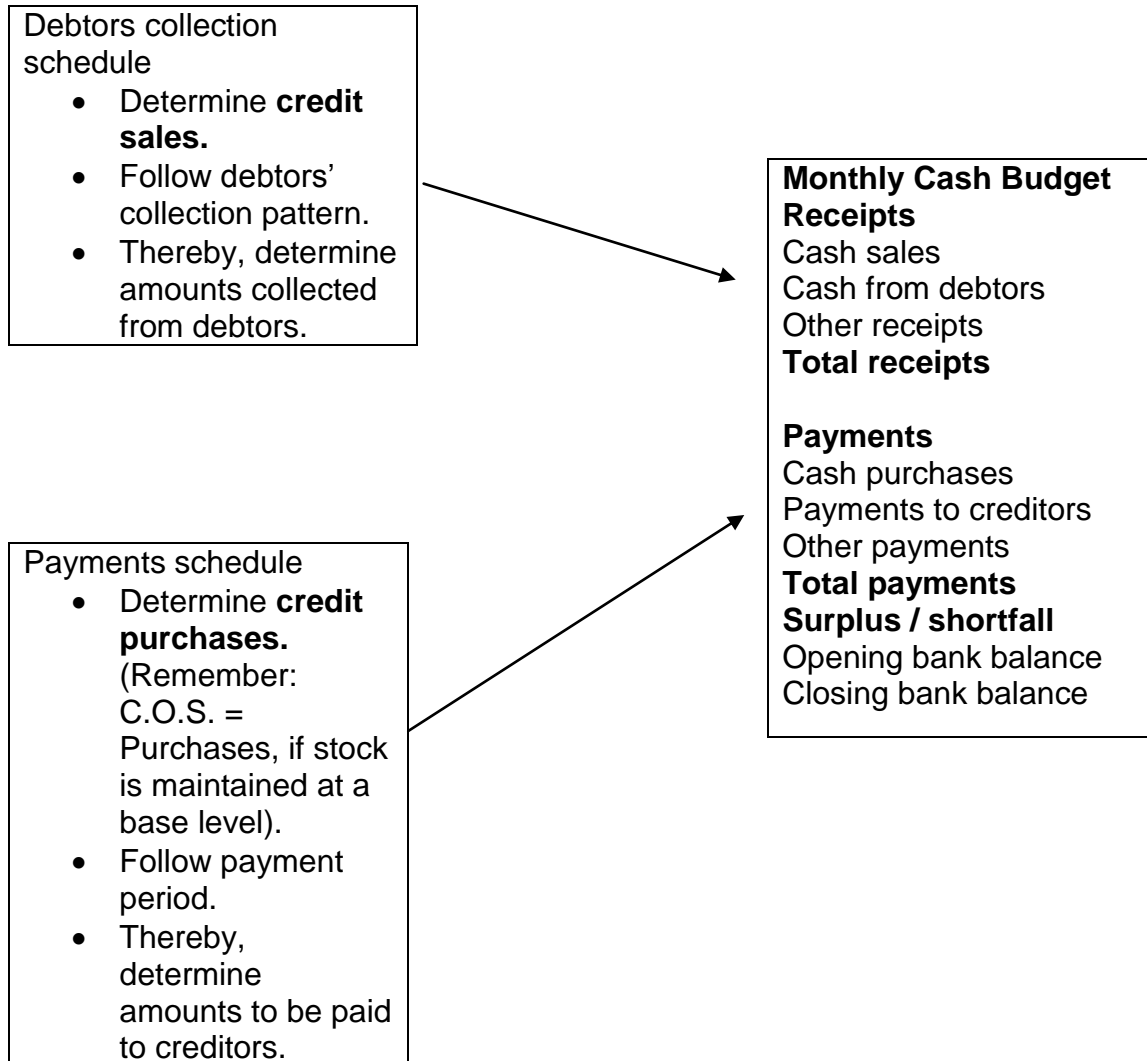
- Business people
- Government
- Salary and wage earners
- Administrators of non profit organisations
- Informal traders and a host of other parties

Therefore, it would be very realistic to assume that each one of us, some time in our lives, might be preparing and analysing budgets.

Purpose of analysing the Monthly Cash Budget:

- Observations can assist with future planning.
- Assist in exercising control over business operations.
- Assist management with decision making.
- Allow for redistribution of resources where necessary.
- Assist with setting of targets for the business.
- Help to determine effective utilisation of cash resources.
- Help to maintain control over expenditure.
- Determine availability or shortage of cash.

How to do a Monthly Cash Budget.



*Remember Cost of sales = $\frac{\text{COST PRICE (100)} \times \text{ACTUAL SELLING PRICE (RANDS)}}{\text{SELLING PRICE (100+mark up)}}$

ANALYSIS OF CASH BUDGETS

An analysis of the monthly cash budget can reveal, amongst others, the following:

- Availability of excess cash lying idle.
- Shortage of cash / bank overdraft.
- Period of collection from debtors and sales policy.

SECTION C: HOMEWORK**QUESTION 1:** 45 marks 35 minutes**(DoE Nov. 2009)****PROJECTED INCOME STATEMENT**

Mike Camp owns Camping Traders, which sells camping equipment. They also charge fees (cash only) for repairing the equipment. You are provided with a Projected Income Statement for September and October 2009. The actual figures are also provided.

REQUIRED

- 1.1 Why is it a good idea to compare budgeted against actual figures? (2)
- 1.2 Mike budgeted to achieve a 60% mark-up on cost. However, owing to increased competition, he found it necessary to reduce his prices during the budget period.
 - 1.2.1 Calculate the mark-up % that Mike actually achieved in September. (3)
 - 1.2.2 Mike feels that the business benefited from the price reductions. Quote figures from the question to support his opinion. (2)
- 1.3 Over the past three months, Mike has needed to contribute capital in order to settle the debts of the business. Explain why the Projected Income Statement will not help him in identifying the reasons for this problem. (2)
- 1.4 On 1 September 2009, the business had a loan from Good Day Bank at an interest rate of 18% p.a.
 - 1.4.1 Calculate the amount owing on the loan on 1 September 2009. (4)
 - 1.4.2 On 1 October Mike decided to increase the loan by R1 million to purchase the shop premises instead of renting the premises. How has this decision affected the profit he is earning? Quote figures to support your answer. (6)
- 1.5 What is the main reason for the disappointing actual net profit in October? Provide a figure to support your answer. (3)
- 1.6 Mike budgeted to increase the number of shop assistants during October 2009. However, he changed his mind and decided to give the existing shop assistants an increase with effect from October and not employ any extra staff.
 - 1.6.1 Calculate the percentage increase he granted the shop assistants in October 2009. (3)
 - 1.6.2 In your opinion, was this a correct decision for the business as a whole? Briefly explain, quoting evidence from the question. (3)

- 1.7 Prepare a debtors' collection schedule for October. Use budgeted sales and the following information:
- 75% of sales are on credit
 - 40% pay in the month of sale and receive a 5% settlement discount
 - 50% pay in the first month after the date of sale
 - 8% pay in the second month after the date of sale
 - 2% is written off in the third month after the date of sale (9)
- 1.8 Provide TWO figures from the information below that indicate that Mike has not handled collection from debtors effectively. (4)
- 1.9 Apart from what has been mentioned in your previous answers, select TWO other operating expenses that Mike should investigate. Provide ONE point of practical advice in respect of each item. (4)

INFORMATION**CAMPING TRADERS****PROJECTED INCOME STATEMENT FOR SEPTEMBER AND OCTOBER 2009
(WITH COMPARATIVE ACTUAL FIGURES)**

| | SEPTEMBER BUDGET | SEPTEMBER ACTUAL | OCTOBER BUDGET | OCTOBER ACTUAL |
|-----------------------------|-----------------------------|-----------------------------|---------------------------|---------------------------|
| Sales | 320 000 | 372 000 | 352 000 | 387 500 |
| Cost of sales | (200 000) | (240 000) | (220 000) | (250 000) |
| Gross profit | 120 000 | 132 000 | 132 000 | 137 500 |
| Other income | 81 200 | 88 650 | 97 200 | 56 400 |
| Sundry income | 1 200 | 650 | 1 200 | 400 |
| Fee income | 80 000 | 88 000 | 96 000 | 56 000 |
| Gross operating income | 201 200 | 220 650 | 229 200 | 193 900 |
| Operating expenses | (127 500) | (130 350) | (147 680) | (144 670) |
| Salary of the store manager | 22 000 | 22 000 | 22 000 | 22 000 |

| | | | | |
|--------------------------------|---------|----------------|----------|-----------------|
| Wages of shop assistants | 28 000 | 28 000 | 39 200 | 31 080 |
| Sundry operating expenses | 8 000 | 9 000 | 14 000 | 9 000 |
| Rates on property | 0 | 0 | 0 | 10 000 |
| Telephone | 2 000 | 3 000 | 1 000 | 5 000 |
| Security expenses | 5 000 | 3 500 | 7 000 | 3 500 |
| Trading stock deficit | 0 | 0 | 0 | 8 000 |
| Rent expense | 24 000 | 24 000 | 24 000 | 0 |
| Advertising | 5 000 | 1 000 | 5 000 | 1 000 |
| Discount allowed | 4 800 | 4 100 | 5 280 | 2 640 |
| Bad debts | 4 200 | 8 550 | 4 200 | 22 450 |
| Consumable stores | 14 500 | 17 200 | 16 000 | 18 000 |
| Depreciation | 10 000 | 10 000 | 10 000 | 12 000 |
| Operating profit | 73 700 | 90 300 | 81 520 | 49 230 |
| Interest income | 10 000 | 10 000 | 11 000 | 11 000 |
| Profit before interest expense | 83 700 | 100 300 | 92 520 | 60 230 |
| Interest expense (18% p.a.) | (2 250) | (2 250) | (17 250) | (17 250) |
| Net profit for the month | 81 450 | 98 050 | 75 270 | 42 980 |

[45]

Learner Note: From the above, you can see the importance of understanding your concepts of budgets. As you attempt the homework, you need to ensure that you are able to answer the questions in the allocated time frames. If you get stuck, you should refer either to the additional notes or your class teacher.

SECTION D: SOLUTIONS AND HINTS TO SECTION A

QUESTION 11.1 **Calculate the figures:**(a) **November 2008 Cash Sales figure**

$$20\,000 \times 0.8 = R\,176\,000 \checkmark\checkmark \quad (2)$$

(b) **October Cash Purchase of Trading Stock figure.**

$$144\,000 \times 0.35 = R\,50\,400 \checkmark\checkmark \quad (2)$$

(c) **November 2008 Debtors Collections figure.**

$$180\,000 \times 0.2 = 36\,000$$

$$36\,000 \times 0.7 = 25\,200$$

$$200\,000 \times 0.2 \times 28\% = 11\,200$$

$$25\,200 \checkmark\checkmark\checkmark + 11\,200 \checkmark\checkmark\checkmark = R\,36\,400 \checkmark \quad (7)$$

(d) **October 2008 Payments to Creditors figure**

$$160\,000 \checkmark \times 0.65 \checkmark = 104\,000 \checkmark$$

$$104\,000 \times 0.95 \checkmark = R\,98\,800 \checkmark \quad (5)$$

(e) **Bank balance of The Smart Store at the end of November 2008.**

$$18\,855 - 7\,795 = R\,11\,060 \checkmark\checkmark \quad (2)$$

1.2.1 **Any valid explanation** $\checkmark\checkmark$

A Fixed Deposit of R 20 000 will mature on 1 November 2008.

The money will be deposited into the businesses current banking account. (2)

$$1.2.2 \quad R 3\,000 + (R 4\,700 \times 4) = R 3\,000 \checkmark + R 18\,800 \checkmark \\ = R 21\,800 \checkmark \quad (3)$$

1.2.3 **One point to support her opinion**

Any valid point mentioned ✓✓

Her salary only expected to increase by 2½ % (this is way below the current CPI) while managers salary is expected to increase by 14%. ✓

One point against her opinion

Any valid point mentioned ✓✓

Sales have been decreasing over the past months (stated in question and can be picked up from 6.1.1) and business are experiencing huge difficulties at present as a result of the weakening economy. (4)

1.2.4 → **Change in Advertising figures:**

Any one valid point ✓✓✓

Possible answers

- R 2000 was budgeted but only R 600 was spent.
- This could have been why the total sales decreased in October.
- Continuous advertising is important for continuous sales – especially now that it is nearing Holiday Season. (3)

[30]

QUESTION 2

2.1 **LIMPOPO TRADERS**

2.1.1 *Any valid answer ✓✓* (2)

Good answer: 2 marks; Answered in part: 1 mark

If candidate confuses income (revenue) with receipts and expenditure with payments:

max 1 mark

Expected responses:

- To anticipate future receipts and payments (2 marks)
- To identify future bank balances (2 marks)
- To anticipate future cash movements (2 marks)
- To assist with control of / monitor receipts and payments (2 marks)
- Planning for the future (1 mark)
- To anticipate future receipts (1 mark)
- To anticipate future payments / how they will spend their money (1 mark)

2.1.2 Any valid answer ✓✓ Figures not essential in answer

Good explanation: 2 marks; Satisfactory explanation: 1 mark

Expected responses to include a comparison of budget to actual (1 mark) & explanation (1 mark).

Repairs & maintenance:

Favourable variance (actual less than budget). Efficient and well controlled. Poor maintenance. ✓✓

Telephone:

Significantly overspent (actual more than budget). Extra control needed / tariff increase / unnecessary (private) calls not related to business. Unbudgeted items / unusual expenditure, e.g. deliberately done to create awareness of the business / follow up on problems. ✓✓

Rent income:

Significantly under budget (actual less than budget) / Budget was unrealistically high. Investigate shortfall, e.g. poor collection, tenant has left, etc. ✓✓
No marks if regarded as a payment.

Advertising: Good planning / Budget fully spent as expected (could assess whether this is valid expenditure e.g. did they need to spend it all? / did they need a bigger allocation?) ✓✓

(8)

2.1.3

$$\begin{array}{ccc} \checkmark & [\checkmark\checkmark] & \checkmark \\ 144\,000 \times 100 / 20 \text{ (i.e. } \times 5) & = & \text{R } 720\,000 \end{array}$$

$$\begin{array}{ccc} \checkmark & \checkmark & \checkmark \\ \text{OR } (57\,600 \times 100 / 10) + 144\,000 & = & \text{R } 720\,000 \end{array} \quad \checkmark$$

$$\begin{array}{ccc} \checkmark & \checkmark & \checkmark \\ \text{OR } 57\,600 \times 100 / 10 \times 100 / 80 & = & \text{R } 720\,000 \end{array} \quad \checkmark$$

$$\begin{array}{ccc} \checkmark & [\checkmark\checkmark] & \checkmark \\ \text{OR } 480\,000 \times 150 / 100 & = & \text{R } 720\,000 \end{array} \quad \checkmark$$

NB: This method applies only in the case of a fixed base stock policy

(4)

2.1.4

| DEBTORS COLLECTION SCHEDULE FOR TWO MONTHS ENDING 31 MARCH 2009 | | | |
|--|---|--|---|
| * If 576 000 not shown, rework workings done by learner | CREDIT SALES * if 80% of 2.1.3 | COLLECTIONS: | |
| | | FEBRUARY | MARCH |
| February credit sales | * <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> 576 000 | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> # 57 600 | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> # 316 800 |
| March credit sales | 648 000 | | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> 64 800 |
| | <i>Both totals-inspection</i> <input checked="" type="checkbox"/> | 57 600 | 381 600 |

Wrong columns: no marks

Inspection: if 10% & 55% of Feb credit sales figure

(9)

2.1.5 Any valid answer ✓✓✓ Figures are essential in answer – correspond to previous responses

Mention point: 1 mark; Figures must relate to the point: 2 marks

One point to support Thabo's opinion: ✓✓✓

Total sales are expected to increase / Extra customers (from R600 000) to R720 000 (3 marks)

OR They will earn extra gross profit of R40 000 (R240 000 instead of R200 000) (3 marks)

One point against Thabo's opinion: ✓✓✓

The cash flow is severely affected (difficult to pay for stock, etc.) e.g. in February cash collected from debtors and cash sales will be only R144 000 + R57 600 = R201 600 instead of R600 000 (3 marks)

OR Bad debts of 7% are expected (3 marks)

OR It takes 3 months to collect 93% of the credit sales (3 marks)

OR Collection period is 3 months but stock is bought for cash (3 marks)

OR Will severely affect cash balances / liquidity (1 mark)

OR Increased administration costs / More people to be employed (1 mark) (6)

2.1.6 Any three valid answers ✓✓✓ ✓✓✓ ✓✓✓ *Figures/ratios/% are essential in answer*

Explain a point: 1 mark; Figures: 2 marks

Explanation may be limited description of item in cash budget – inferences not needed.

Cash on hand / Total Receipts or Payments: The cash on hand decreased from R174 430 to R27 250 in February and March respectively / Receipts increased from R675 000 to R1093 600 (similarly for payments). Despite the extra money received (e.g. through loan / fixed deposits) the business cash flow still seems disappointing.

Mortgage: A large part of the R900 000 bond is used to pay the operating expenses.

Fixed deposit maturing in March R470 000: The business is losing interest R3 000 because they have not reinvested these funds – used on running costs or drawings.

Cash purchases of stock (R400 000 for Jan etc): Could possibly buy on credit to allow more funds to flow in before creditors are paid.

Bank charges: Decreased by R5 000 due to less cash sales, i.e. lower cash deposit fees / Fewer credit card sales.

Insurance: Increased by R2 310 due to the addition of vehicles. Consider to look for a better insurance deal.

Salaries & wages: Salaries increased by 20% during March The salaries should only increase with inflation rate $\pm 7\%$. Wages increased by only 4% compared to 20% increase in salaries. Not fair.

Vehicle: Limit the vehicle expenses, R9 000 expense is very high for a new vehicle.

Drawings: The drawings affect ability to pay operating costs. Increase of 100% is excessive compared to the salaries and wages which increased by 20% and 4% respectively.

Sundry expenses: Increase by R1 000 per month (5% in Jan). Investigate if this is sufficient / necessary.

(9)

2.2 PRESTIGE HOTELS LIMITED

2.2.1 Any two valid and separate questions ✓✓✓ ✓✓✓

Valid response = 3 Invalid response = 0

Examples of expected responses (does not have to be in question form):

- How will this sponsorship benefit the company after a loss of R83m during the 2006/2007 financial year?
- What are the reasons for the loss of R83m?
- What are the reasons for retaining my shareholding in the company?
- What plans and control measures does management have in place to prevent another loss?
- What other plans does management have in place to decrease the operating loss / ensure a profit in future?
- How can you approve a sponsorship if a loan was needed?
- What response will be given to employees when only 8 % increase has been approved on their salaries?
- Why has the number of sponsorship events decreased significantly? Are they focusing on high-profile events only? Will it affect their overall profile? (6)

2.2.2 Any two valid and separate points ✓✓✓ ✓✓✓

Excellent = 3 Good = 2 Satisfactory = 1 Incorrect = 0

Examples of expected responses:

- In the long run the company and shareholders will benefit from increased profits when the marketing initiatives take effect.
- The decrease in sponsorship – reasons for this and effect on company
- Remuneration increases were given despite downturn in the economy – company's ability to sustain this
- Addressing social responsibility – King Code
- World wide exposure / publicity for the company – effect on future prospects
- Sponsorship is tax-deductible – effect to be ascertained – cost vs benefit (6)
- Free accommodation will attract others to stay in the same hotel.

[50]

QUESTION 3

3.1 **Calculate the mark-up % that Cheryl uses for her business.**

$$\begin{array}{ccc} \checkmark & \checkmark & \checkmark\checkmark \\ 240\,000 / 300\,000 \times 100 = 80\% \end{array}$$

Or: use figures from any of the other columns (4)

3.2 **Probable reason for interest income:**

The investment was decreased. ✓✓

Probable reason for depreciation:

More fixed/tangible assets were bought. ✓✓ (4)

3.3 **Comment on Stationery:**

Responses may be expressed differently

Part-marks can be awarded

Well controlled in January, but R3 000 over budget in February. This is possibly due to wastage/theft. ✓✓

Comment on Telephone:

Abuse is apparent. R2 000 over budget in January and R4 000 over budget in February. Not well controlled. ✓✓

Comment on Motor vehicle expenses:

Well controlled. The variance is only 10% (1 200/ 12 000) whilst the price of petrol increased by 25%. ✓✓✓ (7)

3.4 *Responses may be expressed differently* ✓✓✓

Excellent = 3; Good =2; Poor=1; Incorrect=0

Cash problems will be identified in the Cash Budget. The projected Income Statement reflects profit. Certain income items might not have been collected, while payments for debts are not reflected in the Projected Income Statement. ✓✓✓ (3)

3.5 Calculate the amount of the loan.

$$\begin{array}{cccc} \checkmark & \checkmark & \checkmark & \checkmark \\ 37\ 500 / 0.15 \times 12 = R3\ m \end{array}$$

What advice would you give her regarding accessing funds in order to repay the loan? Name TWO points.

Any TWO valid points, e.g. ✓✓ ✓✓

- Liquidate the investment as the interest is only 6%
- Admit a partner/member
- Sell off unused property
- Any other valid point

(8)

3.6 *Each point named: 1 mark; Figure provided: 1 mark*

Jan. actual sales R396 000 Budgeted R540 000 ✓✓

OR Feb. actual sales R360 000 Budgeted R594 000

OR Feb. actual sales R360 000 are less than Jan R396 000

Identify THREE points, with appropriate figures from the Projected Income Statement, which indicate that she has made mistakes in dealing with her customers.

Any THREE valid points, e.g. ✓✓ ✓✓ ✓✓

- Advertising only R1 000 per month compared to R5 000 budget
- Discount allowed is nil, despite R2 000 monthly budget – not granting discount, or debtors are paying too slowly to gain the benefit
- The 80% mark-up at all times might be a problem in relation to prices of competitors – offer trade discounts
- Security spent is 50% of the budget of R7 000 – this is causing shop-lifting as evidenced by trading stock deficits which were not budgeted.
- Bad debts R11 880/R10 800 exceed the budget R6 480/R7 128 – indicates poor screening or poor collection.

(8)

3.7 Calculate the monthly salary earned by each shop assistant in January.

$$\begin{array}{ccc} \checkmark & \checkmark & \checkmark \\ R24\ 000 / 6 = R4\ 000 \end{array}$$

Calculate the % salary increase that Cheryl granted the shop assistants in February.

$$R16\ 800 / 4 = R4\ 200 \quad \checkmark \qquad R4\ 000 \times 4 = R16\ 000$$

$$\text{Increase} = R4\ 200 - R4\ 000 \quad \checkmark = R200 \quad R16\ 800 - R16\ 000 = R800$$

$$\% \text{ increase} = 200 / 4000 \times 100 = 5\% \quad \checkmark \quad R800 / R16\ 000 = 5\%$$

Give TWO reasons why they would not be happy with this increase. Quote evidence to support your answer.

Any TWO valid points, e.g. ✓✓ ✓✓

- The manager received a 25% increase while the assistants received 5%
- The 5% increase is significantly less than the inflation rate of approximately 11%.
- The assistants who resigned were not replaced. The remaining assistants probably have to work harder for a small increase. (11)

[45]

TOPIC 1: VAT

SECTION A: TYPICAL EXAM QUESTIONS

Learner Note:

- Always answer in point form.
- Make sure you learn your CALCULATIONS for VAT.
- Open ended questions do not have one correct answer.

QUESTION 1:**25 marks****15 minutes***(DoE Exemplar 2 2008)***VAT AND ETHICS****REQUIRED**

- 1.1 What is the difference between Output VAT and Input VAT? (4)
- 1.2 At what rate is VAT currently being charged in South Africa? (2)
- 1.3 Is the current rate of VAT being charged on all goods in South Africa? Explain. (5)
- 1.4 George Gummy the owner of Gummy Traders wants to know how much he owes SARS in respect of VAT for the two-month period July-August 2008. Calculate the amount owing to SARS based on the following figures:
Round off to the nearest cent
- Total sales for July and August, R880 800 (exclusive of VAT).
 - Total purchases for July and August, R415 500 (inclusive of VAT).
 - Purchase of equipment in July, R65 000 (inclusive of VAT). (10)
- 1.5 George Gummy regularly purchases goods from Sneaky Stores. The owner has offered you a special price of R6 800 including VAT, instead of the normal price of R7 400, provided you pay cash and do not require a document. George is tempted, as this seems like a good offer. Advise him as to whether he should accept the offer. Explain briefly. (4)
- [25]

QUESTION 2:**45 marks****25 minutes***(GDE Prep. Exam 2008)***STOCK SYSTEMS AND VALUE ADDED TAX****2.1 STOCK SYSTEMS**

You are provided with information relating to Vision Traders for the year ended 29 February 2008. The business sells only DSTV decoders. The periodic inventory system and the weighted average stock valuation method are in operation. They buy all their stock from one supplier.

REQUIRED

- 2.1.1 Explain **ONE** main difference between the periodic and continuous (perpetual) inventory systems. (4)
- 2.2.2 Using the weighted average stock valuation method, calculate the following:
- Value of closing stock on 29 February 2008 (12)
 - Gross Profit for the year ended 29 February 2008 (6)
- 2.1.3 Calculate the value of closing stock using the FIFO method. (5)
- [27]

INFORMATION

1. Stock on 1 March 2007 (100 decoders) R55 600 (includes carriage on purchases).
2. Purchases during the year, 1150 units, for R747 500 were as follows:

| | | |
|--------------|------------------------|----------|
| May 2007 | 250 units at R630 each | R157 500 |
| October 2007 | 800 units at R650 each | R520 000 |
| January 2008 | 100 units at R700 each | R 70 000 |

3. Carriage on purchases during the year was charged at R25 per decoder by the supplier.
4. Returned 10 defective decoders purchased during January 2008 to the supplier. The supplier granted a full refund including carriage.
5. A selling price of R1 095 was maintained throughout the year. Sales amounted to R1 215 450.
6. On 29 February 2008, physical stock taking revealed stock of 130 decoders on hand.

2.2 VALUE ADDED TAX AND ETHICS

The following article appeared in a newspaper in a small rural town.

TROMP PHARMACY IN HOT WATER AGAIN

By Ina Prodd, 30 June 2008

Tromp Pharmacy has recently reopened after a week-long strike by its six employees after a dispute over poor wage increases. But owner and local entrepreneur Terry Tromp now has an even bigger fight on his hands with regard to allegations of unethical methods of setting the marked prices of the medicines he sells. The Pharmaceutical Society of South Africa (PSSA) is investigating.

A recently dismissed employee, Magda Klaar, revealed to the *Woodvlei News* that Tromp would revalue all his stock of medicines on hand at the latest replacement costs even if old stock had been bought at lower prices.

“He then adds a 100% mark-up as well as VAT on that value. He collects R100 000 per month from customers who are forced to buy their medicines from him as there is no other pharmacy within 50 km of Woodvlei,” a disgruntled Klaar said.

Klaar’s allegations in the press also attracted the interest of SARS who have received no VAT payments from Tromp since the pharmacy was established six months ago.

Tromp told the *Woodvlei News* that he was “fed up” with all the trouble the pharmacy had caused him. “I operate several successful businesses in Woodvlei, and I should be able to charge whatever I want to for my goods. In addition to the rapidly increasing cost of my stock, the biggest expenses are petrol and wages. I am seriously considering closing this business down. This is a lot of nonsense,” he said.

REQUIRED

- 2.2.1 How would you respond to Terry’s comment in the last sentence about this is a lot of nonsense’? (3)
- 2.2.2 If you bought this business from Terry, what would you do differently? Explain two points that you would do differently and provide a reason for each point. (6)
- 2.2.3 Based on the information contained in this article, how much output VAT should Terry have declared to SARS? Provide a calculation to support your answer. (4)

2.2.4 Tromp Pharmacy is experiencing a cash flow problem and there is no money available to pay SARS. The bank account reflects an overdraft of R183 860 on 31 August 2008. You are the accountant, and the owner of Tromp Pharmacy approaches you to reduce the sales amount to an extent where the VAT input exceeds the VAT output so that the business receives a refund from SARS.

As the accountant will you go along with this suggestion? Motivate your response by providing two reasons for your decision.

(5)

(18)

[45]

QUESTION 3: 40 marks 25 minutes

(DoE Nov. 2009)

INVENTORY VALUATION, CONTROL AND VAT

3.1 INVENTORY VALUATION

Laser Stores sell television sets to the public. The financial year ends on 28 February 2009. They are unsure which method to use in valuing their stock. The cost price of the product has changed significantly during the current year.

The owner Larry Laser has decided to keep selling the same model of TV set (*Mabona* TV sets, Model XC456), despite the fact that other shops are selling newer models.

REQUIRED

3.1.1 Calculate the value of closing stock using the FIFO (first-in-first-out) method. (6)

3.1.2 Calculate the value of closing stock using the weighted average method. (7)

3.1.3 Which method of stock valuation would you advise the owner to use? Give a reason for your answer. (3)

3.1.4 Calculate the gross profit on TV sets for the year based on the stock valuation method you advised in QUESTION 3.1.3. (4)

[20]

INFORMATION

The following information appeared in the records of Laser Stores for the year ended 28 February 2009. The business used a fixed selling price of R16 000 per TV set.

| Information on stock of <i>Mabona</i> TV sets Model XC456 | Number of TV sets | Value per unit | Total value |
|--|----------------------|-------------------|-------------------|
| TV sets on hand on 1 March 2008 | 50 | R11 000 | R550 000 |
| TV sets bought during the year | 750 | | R8 090 000 |
| May 2008 | 300 | R12 000 | R3 600 000 |
| September 2008 | 250 | R11 560 | R2 890 000 |
| February 2009 | 200 | R8 000 | R1 600 000 |
| Subtotal | 800 | | R8 640 000 |
| TV sets sold during the year | 440 | R16 000 | R7 040 000 |
| TV sets on hand on 28 February 2009 | 360 | ? | ? |

3.2 CONTROL OF INVENTORY

Apart from TV sets, Laser Stores also sell other products. You are provided with information taken from their stock records on 28 February 2009. The owner Larry Laser is uncertain if he should be satisfied with control of all of these items.

REQUIRED

Comment on the stock control of each item, quoting figures to support your comment. In each case, offer Larry practical advice for the future.

[9]

INFORMATION

| Item | Number of units sold during the year | Number of units on hand per stock records at year-end | Number of units per physical count at year-end | Selling price per unit | Period of stock on hand |
|------------------------------|---|--|--|------------------------------|-------------------------------|
| <i>Mabona</i> TV sets | 440 | 360 | 360 | R16 000 | ? |
| <i>Khuluma</i> Cellphones | 2 250 | 150 | 100 | R1 200 | 15 days |
| <i>Lalela</i> Radios | 120 | 10 | 9 | R100 | 27 days |

3.3 VALUE-ADDED TAX

The following information was taken from the books of Laser Stores for February 2009. All goods bought and sold by Laser Stores are subject to 14% VAT

REQUIRED

Calculate the amount of VAT payable to/by SARS on 28 February 2009 and indicate whether the amount is payable to or receivable from SARS.

Show ALL workings. Ledger accounts for VAT are not required, but you may use this to arrive at your answer.

[11]

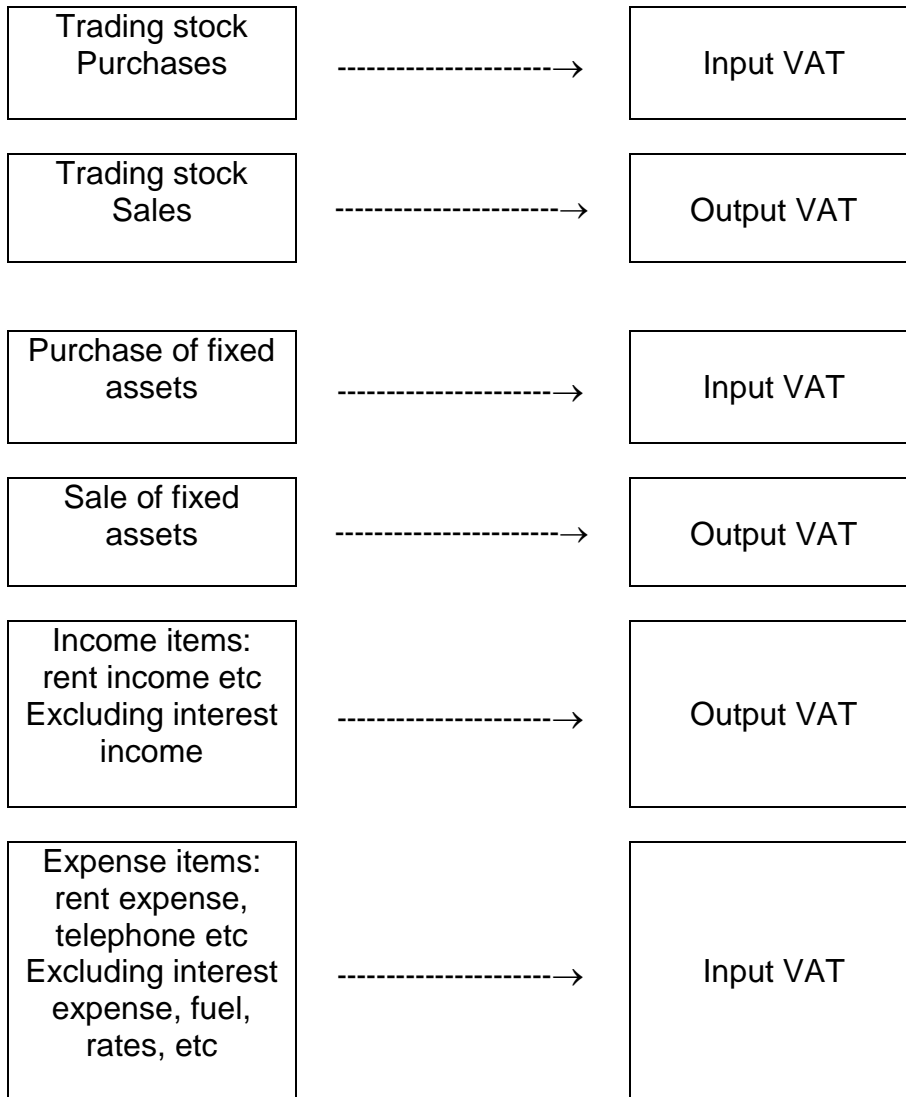
| INFORMATION: | 1.1 Excluding VAT | Including VAT |
|---|--------------------------|----------------------|
| Stock purchased by cheque | R1 760 000 | ? |
| Equipment purchased by cheque | R40 000 | R45 600 |
| Sales of goods for cash and on credit | ? | R930 240 |
| Goods returned by customers | R48 000 | R54 720 |
| Discount allowed to debtors on settlement of their accounts | R4 000 | ? |
| Drawings of stock by the owner | R24 000 | R27 360 |
| Bad debts | ? | R18 240 |

[40]

| |
|--|
| SECTION B: ADDITIONAL CONTENT NOTES |
|--|

| Terms | Description | Examples | | | | | | | | | | | | |
|------------------------|--|---|--------------|-------|--------|--------|-----|-------|--|--|--|--|--|--------------|
| <i>VAT</i> | Value-Added Tax (VAT) is a tax charged on the supply of goods or services by a vendor | Cash sales (excl VAT)= R400 VAT @ 14% = 56 Cash sales (Incl. VAT) = R456 | | | | | | | | | | | | |
| <i>VAT Vendors</i> | Vendors registered for VAT; are obliged to collect VAT from their customers or clients on behalf of the SARS. | Any business with a turnover of more than R300 000 a year must register as a VAT vendor. Vendors with a turnover of between R20 000 and R300 000 may apply for voluntary registration. | | | | | | | | | | | | |
| <i>VAT Input</i> | VAT Input is the VAT paid by the business to the supplier and can be claimed back from SARS. In other words it is the VAT paid on purchases. | Purchase price including VAT is R600.00 VAT charged is R73.68 (14%) Amount to be claimed from SARS is R73.68 | | | | | | | | | | | | |
| <i>VAT Output</i> | VAT Output is VAT that the business charges on goods and services to customers and it must be paid over to SARS. This is VAT collected on sales. | Selling price including VAT is R1 399.99 VAT charged is R171.93 (14%) Amount to be paid over to SARS is R171.93 | | | | | | | | | | | | |
| <i>VAT Control</i> | It is a summary of the VAT INPUT and VAT OUTPUT and shows whether the business owes SARS money or whether SARS owes the business money. | <table border="1"> <tr> <td>Input</td> <td>73.68</td> <td>Output</td> <td>171.93</td> </tr> <tr> <td>Bal</td> <td>98.25</td> <td></td> <td></td> </tr> <tr> <td></td> <td></td> <td></td> <td>Owed to SARS</td> </tr> </table> | Input | 73.68 | Output | 171.93 | Bal | 98.25 | | | | | | Owed to SARS |
| Input | 73.68 | Output | 171.93 | | | | | | | | | | | |
| Bal | 98.25 | | | | | | | | | | | | | |
| | | | Owed to SARS | | | | | | | | | | | |
| <i>Exempt supplies</i> | The law does not subject certain products or services to VAT at either the standard rate or zero rate. No VAT charged. | Interest, export services, childcare services, educational services and services provided by associations not for profit. VAT cannot be added to the price at all. | | | | | | | | | | | | |
| <i>Zero-rate</i> | Zero-rated items are goods or services that are taxed at a rate of 0%. VAT is charged at a rate of 0%. | Brown bread, milk, maize products, rice, lentils, dried beans, legumes, fruit, vegetables, milk, milk powders, cooking oil, eggs, canned pilchards and paraffin. The Minister of Finance can adjust the percentage at any time. | | | | | | | | | | | | |

Remember:



FORMATS OF THE THREE VAT LEDGER ACCOUNTS

| Dr | | | | | | VAT Output | | | | | | N6 | | Cr | |
|-----|----|-----------------|-----|-----|---|------------|----|-----------------|-----|-----|---|----|--|----|--|
| May | 31 | Debtors Control | DAJ | XXX | - | May | 31 | Bank | CRJ | XXX | - | | | | |
| | | Bad Debts | GJ | XXX | - | | | Debtors Control | DJ | XXX | - | | | | |
| | | VAT Control | GJ | XXX | - | | | Drawing | GJ | XXX | - | | | | |
| | | | | XXX | - | | | | | XXX | - | | | | |
| | | | | | | | | | | | | | | | |

| VAT Input | | | | | | N7 | | | | | | | | | |
|-----------|----|-------------------|-----|-----|---|-----|----|-------------------|-----|-----|---|--|--|--|--|
| May | 31 | Bank | CPJ | XXX | - | May | 31 | Creditors Control | CAJ | XXX | - | | | | |
| | | Creditors Control | CJ | XXX | - | | | VAT Control | GJ | XXX | - | | | | |
| | | Petty Cash | PCJ | XXX | - | | | | | | | | | | |
| | | | | XXX | - | | | | | XXX | - | | | | |
| | | | | | | | | | | | | | | | |

| VAT Control Account | | | | | | B9 | | | | | | | | | |
|---------------------|----|-----------|-----|-----|---|------|----|------------|-----|-----|---|--|--|--|--|
| May | 31 | VAT Input | GJ | XXX | - | May | 31 | VAT Output | GJ | XXX | - | | | | |
| | 31 | Balance | c/d | XXX | - | | | | | | | | | | |
| | | | | XXX | - | | | | | XXX | - | | | | |
| | | | | | | June | 1 | Balance | b/d | XXX | - | | | | |
| | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | |

Learner Note: From the above you can see the importance of understanding your concepts of VAT. As you attempt the homework, you need to ensure that you are able to answer the questions in the allocated time frames. If you get stuck, you should refer either to the additional notes or your class teacher.

SECTION C: HOMEWORK

QUESTION 1: **30 marks** **20 minutes** (*DoE Exemplar 2008*)

VALUE ADDED TAX

Manzini Stores, owned by Ivy Manzini, is registered for VAT under Category B (the invoice basis) on a one-month period. The business also only deals with other VAT-vendors.

You have been provided with the information from the journals for August 2008.

REQUIRED

- 1.1 What is meant by 'Value Added Tax' and at what rate is VAT is calculated? (2)
- 1.2
 - 1.2.1 Calculate the VAT Output amount from the CRJ. (2)
 - 1.2.2 Calculate the VAT Input amount from the CPJ. (3)
 - 1.2.3 Calculate the VAT Output amount from the DJ (3)
- 1.3 Ivy is unsure how her bookkeeper should enter the VAT amounts in the ledger. Indicate to her how the VAT totals of the following journals will be posted to the General Ledger:
 - CRJ
 - CPJ
 - DJ
 - GJ (12)
- 1.4 Calculate the amount of VAT to be paid over to SARS in respect of August 2008 (4)
- 1.5 Ivy does not have enough money in her bank account to pay SARS for the VAT. The bank balance is currently in overdraft at approximately R50 000. What advice would you offer her in order to:
 - Solve the problem now?
 - Solve the problem in the future? (4)

INFORMATION FROM THE JOURNALS**1 1. Cash Receipts Journal**

- Total of Sales column R942 000
- Total of Debtors control column R420 000
- Total of Sundry accounts column Nil
- Total of VAT Output column R ?

2 Cash Payments Journal

- Total of Trading stock column R248 000
 - Total of Creditors control column R494 000
 - Total of Sundry accounts column (all Equipment) R580 000
- Note that Equipment is subject to VAT.

3 Debtors Journal

- Goods were sold on credit for R397 860 including VAT.

4 Debtors Allowance Journal

- Total of VAT Output column R6 930

5 Creditors Journal

- Total of VAT Input column R58 170

6 Creditors Allowances Journal

- Total of VAT Input column R7 210

7 General Journal

- 7.1 The owner took stock at cost price, R9 000, for personal use. The VAT on this item is R1 260.
- 7.2 A debtor D Dodge has disappeared. Write off his debt of R4 560 as irrecoverable. All items sold to D Dodge were subject to VAT of R560.

[30]

SECTION D: SOLUTIONS AND HINTS TO SECTION A

QUESTION 1

1.1 **Output VAT** - Output VAT is charged on goods sold ✓✓

Input VAT - Input VAT is charged on goods bought ✓✓ (4)

1.2 VAT = 14% ✓✓ (2)

1.3 No ✓

VAT is charged on zero-rated items at 0% ✓✓

VAT is not charged on VAT exempted items ✓✓ (5)

1.4 Output Vat R880 800 ✓ x 14/100 ✓ = R123 326,00 ✓

Input VAT R415 500 ✓ + R65 000 ✓ =

R480 500 ✓ x 14 / 114 ✓

= R59 008,77(8) ✓

OR = R51 026,32 + R7 982,46

Amount payable to SARS = Output – Input

= R64 317,23 ✓✓ (10)

1.5 No, he should not accept the offer ✓

Any valid explanation including the ethical aspect ✓✓✓

Possible explanation

It is unethical to accept offers like this, as it is obvious that Sneaky Stores will then not record this as a Sale and, therefore, not be reflecting the real Sales totals to SARS. The reputation of Gummy Stores is at stake. (4)

[25]

QUESTION 2

2.2.1 Continuous (perpetual): stock figures are updated continuously

OR stock deficits identified easily and quickly. ✓✓

Periodic: stock figures are not updated and can only be determined by taking stock

OR cannot detect deficits. ✓✓ (4)

2.2.2 Value of closing stock on 29 February 2008

$$(55\ 600 \checkmark + 747\ 500 \checkmark - 7\ 000 \checkmark + 28\ 500 \checkmark) / (100 \checkmark + 1150 \checkmark - 10 \checkmark)$$

$$\checkmark \quad \checkmark$$

$$= 824\ 600 / 1\ 240$$

$$= 665 \checkmark \times 130 \checkmark$$

$$= R86\ 450 \checkmark$$

(12)

Gross Profit for the year ended 29 February 2008

| Trading account | | | | | |
|-----------------------|---|-----------|---------------|---|-----------|
| Opening stock | ✓ | 55 600 | Sales | ✓ | 1 215 450 |
| Purchases | ✓ | 740 500 | Closing stock | ☑ | 86 560 |
| Carriage on purchases | ✓ | 28 500 | | | |
| Profit and loss (GP) | ☑ | 477 300 | | | |
| | | 1 310 900 | | | 1 310 900 |

OR

CALCULATION:

$$1\ 215\ 450 \checkmark - (55\ 600 \checkmark + 740\ 500 \checkmark + 28\ 500 \checkmark) + 86\ 450 \checkmark$$

$$= 477\ 300 \checkmark$$

(6)

$$2.1.3 \quad 90 \times 725 = 65\ 250 \checkmark \checkmark$$

$$40 \times 675 = 27\ 000 \checkmark \checkmark$$

$$65\ 250 + 27\ 000$$

$$= 92\ 250 \checkmark$$

(5)

2.2.1 Excellent answer = 3 marks; Good/Satisfactory = 2 marks; Poor = 1; Incorrect = 0

Expected responses, e.g.

He owns the sole pharmacy in the area. He should be properly serving all the stakeholders (i.e. customers, community, employees, SARS) otherwise his business is not sustainable.

(3)

2.2.2 Point 1: ✓ Reason: ✓✓ Point 2: ✓ Reason: ✓✓

Excellent point & reason = 3 marks; Good/Satisfactory = 2 marks; Poor = 1;
Incorrect = 0

Expected responses – any two, e.g.:

- Establish a code of ethics for the business covering relationships with customers, expectations of conduct regarding staff members – engenders the confidence of the community
- Use a more responsible method of valuing stock and setting prices, e.g. FIFO with prices set accordingly; and use a more reasonable MU% - so that pricing is fair – generate goodwill
- Obey the law e.g. pay VAT when it is due – to avoid legal issues and avoid penalties

(6)

2.2.3 ✓ ✓ ✓ reasonableness

$14/114 \times R100\,000 \times 6 \text{ months} = R73\,684,21$

(4)

2.2.4 No ✓

Any two valid reasons ✓✓ ✓✓

Possible reasons:

- This is tax fraud
- It will be detected by SARS when a VAT audit is done
- Every claim for VAT input & output must be supported with documentation
- Risk of being prosecuted for tax fraud as this is a serious offence.
- The company could be charged penalties and interest and in addition fined or imprisoned

(5)

[45]

QUESTION 3

3.1.1 200 x R8 000 = R1 600 000 ✓✓

160✓ x R11 560✓ = R1 849 600 ✓

R3 449 600 *

(6)

3.1.2 WA value per unit = R8 640 000 ✓ / 800 ✓

= R10 800 ✓

Value of closing stock = 360 ✓✓ x R10 800 see above

= R3 888 000 *

OR 8 640 000 ✓✓ / 800 ✓✓ x 360 ✓✓ = R3 888 000

(7)

3.1.3 Possible answers

Decision ✓ Reason ✓✓

FIFO because TV sets are discrete units and it is easy to identify the cost price of each TV set.

OR

Weighted average method because the gross profit will be higher or there is no need to track the cost price on each TV set. (3)

3.1.4 Either based on FIFO:

$$R7\,040\,000 - (R8\,640\,000 - R3\,449\,600) = R1\,849\,600$$

OR based on Weighted Average:

$$R7\,040\,000 - (R8\,640\,000 - R3\,888\,000) = R2\,288\,000$$

To mark this:

✓

✓*

(Answer to 5.1.1 or 5.1.2) – R1 600 000 = Gross profit (4)

3.2 Each comment: one mark; quoting figures: one mark; advice: one mark.

| Stock item | Comment and advice |
|-------------------------------|--|
| <i>Mabona</i> TV sets | The stock is not selling well because new models are on the market. Too much stock on hand (360 units) compared to stock sales for the year (440 units). <i>Advice:</i> Reduce the price to clear the stock (cost is now R8 000) and stock new models. ✓✓✓ |
| <i>Khuluma</i> Cell phones | The cell phones are selling well (2 250 sold) and the stock is relatively low (15 days). The control of stock is a problem (50 cell phones missing). <i>Advice:</i> Institute procedures to safeguard the stock e.g. special cabinets with one person controlling the keys. ✓✓✓ |
| <i>Lalela</i> Radios | The radios are not selling well (only 10 per month) and they are low-profit items (R100 selling price). <i>Advice:</i> Discontinue selling the radios. It is not worth it. ✓✓✓ (9) |

3.3 ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓

$$R246\ 400 + 5\ 600 + 6\ 720 + 2\ 240 + 560 - (R114\ 240 + 3\ 360) = R143\ 920$$

OR

$$\text{Input VAT} = 246\ 400 + 5\ 600 = R252\ 000$$

$$\text{Output VAT} = 114\ 240 - 6\ 720 - 560 + 3\ 360 - 2\ 240 = R108\ 080$$

$$\text{Difference} = R143\ 920$$

VAT CONTROL

| | | | |
|------------------------------|------------------|-------------------------|-------------------|
| Bank (Purchases) | ✓ 246 400 | Bank & Debtors' control | ✓ 114 240 |
| Bank (Equipment) | ✓ 5 600 | Sundry account | ✓ 3 360 |
| Debtors' control (Returns) | ✓ 6 720 | Balance c/d | ✓✓ 143 920 |
| Sundry account (2 240 + 560) | ✓✓ 2 800 | | |
| | 261 520 | | 261 520 |
| Balance b/d | 143 920 | | |

The amount is owed by SARS to Laser Stores ✓✓

(11)

[40]

TOPIC 2: INVENTORY VALUATION AND NON CURRENT ASSETS**SECTION A: TYPICAL EXAM QUESTIONS****Learner Note:**

- Always answer in point form
- Make sure you that you show calculations to earn part marks
- Open ended questions do not have one correct answer

QUESTION 1: **33 marks** **20 minutes** *(GDE Prep. Exam 2008)*

INVENTORY (STOCK) VALUATION

The following information was extracted from the accounting records of Goodie2Shoes.

INFORMATION

Goodie2Shoes buys and sells one type of shoes. The business uses the periodic inventory system and the weighted average method of valuing inventory.

Inventory (Stock):

- 145 pairs were on hand at R180 per pair on 1 August 2009.
- 125 pairs were purchased at R210 per pair on 7 August 2009.
- One of the suppliers was having a sale. Purchased 100 pairs for R11 000 on 20 August 2009.
- 110 pairs were imported at R230 per pair on 26 August 2009. Import duties paid was R3 610.
- 140 pairs were on hand on 31 August 2009.

Shoes are sold at R400 per pair.

REQUIRED

- 1.1 Calculate the weighted average value per unit on 31 August 2009. (9)
- 1.2 Calculate the value of the inventory (stock) on hand on 31 August 2009. (Round off to the nearest Rand.) (3)
- 1.3 Draw up the trading account to determine the gross profit for the month ended 31 August 2009. (9)

- 1.4 The owner, Bongi Modiba, wants to sell her business. She approached you as the accountant of Goodie2Shoes and requested that you change their inventory (stock) valuation method to the FIFO method to create a higher profit and a higher closing inventory for the business to enable her to sell the business at a much higher price.
- 1.4.1 Calculate the value of the inventory (stock) on hand on 31 August 2009 by using the FIFO inventory (stock) valuation method. (7)
- 1.4.2 Will it be ethical for Bongi Modiba to change the inventory (stock) valuation method? Provide TWO reasons to support your answer. (5)
- [33]

QUESTION 2: **30 marks** **25 minutes** (*DoE Exemplar 2 2008*)

INVENTORIES

You are provided with information relating to Dean's Sport, a small business owned by Dean, that sells one type of soccer ball to spectators who attend soccer matches.

The business uses the periodic stock system. He sells the soccer balls for R120 each, although the cost price has been changing over the months. He has always made use of the FIFO method for valuing his stock.

REQUIRED

- 2.1 Calculate the value of the closing stock using the **FIFO** method. (7)
- 2.2 Calculate the gross profit made on the stock if the **FIFO** method is used. (7)
- 2.3 Dean has been told that he would make a larger gross profit if he used the **weighted average method** of valuing his stock. However, he feels it will make no difference to the overall profits of the business over a period of time. Do you agree? Explain your answer. You are not required to make any calculations. (4)
- 2.4 Dean is concerned, as the Gross Profit has decreased from last year. Discuss one possible reason for this based on the information given to you and provide a possible solution to this problem. (6)
- 2.5 Dean heard from a friend of his who did accounting at school that he should use the perpetual stock system instead of the periodic system. He is confused and has asked you for advice in this matter. Explain to him the difference and give him advice on which method he should use. (6)

INFORMATION

Dean has given the following information to you on all his purchases and sales over the last 3 months.

| | Number of soccer balls | Unit price | Total |
|---|-------------------------------|-------------------|--------------|
| Opening stock 1 June 2008 | 30 | R40 | R1 200 |
| Total purchases: | 60 | | R3 800 |
| June 2008 | 20 | R55 | R1 100 |
| July 2008 | 25 | R60 | R1 500 |
| August 2008 | 15 | R80 | R1 200 |
| Sales of soccer balls: June – August 2008 | 70 | | |

[30]

QUESTION 3: 35 marks 30 minutes*(DoE Nov. 2008)***FIXED ASSETS AND INTERNAL CONTROL**

You are provided with information in respect of Bloemfontein Hardware for the year ended 29 February 2008. The business is owned by Mike Moore and Milly Miles.

REQUIRED

- 3.1 Prepare the Asset Disposal Account for office equipment (computers) stolen on 30 June 2007 (see information 1 below). (12)
- 3.2 One of the office employees, Di Vulge, knows that the insurance policy only covers theft if there is evidence of forced entry. She also knows that Mike broke the security gate of the office to make the incident look like forced entry. She is not sure if Milly knows about this.
What advice would you give Di? Explain ONE point. (3)
- 3.3 Explain how and why the Fixed Assets Register will assist the internal auditor in his duties. (3)
- 3.4 In order to solve their cash flow problems, Mike has sold a portion of the premises at cost price. Milly disagrees with him on this.
Do you support Milly's opinion? Give a reason. (3)

3.5 The business owns three delivery vehicles. Refer to the information in respect of each delivery vehicle from the Fixed Asset Register (see information 4 below).

- Identify the cost price of delivery vehicle 3. (3)
- Explain why delivery vehicle 2 is shown at a book value of R1,00 (one rand). (2)

3.6 As a service to their customers, the business delivers goods within Bloemfontein. They charge a flat rate of R250 per delivery. Clients pay cash directly to the drivers. A total of 3 680 deliveries was done during the year. The delivery service operated on 260 days during the year.

You are the internal auditor and you are concerned about possible problems relating to the delivery vehicles and their drivers.

Refer to the information in point 4 below. Identify and explain ONE major problem relating to each delivery vehicle or its driver. Quote figures from the information to support your answer. Provide a valid solution to each problem. (9)

INFORMATION

1. Office equipment and disposals:

Office equipment includes the office computers. Six of the office computers were stolen on 30 June 2007. These six computers were originally bought at a cost price of R13 200 each. The insurance company, Ace Insurers, only paid out R5 000 for each computer. These computers were replaced at a higher price on 31 August 2007

2. Delivery vehicles:

The business owns three delivery vehicles that they use to generate their income.

3. Information from the financial statements for year ended 29 February 2008:

| FIXED ASSETS | Land & buildings | Office equipment | Vehicles |
|-------------------------------------|-----------------------------|-------------------------|-----------------|
| Carrying value at beginning of year | 1 200 000 | 630 000 | 403 501 |
| Cost | 1 200 000 | 980 000 | 699 000 |
| Accumulated depreciation | | (350 000) | (295 499) |
| | | | |
| Movements | (700 000) | 19 560 | (111 000) |
| Additions | | 240 000 | |
| Disposals at carrying value | (700 000) | (63 360) | |
| Depreciation | | (157 080) | (111 000) |
| | | | |
| Carrying value at end of year | 500 000 | 649 560 | 292 501 |
| Cost | 500 000 | 1 140 800 | 699 000 |
| Accumulated depreciation | | (491 240) | (406 499) |

4. Information from the Fixed Assets Register and the accounting records on 29 February 2008:

| Fixed Assets Register | Delivery vehicle 1 | Delivery vehicle 2 | Delivery vehicle 3 |
|------------------------------|---------------------------|---------------------------|---------------------------|
| Date purchased | 1 April 2007 | 1 January 1999 | 1 April 2005 |
| Cost price of vehicle | R315 000 | R144 000 | ? |
| Accumulated depreciation | R94 500 | R143 999 | R168 000 |
| Carrying value | R220 500 | R1 | R72 000 |

| Information from the accounting records | Delivery vehicle 1 | Delivery vehicle 2 | Delivery vehicle 3 |
|--|--------------------|--------------------|--------------------|
| Name of driver | <i>Solly</i> | <i>Themba</i> | <i>Goldie</i> |
| Number of days worked | 210 days | 260 days | 260 days |
| Number of deliveries done | 280 deliveries | 2 100 deliveries | 1 300 deliveries |
| Cash paid in by drivers | R70 000 | R525 000 | R275 000 |
| Salary paid to drivers | R52 000 | R52 000 | R52 000 |
| Fuel and maintenance costs for the year | R36 400 | R430 500 | R201 500 |
| Fuel and maintenance costs per kilometre | R1,30 | R2,05 | R1,55 |

[35]

SECTION B: ADDITIONAL CONTENT NOTES

STOCK VALUATION

As a result of changing prices and inflation as well as other economic factors, the actual value of stock changes all the time. Thus a business is faced with the dilemma of deciding what the correct value of stock on hand should be. It is apparent from what we already know, that the value of stock will determine our cost of sales which, in turn, will have an impact on the gross profit as well as the net profit of the business. Therefore, stock valuation plays an important role in determining the true financial performance of the business. The value of stock on hand is also reflected in the notes to the financial statements, and has an impact on the current assets of the business, therefore, playing an important role in establishing the financial position of the business as reflected in the Balance Sheet. Valuation of stock is also important for manufacturing concerns in terms of determining the cost of raw materials used when determining the cost of production.

Consider the following situation:

During the financial year, an enterprise paid different prices for various stock purchases. Only a portion of the stock purchased will be left at the end of the financial period. A decision has to be taken as to which of the various prices paid for the stock purchased during the year, must be regarded as the purchase price for those items still on hand.

Methods of determining stock value

When adopting a method to determine the cost price of the stock still on hand, the wisest choice would be that method which can facilitate the most realistic determination of profits for any specific business.

The four methods most generally used to determine cost price of stock on hand at the end of the financial period are:

- ♦ Specific identification method
- ♦ Weighted average method
- ♦ First-in-first-out method (FIFO)
- ♦ Last-in-first-out method (LIFO)

Please note: At school level we will be working with FIFO and the weighted average method.

FIFO means that the stock that was purchased first is sold first. Hence it can be deduced that the stock left over at the end of the year should consist of those items that were purchased most recently.

The above point can be illustrated by the following example:

• Information

Transactions concluded in respect of a particular stock item:

Feb

| | | |
|----|----------------------|------------------------------|
| 1 | Stock on hand | 60 units @ R7.50 per unit |
| 3 | Sales | 40 units |
| 5 | Received | 90 units @R8.00 per unit |
| 18 | Sales | 50 units |
| 27 | Returned to supplier | 15 units (received on 5 Feb) |

Calculation of stock at the end of February

| FIFO METHOD | | | | | | | | | | Total stock |
|-------------|--------------------|-------|----------|---------------|-------|--------|----------|-------|--------|----------------|
| Date | Purchased / Bought | | | Cost of Sales | | | Balance | | | |
| Feb | Quantity | Price | Amount | Quantity | Price | Amount | Quantity | Price | Amount | |
| 1 | | | | | | | 60 | 7.50 | 450.00 | 450.00 |
| 3 | | | | 40 | 7.50 | 300.00 | 20 | 7.50 | 150.00 | 150.00 |
| 5 | 90 | 8.00 | 720.00 | | | | 20 | 7.50 | 150.00 | |
| | | | | | | | 90 | 8.00 | 720.00 | *870.00 |
| 18 | | | | *20 | 7.50 | 150.00 | | | | |
| | | | | *30 | 8.00 | 240.00 | 60 | 8.00 | 480.00 | 480.00 |
| 27 | (15) | 8.00 | (120.00) | | | | 45 | 8.00 | 360.00 | 360.00 |

Take Note:

- 1st Opening balance 60 units @ 7.50
- 3rd 60 units – 40 units sold = 20 units @ 7.50
- 5th – 20 units @ 7.50 old stock + 90 units @ 8.00 new stock
- 18th – 50 units were sold of which the first 20 units were from the stock that came in first @7.50 and the remainder 30 units were from the stock that came in on the 5th @ 8.00. Therefore, the remaining stock is 60 units (90 – 30) @ 8.00.
- 27th 15 units @ 8.00 were returned; therefore, the balance is 45 units @ 8.00.

NON CURRENT ASSETS

Steps to be followed when recording the disposal of a fixed asset:

➤ **Step 1**

Calculate and record the depreciation on the asset sold. (This does not apply if the asset was sold at the beginning of the year).

Dr Depreciation

Cr Accumulated depreciation

➤ **Step 2**

Transfer the asset sold to the Asset Disposal account. (Use the cost price of the asset).

Dr Asset disposal

Cr Asset account

➤ **Step 3**

Transfer the total accumulated depreciation on that asset to the Asset Disposal account. **# Total accumulated depreciation = Accumulated depreciation at the beginning of the year on that asset + the depreciation calculated as in step 1.**

Dr Accumulated depreciation

Cr Asset disposal

➤ **Step 4**

Record the sale / disposal of the asset. Use the selling price or the price obtained for the asset.

If for cash then: Dr Bank
 Cr Asset disposal

If on credit then: Dr Debtors control
 Cr Asset disposal

If a trade-in then: Dr Creditors control
 Cr Asset disposal

➤ **Step 5**

Determine whether there is a profit or a loss on the disposal of the asset.

If selling price > carrying value = Profit on sale of asset

DR Asset disposal

CR Profit on sale of asset

If selling price < carrying value = Loss on sale of asset

DR Loss on sale of asset

CR Asset disposal

NB: Thereafter, depreciation on the remainder of the fixed assets should be calculated, if the information is to be completed for the year-end.

Fixed Asset account

| | | | | | |
|------------------------|-----|------|----------------|-----|------|
| Balance | B/d | xxxx | Asset disposal | GJ | xxxx |
| Bank/Debtors/Creditors | | xxxx | Balance | C/d | xxxx |
| | | xxxx | | | xxxx |
| Balance | B/d | xxxx | | | |
| | | | | | |

Accumulated depreciation account

| | | | | | |
|----------------|-----|------|--------------|-----|------|
| Asset disposal | GJ | xxxx | Balance | B/d | xxxx |
| | | | Depreciation | GJ | xxx |
| Balance | C/d | xxxx | Depreciation | | xxxx |
| | | xxxx | | | xxxx |
| | | | Balance | B/d | xxxx |

Nominal section Asset disposal account

| | | | | | |
|-------------------------|----|------|--------------------------|----|------|
| Fixed asset | GJ | xxxx | Accumulated depreciation | GJ | xxxx |
| Profit on sale of asset | | xxxx | Bank/Debtors/Creditors | | xxxx |
| | | | Loss on sale of asset | | xxxx |
| | | xxxx | | | xxxx |
| | | | | | |

Depreciation account

| | | | | | |
|--------------------------|----|------|-----------------|----|------|
| Accumulated depreciation | GJ | xxxx | Profit and loss | GJ | xxxx |
| Accumulated depreciation | GJ | xxxx | | | |

Learner Note: From the above you can see the importance of understanding your concepts of non-current assets and stock valuation. As you attempt the homework, you need to ensure that you are able to answer the questions in the allocated time frames. If you get stuck, you should refer either to the additional notes or your class teacher.

| |
|----------------------------|
| SECTION C: HOMEWORK |
|----------------------------|

QUESTION 1: 40 marks 24 minutes

(DoE Nov. 2009)

INVENTORY VALUATION AND CONTROL

You are provided with information relating to Banyana Traders, owned by David Hambeck, for the financial year ended 28 February 2009. The business is situated in Johannesburg.

David buys and sells soccer balls and jerseys. The business uses the periodic inventory system.

The soccer balls are bought from South African suppliers, and the soccer jerseys of different clubs and countries are imported from overseas.

David employs salespersons to control each item of stock:

- James controls and sells the soccer balls
- Cyril controls and sells the soccer jerseys

David has decided on the following accounting policies for valuing inventory:

- Soccer balls – Weighted-average method
- Soccer jerseys – First-in-first-out method (FIFO)

REQUIRED

- 1.1 Although this business has done well, David is considering closing it down and investing his capital in fixed property. State TWO points that he should consider before making a final decision. (4)
- 1.2 David suspects that a number of soccer balls have been shoplifted. Calculate the number of soccer balls stolen. (5)
- 1.3 Use the relevant information to calculate the closing stock value of:
- Soccer balls (using the weighted-average method)
 - Soccer jerseys (using the FIFO method)
- Show your workings to earn part-marks. (11)
- 1.4 Calculate the following for soccer jerseys (you may prepare a Trading Account to calculate these figures):
- Cost of sales (5)
 - Mark-up % on cost (4)
 - Stock turnover rate (5)

- 1.5 If David decides to continue with this business, what advice would you offer him? State TWO points and quote financial indicators or specific information from the question to support your answer. (6)

INFORMATION

1. Inventories:

The stocks were valued as follows at the beginning and end of the financial year:

| Date | Soccer balls | | | Soccer jerseys | | |
|----------|--------------|----------|-------------|----------------|----------|-------------|
| | No. of units | Per unit | Total value | No. of units | Per unit | Total value |
| 01/03/08 | 1 200 | R120 | R144 000 | 520 | R320 | R166 400 |
| 28/02/09 | 900 | ? | ? | 250 | ? | ? |

2. Purchases:

During the financial year ended 28 February 2009, the following stock items were purchased:

| Date of purchases | Soccer balls | | | Soccer jerseys | | |
|-------------------|--------------|----------|-----------------|----------------|----------|-----------------|
| | No. of units | Per unit | Total value | No. of units | Per unit | Total value |
| 31/03/08 | 1 300 | R120 | R156 000 | 400 | R200 | R 80 000 |
| 30/06/08 | 900 | R150 | R135 000 | 600 | R225 | R135 000 |
| 30/09/08 | 1 000 | R175 | R175 000 | 1 400 | R255 | R357 000 |
| 02/01/09 | 200 | R180 | R 36 000 | 100 | R300 | R 30 000 |
| Totals | 3 400 | | R502 000 | 2 500 | | R602 000 |

3. Carriage on purchases:

During the year, the business paid a total of R30 200 to transport soccer balls to the shop. The price of the soccer jerseys includes carriage.

4. **Sales:**

| Items | Details | Total |
|----------------|--------------------------|------------|
| Soccer balls | 3 500 units at R320 each | R1 120 000 |
| Soccer jerseys | 2 770 units at R400 each | R1 108 000 |

5. **Financial indicators:**

| Items | Mark-up % on cost | Stock turnover rate |
|----------------|-------------------|---------------------|
| Soccer balls | 48,5% | 3,9 times p.a. |
| Soccer jerseys | ? | ? times p.a. |

[40]

SECTION D: SOLUTIONS AND HINTS TO SECTION A**QUESTION 1**

$$\begin{array}{rclcl}
 1.1 & 145 & \times & R180 & = & R26\,100 & \checkmark \\
 & 125 & \times & R210 & = & R26\,250 & \checkmark \\
 & 100 & \times & R110 & = & R11\,000 & \checkmark \\
 & 110 & \times & R230 & = & R25\,300 & \checkmark \\
 & \underline{\quad} & & \text{Import duties} & = & \underline{R\,3\,610} & \checkmark \\
 & 480 & & & = & R92\,260 &
 \end{array}$$

$$\begin{array}{r}
 \underline{R92\,260} \checkmark \\
 480 \checkmark
 \end{array}$$

$$= R192,21 \checkmark \square \quad (9)$$

1.2 *As per 6.1*

$$140 \checkmark \times R192,21 \square$$

$$= R26\,909 \square$$

Give method mark for operation if one of components is correct. (3)

1.3

| TRADING ACCOUNT | | | | | | | | | |
|-----------------|----|-----------------------------|----|-----------|-------------|----|--------------------------------|----|-------------------|
| 2009 Aug | 31 | Opening inventory | GJ | ✓ 26 100 | 2009 Aug | 31 | (480 – 140 x R400) Sales | GJ | ✓✓☑ 136 000 |
| | | Purchases * ¹ | GJ | ✓☑ 62 550 | | | Closing inventory | GJ | ☑ 26 909 |
| | | Import duties | GJ | ✓ 3 610 | | | | | <i>As per 6.2</i> |
| | | Profit & loss | GJ | ☑ 70 649 | | | | | |
| | | <i>Balancing figure</i> | | 162 909 | | | | | 162 909 |

*¹ R26 250 + R11 000 + R25 300

(9)

1.4

$$1.4.1 \quad 110 \times R230 = R25\,300 \quad \checkmark\checkmark$$

$$\text{Import duty} \quad R3\,610 \quad \checkmark$$

$$\frac{30}{140} \times R110 = \frac{R\,3\,300}{R32\,210} \quad \checkmark\checkmark$$

$$= R32\,210 \quad \checkmark\checkmark$$

Give method mark for operation if one of components is correct.

(7)

1.4.2 Unethical ✓

Reasons:

Two reasons – 2 marks each ✓✓ ✓✓

Good = 2 Satisfactory = 1 Incorrect = 0

Misrepresentation of actual profit and value of inventory to mislead prospective buyers – cannot be done without disclosing it in financial statements. ✓✓

Must apply in writing to SARS stating reason for change – SARS will not accept change to increase value of assets and profits to ensure higher selling price – any changes must also be disclosed in financial statements. ✓✓

(5)

[33]

QUESTION 2

2.1

| | | | |
|-------------|---|----------------|-----|
| 90 – 70 | = | 20 balls | |
| 15 ✓ x 80 ✓ | = | R1 200 ✓ | |
| 5 ✓ x 60 ✓ | = | <u>R 300</u> ✓ | |
| 20 | | R1 500 ✓ | (7) |

2.2

| Trading account | | | |
|--------------------|-------|-----------------|-------|
| Opening stock ✓ | 1 200 | Sales ✓✓ | 8 400 |
| Purchases ✓ | 3 800 | Closing stock ☑ | 1 500 |
| Profit and loss ☑☑ | 4 900 | | |

OR CALCULATION:

$$8\ 400\ \checkmark\checkmark - (1\ 200\ \checkmark + 3\ 800\ \checkmark + -\ 1\ 500\ \checkmark) = R4\ 900\ \checkmark\checkmark \quad (7)$$

2.3 YES. ✓ Closing stock of one year becomes the opening stock of the next year. Therefore, over a period of time the overall profit will balance out. ✓✓✓ (4)

2.4 *Good explanation and quoting appropriate figures* = 6

Good explanation = 5 *Reasonable* = 3 *Poor* = 1 *Incorrect* = 0

Possible answer:

The selling price per soccer ball has remained the same (R120) but the cost price of the soccer balls has increased from R40 to R80. Therefore, less profit is being made. Mark-up % was 200% on the opening stock but only 50% on the purchases for August. (6)

2.5 Continuous (perpetual): stock figures are updated continuously **OR** stock deficits identified easily and quickly. ✓✓

Periodic: stock figures are not updated and can only be determined by taking stock **OR** cannot detect deficits. ✓✓

Any one valid measure ✓✓ *Possible answer*

It is easy to determine the cost price of the soccer balls and to detect theft and, therefore, it will be advisable to use the perpetual system (6)

[30]

QUESTION 3

3.1

| ASSET DISPOSAL | | | | | | | |
|----------------|----|-------------|-----------|------|----|--------------------------------------|-------------|
| June | 30 | Equipment ✓ | ✓✓ 79 200 | June | 30 | Accu Depr on Equip ✓ | ✓☑# 15 840 |
| | | | | | | * Bank ✓ | ✓✓ 30 000 |
| | | | | | | * Loss on disposal/theft of assets ✓ | ✓☑\$ 33 360 |
| | | | 79 200 | | | # Any figure \$ Inspection | 79 200 |

* If these two entries are combined to debit Insurance Claim/Debtors/the Loss account/Suspense, then 2 marks for relevant details and 4 marks for R63 360. (12)

3.2 Any one valid point provided it is ethical e.g. ✓✓✓

Excellent = 3 Good = 2 Satisfactory = 1 Unethical = 0

- She should take the morally and ethically correct action – advise Mike not to lay the insurance claim.
- Advise/find out if Milly knows about Mike's dishonesty – affects partners' relationship in the business
- Consider whistle-blowing issues – e.g. should she speak to Mike / advise Mike first / inform the partner or the insurance company (3)

3.3 Any valid response e.g. ✓✓✓

Excellent = 3 Good = 2 Satisfactory = 1 Incorrect = 0

- Assists internal control – he can check the physical existence of the assets and compare these to the register which must agree with the ledger – he will then be sure that all fixed assets are accounted for.
- Could see the complete history / life-span of the assets & their depreciation – for valuation of the asset & financial reporting. (3)

3.4 Yes ✓ Any valid reason ✓✓

Reasons for Yes:

- This will affect the operations of the business in future.
- Property is a growing investment which will appreciate in future – they should have sold it at a lot more than cost price / market value.
- The property should rather have been kept and a mortgage loan should have been taken out.

OR

No ✓ Any valid reason ✓✓

Reasons for No:

- If the property is not being properly utilised or is situated in an area where there is no appreciation in property values

Do not accept solving of cash flow problem as a reason (3)

$$3.5 \quad \checkmark \quad \checkmark \quad \checkmark$$

$$R699\ 000 - (R315\ 000 + R144\ 000) = R240\ 000$$

$$\text{OR } R168\ 000 + R72\ 000 = R240\ 000$$

The delivery vehicle is very old and has been fully depreciated, but the business must reflect it at a value in the books / The vehicle is still in use and has not reached the end of its life-span although full depreciated

✓✓ *part-marks may be given***Do not accept accu depr of R143 999 as an answer.** (5)3.6 **Delivery vehicle 1:** Any valid problem identified ✓ Quoting of relevant figure ✓*Possible responses:*

- The driver has been lazy/not working too hard – only did 280 deliveries in the year.
- The driver is absent from work too often – 50 days away from work.
- The vehicle is not being utilised enough – only did 10% of the trips yet it has the lowest running costs (R1,30).
- The driver is being paid the same salary as other drivers despite only doing 10% of the work.
- Lack of internal control/This vehicle is running at a loss – income R70 000 less expenses R88 400 = R18 400 loss.

Any valid solution related to the problem identified above ✓

Possible responses

- Pay drivers per delivery – this will encourage them to work harder.
- Allocate this vehicle to the busiest driver.

Delivery vehicle 2:

Any valid problem identified ✓ Quoting of relevant figure ✓

Possible responses:

- The driver has been working too hard – did 8 deliveries per day (2100 / 260).
- This vehicle is old / has a high running cost yet it is used for 2 100 out of 3 680 deliveries.

Any valid solution related to the problem identified above ✓

Possible responses

- Allocate this vehicle to the least busy driver.
- Restrict usage of this vehicle.

Delivery vehicle 3:

Any valid problem identified ✓ Quoting of relevant figure ✓

Possible responses:

The driver has been fraudulent – fees collected are R50 000 short (R325 000 – R275 000).

Any valid solution related to the problem identified above ✓

Possible responses

- Conduct an internal audit of fees collected.
- Conduct a disciplinary enquiry against the driver.

(9)

[35]