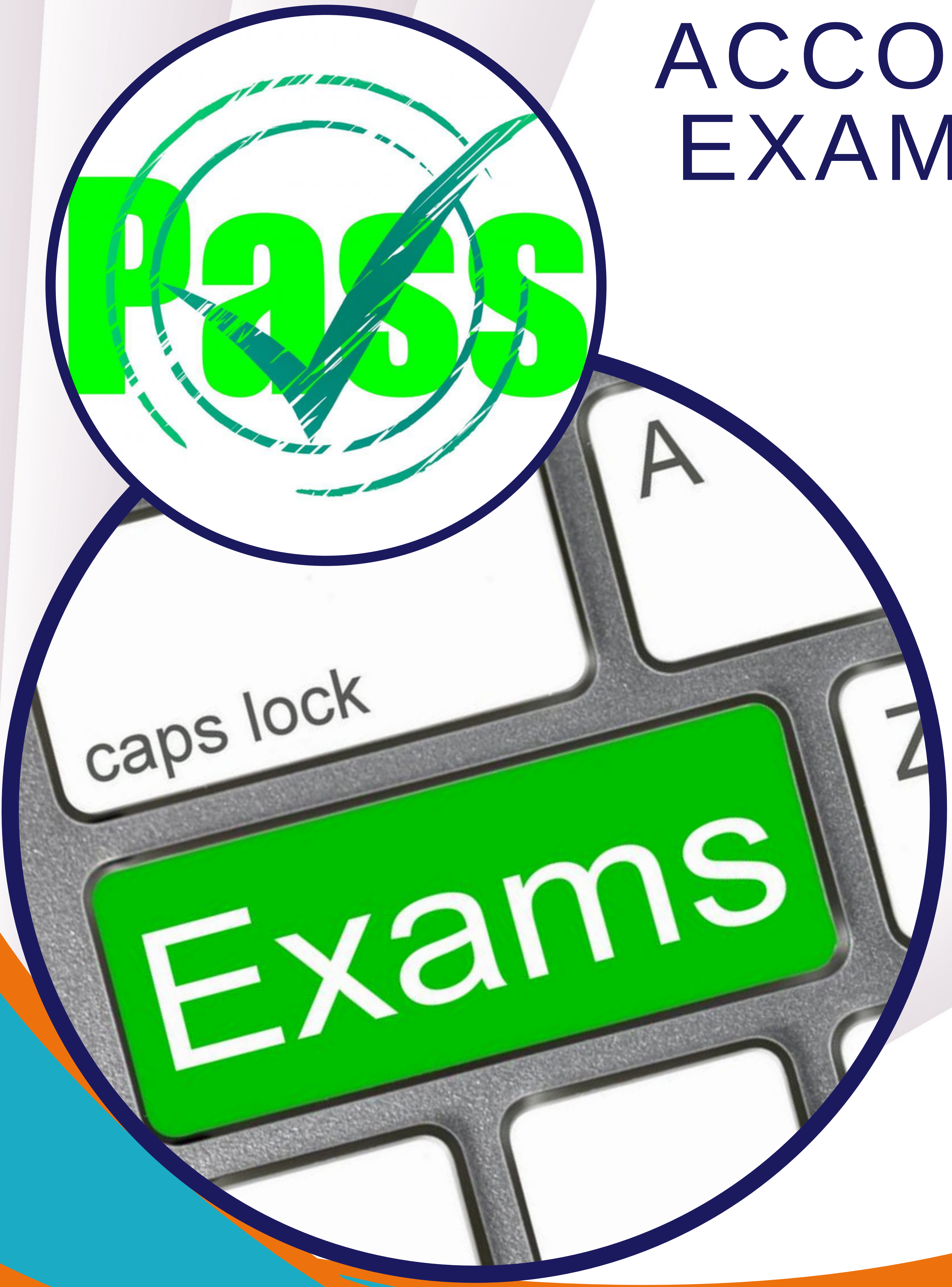
VHA ACCOUNTING
SOLUTIONS INC

SCHOOL
OF ACCOUNTING & TAX

GRADE 12



ACCOUNTING EXAM STUDY GUIDE

2024
EDITION

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Dear Readers

Product Description: This up-to-date Study Guide for Grade 12 Accounting exams contains several chapters of preparation that gives you everything you need in order to score to your full potential.

This Accounting Exam Study Guidebook is specifically formatted in a manner to help you outscore your competition and help you get the career you are after. It's super simple, easy and fast to prepare with. In fact, you get prepared with minimal effort, and time.

The study guide has more questions from past papers. Every question is followed by a solution. We will continue improving this study guide every six months.

WISH YOU SUCCESS IN YOUR EXAMS

GRADE 12 ACCOUNTING EXAM DRILL BOOK

What is Accounting?

From CAPS document

Accounting focuses on measuring performance and processing and communicating financial information about economic sectors. The discipline ensures that principles such as ethical behaviour, transparency and accountability are adhered to. It deals with the logical, systematic and accurate selection and recording of financial information and transactions, as well as the compilation, analysis, interpretation and communication of financial statements and managerial reports for use by interested parties.

The subject encompasses accounting knowledge, skills and values the focus on the financial accounting, managerial accounting and auditing fields. These fields cover a broad spectrum of accounting concepts and skills to prepare learners for a variety of career opportunities.

The purpose of Accounting

From CAPS document

Accounting learners will be able to:

record, analyse and interpret financial and other relevant data in order to make informed decisions,

present and/or communicate financial information effectively by using Generally Accepted Accounting Practices (GAAP) in line with current developments and legislation,

develop and demonstrate an understanding of fundamental accounting concepts,

relate skills, knowledge and values to real-life situations in order to ensure the balance between theory and practice, in order to enter the world of work and/or to move to higher education, and to encourage self-development,

- ➢ organise and manage their own finances and activities responsibly and effectively,
- ➢ apply principles to solve problems in a judicious and systematic manner in familiar and unfamiliar situations, thus developing the ability to identify and solve problems in the context of the various fields of Accounting,
- ➢ develop critical, logical and analytical abilities and thought processes to enable learners to apply skills to current and new situations,
- ➢ develop the following characteristics:
    - ✓ ethical behaviour
    - ✓ sound judgement
    - ✓ thoroughness
    - ✓ orderliness
    - ✓ accuracy
    - ✓ neatness

Examination preparation tips

- Have a variety of at least 7 to 10 questions **per topic** which you attempt and answer correctly. If you achieve this on a given topic then know that you have become a genius in that topic. The questions must be from recommended texts and past examination papers.

- Source books and plain papers for your workings.

- Work on your speed in answering questions. A slow and intelligent student becomes an average student because of lateness and delay in finishing work tasks.

Examination time tips

- Read instructions carefully and understand.
- Read the question paper carefully, it will give you an idea about how to start the answering the question.
- Relax do not panic, panicking reduces your ability to think, confidence opens your mind.
- Write the questions that are easier to you first and end with challenging questions.
- Put your small workings behind the final entry, you will recover some marks in case your answer is wrong, and workings makes it easier to review your work.
- Good handwriting and presentation matters. Write bold and clear letters and figures and avoid cursive writing.
- Make sure your workings are based on correct figures.
- For the questions with notes, make sure you read the notes and do necessary adjustments.

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VAT - VALUE ADDED TAX

VAT is an indirect tax that is charged whenever goods are sold, or services are rendered by a registered VAT vendor.

Vendors are charged with the responsibility of levying VAT and paying it over to the South African Revenue Services (SARS) after deducting permissible VAT inputs.

VAT is generally placed into three categories.

- Standard-rated: VAT at 15%
- Zero-rated: VAT at 0%
- Exempt: No VAT

Standard rated goods

These are supplies subject to VAT at the prescribed rate currently pegged at 15%.

Zero rated supplies

Zero rated supplies are supplies which attract VAT at 0%.

Examples of zero-rated supplies include brown bread, maize products, rice, milk, fruit, vegetables, lentils, vegetable oil, eggs, petrol and diesel (subject to fuel levies) and property rates. Please note that this list is not exhaustive and is also not fixed as parliament can make amendments to this list.

Exempt items

These are goods or services on which no VAT is charged, either at standard rate or zero rate.

Examples are financial services, rental of a private residence and educational services supplied by the government. Again, this list is not exhaustive nor fixed and may be amended by parliament.

Output tax and Input tax

Output tax

The VAT charged by a vendor when it sells goods or renders services. The output tax is included in the price that the customer is charged for the goods or services.

Input tax

The VAT charged to or paid by a vendor when buying goods or services from another VAT vendor. The input tax is included in the cost of the goods or services.

Sources of VAT Control account entries

VAT from payments in the bank account cash book

VAT from payments in the petty cash book

VAT from invoices in the purchase’s daybook

VAT from credit notes in the purchases returns daybook.

VAT from cash sales receipts in the cash book

VAT from invoices in the sales daybook

VAT from credit notes in the sales return’s daybook

VAT from irrecoverable debt written off in journal.

VAT from cash payments in the cash book

Calculations

VAT is 15% , a tax fraction is applied on the total invoice amount to get the VAT amount.

VAT = $\frac{15}{100}$ and the tax fraction applied on the sales value is $\frac{15}{115}$

There is a relationship between VAT and its tax fraction on invoice value.

VAT = $\frac{15}{100}$ and the tax fraction applied on the invoice value is $\frac{15}{100+15} = \frac{15}{115}$

Purchases				**Sales**			
	Cost Exc VAT	**Input VAT 15%**	**Total inclusive of VAT**	**Mark up**	**Selling Price Exc VAT**	**Output VAT**	**Selling Price Inc VAT**
A	3 000	450	3 450	60%	5 520	828	6 348
B	6 000	900	6 900	20%	8 280	1 242	9 522
C	9 000	1 350	10 350	20%	12 420	1 863	14 283
D	60 000	9 000	69 000	30%	89 700	13 455	103 155

We may look at the flow of calculations in line D.

The business purchased goods from a supplier at R69 000 and the breakdown is as follows.

Cost 60 000, VAT 9 00 (60 000 X 0.15) and purchase price R69 000 (60 000 + 9 000)

To get Selling price excluding VAT 30% mark-up is added to the invoice value;

69 000 + 60 000 x 30% = 60 000 + 20 700 = 89 700

Output VAT on is 13 455 (69 00x 15%).

The total selling price is 103 155 (89 700 + 13 455)

Application of the tax fraction on the selling price

If you are given the total selling price inclusive of VAT you apply the tax fraction 15/115 to that selling price to deduce the VAT amount.

The selling price of 103 155 the VAT included in the amount is 13 455 calculated as follows

$$103\,155 \times \frac{15}{115} = 13\,455$$

QUESTION 1 NOV 2019: VAT AND RECONCILIATION (35 marks; 20 minutes)

1.1 CONCEPTS

REQUIRED:

Indicate whether the following statements are TRUE or FALSE. Write only 'true' or 'false' next to the question numbers (1.1.1 to 1.1.4) in the ANSWER BOOK.

1.1.1 Output VAT is collected by a business when goods are sold.

1.1.2 The calculation of salaries does not take VAT into account.

1.1.3 A credit balance on the Bank Statement indicates an unfavourable balance.

1.1.4 Recording bank charges separately from interest on an overdraft is an application of the materiality concept. (4 x 1) (4)

1.2 VALUE-ADDED TAX (VAT)

The information relates to Longhill Traders for the VAT period ended 30 April 2019. The VAT rate of 15% applies to all goods and services.

REQUIRED:

Calculate the amount receivable from or payable to SARS for VAT on

INFORMATION:

A. Amount owed to SARS on 1 April 2019, R15 890

B. VAT transactions for April 2019:

DETAILS	EXCLUDING VAT (R)	VAT AMOUNT (R)	INCLUDING VAT (R)
Returns by debtors		1 470	
Drawings by owner		3 075	
Debtors' accounts written off	8 700		10 005
Total purchases (cash and credit)	224 000		
Total sales			396 750

SOLUTION

1.1

1.1.1	**True**
1.1.1	**True**
1.1.2	**False**
1.1.3	**True**

1.2 VAT CONTROL

VAT Control			
Returns by debtor	**1 470**	**Balance b/d**	**15 890**
Purchases	**33 600**	**Debtors written off**	**3 075**
		Sales	**51 750**
Balance c/d	**36 950**	**Drawings by owner**	**1 305**
	72 020		**72 020**

Or

– 15 890 + 1 470 – 3 075 - 1 305 + 33 600 – 51 750 = – 36 950

QUESTION 1 NOV 2020 : VAT

1.1 VAT

Amahle Traders is registered for VAT. The standard VAT rate is 15%.

REQUIRED:

1.1.1 Calculate the figures indicated by (a) to (d) in the table below. (9)

1.1.2 The internal auditor discovered that Amahle has been underpaying the amount due to SARS in respect of VAT, at each submission date. On enquiry, Amahle stated that she used the money to pay business expenses and adjusted the payments later.

Comment on this practice and give Amahle advice. (3)

INFORMATION:

	Excluding VAT	**Including VAT**	**VAT Amount**
Invoices received from suppliers	R78 000	R89 700	(a)
Discount received from suppliers	R12 400		(b)
Credit notes issued to customers		(c)	R210
Invoices issued to customers		R158 700*	(d)

***** This includes sales for R9 200 which should have been sold at zero rate. The bookkeeper incorrectly included VAT of R1 200 on these goods.

This includes sales for R9 200 which should have been sold at zero rate. The bookkeeper incorrectly included VAT of R1 200 on these goods.

SOLUTION

	Workings	Answer
a)	89 700 – 78 000	11 700
b)	12 400 x 15% or 15/100 one mark for both figures only if all workings are correct and no other operations done & if there is no final answer	1 860
c)	210 x 115/15 OR 1 400 + 210 one mark for both figures only if all workings are correct and no other operations done & if there is no final answer	1 610
d)	149 500 (158 700 – 9 200) x 15/115 OR 20 700 – 1 200	19 500

1.1.2

Comment on this practice and provide Amahle advice	
Comment	**Advice**
➢ Unethical to use money not earned by the business to pay running / operational costs. ➢ The business is an agent of SARS and must make payments timeously. ➢ The business can be fined (penalties) for non-compliance / evasion / manipulation / deferring of payment of VAT. ➢ It could result in a more extensive investigation for irregularities in the future. ➢ This is rolling over of cash / evasion, which could escalate to a serious problem.	➢ Keep proper records / ensure that the funds are always available to make payments. ➢ Note submission dates and plan in advance. ➢ Only use business funds to cover business commitments / work within the budget

INTERPRETATION OF FINANCIAL STATEMENTS

Interpretation of financial statements involves many processes like arrangement, analysis, establishing relationship between available facts and drawing conclusions on that basis.

Financial statements are interpreted using ratios and comparisons of figures this is called ration analysis.

5 basic categories of financial analysis

- Profitability
- Solvency
- Liquidity
- Risk
- Return on shareholder equity

Ratio	Formula
Profitability	
Gross profit percentage to sales	$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$
Gross profit percentage to cost of sales	$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$
Operating profit to sales	$\frac{\text{Operating profit}}{\text{Sales}} \times \frac{100}{1}$
Operating expenses to sales	$\frac{\text{Operating expenses}}{\text{Sales}} \times \frac{100}{1}$
Net profit before tax to sales	$\frac{\text{Net profit before tax}}{\text{Sales}} \times \frac{100}{1}$
Net profit after2 tax to sales	$\frac{\text{Net profit after tax}}{\text{Sales}} \times \frac{100}{1}$
Solvency	
Solvency	Total assets : Total liabilities
Net assets	Total assets – Total liabilities
Liquidity	
Current ratio	Current assets : Current liabilities
Acid test ratio Or quick ratio	(Current assets – Inventories) : Current liabilities
	Non-current liabilities : Shareholders' equity
Working capital	Current assets – Current liabilities
Stock turnover rate	$\frac{\text{Cost of sales}}{\text{Average trading stock}}$
Stock holding period	$\frac{\text{Average trading stock}}{\text{Cost of sales}} \times \frac{365}{1}$
Average debtors collection period	$\frac{\text{Average debtors}}{\text{Credit sales}} \times \frac{365}{1}$
Average creditors payment period	$\frac{\text{Average creditors}}{\text{Cost of sales}} \times \frac{365}{1}$
Risk	

Debt to equity ratio	Non current liabilities : Ordinary shareholders equity
ROCE Return on capital employed	Given below
$\frac{\text{Net income before tax + Interest on loans}}{\text{Average shareholders' equity + Average non-current liabilities}} \times \frac{100}{1}$	
Return to shareholders	
Earnings per share	$\frac{\text{Net income after tax}}{\text{Number of issued shares}}$
Dividend per share	$\frac{\text{Dividends for the year}}{\text{Number of issued shares}}$
Return on shareholders equity	$\frac{\text{Net income after tax}}{\text{Average shareholders' equity}} \times \frac{100}{1}$
Net assets	Total assets – Total liabilities
Net assets per share	$\frac{\text{Shareholders' equity}}{\text{Number of issued shares}} \times \frac{100}{1}$

Profitability ratios

Profitability ratios measures the financial performance and efficiency of an entity.

- **Gross profit percentage to sales**
  Measure the amount of gross profit made per every Rand of sales

- **Gross profit percentage to cost of sales**
  Measure the amount of gross profit made per every Rand of cost of sales

- **Operating profit to sales**
  Measures the amount of profit generated per every Rand of sales,

- **Operating expenses to sales**
  Measures the amount of operating expenses incurred per every Rand of sales.

- **Net profit before tax to sales**
  Measures the amount of net profit generated per every Rand of sales.

Profitability ratios may be influenced by

- Theft of stock and pilferage
- Incorrect pricing
- Low profit margin
- Large discounts offered to customers

Solvency

Solvency indicators measures the firm's ability to meet its long term debt. A high solvency ratio is an indication of stability, while a low ratio signals financial weakness.

- Total assets: Total liabilities
- Net assets

Liquidity

Measures the ability of the business to meet its short term financial obligation.

- **Current ratio**

  Current ratio is the most popular liquidity ratio. It is calculated by dividing the current assets by the current liabilities.

- **Acid test ratio Or quick ratio**
  Quick ratio (also called acid-test ratio) is a liquidity ratio that compares those current assets that can be quickly liquidated with current liabilities. Inventory value is excluded from the calculation of the ratio.

- **Working capital**
  Working capital is the amount of money a company has left over after subtracting current liabilities from current assets. Working capital is the amount of available capital that a company can readily use for day-to-day. It measures a company's liquidity, operational efficiency, and short-term financial health. Working capital = Current assets – Current liabilities

Ways to improve working capital

1. Payment plans for debtors
2. Improve stock turnover rate
3. Competitive pricing. Negotiate better pricing with suppliers.
4. Give incentives to customers who pay on time
5. Payment of business liabilities on time
6. Reduce expenses and introduce cost cutting measures.

- **Stock turnover rate**
  Stock turnover rate is considered to be a measure of sales performance; usually the higher the stock turnover rate, the better your stock/business is performing. Basically it's the rate at which the business has been buying and selling stocks. The stock turnover ratio determines how soon an enterprise sells its goods and products and replace its inventories in a set period.
  Rate of stock turn is arrived at by dividing cost of goods sold" by "average inventory".

- **Stock holding period**
  A stock holding period is the amount of time the stock is held by the firm, or the period between the purchase and sale of the stock. You divide average stock by cost of sales and multiply by 365 days to arrive at the stockholding period. The shorter the days the more efficient the business.

Longer days are associated with:

1. breakages,
2. cash tied up in stocks,
3. expiry of some products,

Stock holding period may be enhanced by:

1. Purchasing more of fast-moving product line and less of slow moving products
2. Advertising and product promotion
3. Creating more branches over a large settlement or geographical area
4. Reducing the price
5. Better demand forecasting

- **A debtor collection period**

  It is the amount of time it takes to collect all trade debts. The smaller the period of time it takes to collect these debts, the more efficient a company will seem to be. A longer period indicates problematic trade debtors or less overall efficiency. We arrive at the debtors collection period by dividing average debtors by credit sales then multiply by 365 days.

  Debtors collection period may be improved by

  1. Vetting debtors before issuing goods
  2. Constant reminders
  3. Charging of interest
  4. Engaging lawyers for material troublesome debtors
  5. Use of stop order facilities.
  6. Taking insurance against bad debtors

- **Average creditors payment period**

  Average payment period means the average period taken by the company in making payments to its creditors.

Risk

Risk ratios can be used to assess a company's capital structure and current risk levels, often in terms of a company's debt level and risk of default or bankruptcy. These ratios are used by investors when they are considering investing in a company.

- **Debt to equity ratio**

  Measures the extent to which a business is financed by debt. This ratio is also an indicator of a company's ability to meet outstanding debt obligations. A lower rate is a favourable rate signifying lower financial risk.

- **Interest Coverage**

  It is a debt and profitability ratio used to determine how easily a company can pay interest on its outstanding debt. A relatively lower coverage ratio indicates a greater debt service burden on the company and a correspondingly higher risk of default or financial insolvency.

  Interest Coverage = EBIT/Interest Expense. EBIT = Net profit before interest and tax.

- **ROCE – Return on capital employed**
  Measures the return per Rand of capital employed**.**

Worked Example

The following information relates to Khumalo's Café (Pty) Ltd

Income statements for the year ended 31 December

	20x2	20x1
Sale (80 % on credit)	**12 000 000**	**10 000 000**
Cost of sales	**6 000 000**	**5 800 000**
Gross profit	**6 000 000**	**4 200 000**
Operating expenses	**2 500 000**	**2 600 000**
Operating profit	**3 500 000**	**1 600 000**
Interest expense	**150 000**	**450 000**
Net profit before tax	**3 350 000**	**1 150 000**
Taxation 25 %	**837 000**	**287 500**
Net profit after tax	**2 512 500**	**862 500**

Balance sheet as at:

	20x2	20x1
Non-current assets	**25 000 000**	**23 000 000**
Current assets	**4 005 000**	**5 594 250**
Inventories	2 050 000	1 980 000
Trade debtors	1 089 500	970 000
Bank	850 000	2 630 000
Cash	15 500	14 250
Total assets	**29 005 000**	**298 594 250**
Equity	**23 075 000**	**17 562 500**
Ordinary shares of R200 each	20 000 000	15 000 000
Retained income	3 075 000	2 562 500
Non current liabilities	**3 000 000**	**7 500 000**
Mortgage loan	3 000 000	7 500 000
Current liabilities	**2 930 000**	**3 531 750**
Trade creditors	450 000	460 000
Other current liabilities	2 480 000	3 071 750
Total equity and liabilities	**29 005 000**	**28 594 250**

Retained income

	20x2	20x1
Balance at the beginning of the year	**2 562 500**	**3 200 000**
Dividend paid and declared	(2 000 000)	(1 500 000)

Net profit after tax for the year	2 512 500	862 500
Balance at year end	**3 075 000**	**2 562 500**

Calculate any 14 ratios

Profitability ratios

Ratio	**Formula workings** **2018** **2019**	**2018**	**2017**
Profitability			
Gross profit percentage to sales	$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$ $\frac{6\,000\,000}{12\,000\,000} \times \frac{100}{1}$ $\frac{4\,200\,000}{10\,000\,000} \times \frac{100}{1}$	50%	42%
Gross profit percentage to cost of sales	$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$ $\frac{6\,000\,000}{6\,000\,000} \times \frac{100}{1}$ $\frac{4\,200\,000}{5\,800\,000} \times \frac{100}{1}$	100%	72%
Operating profit to sales	$\frac{\text{Operating profit}}{\text{Sales}} \times \frac{100}{1}$ $\frac{3\,500\,000}{12\,000\,000} \times \frac{100}{1}$ $\frac{1\,600\,000}{10\,000\,000} \times \frac{100}{1}$	29%	16%
Operating expenses to sales	$\frac{\text{Operating expenses}}{\text{Sales}} \times \frac{100}{1}$ $\frac{2\,500\,000}{12\,000\,000} \times \frac{100}{1}$ $\frac{2\,600\,000}{10\,000\,000} \times \frac{100}{1}$	21%	26%
Net profit before tax to sales	$\frac{\text{Net profit before tax}}{\text{Sales}} \times \frac{100}{1}$ $\frac{3\,350\,000}{12\,000\,000} \times \frac{100}{1}$ $\frac{1\,150\,000}{10\,000\,000} \times \frac{100}{1}$	28%	11.5%
Net profit after 2 tax to sales	$\frac{\text{Net profit after tax}}{\text{Sales}} \times \frac{100}{1}$ $\frac{2\,512\,500}{12\,000\,000} \times \frac{100}{1}$ $\frac{862\,500}{10\,000\,000} \times \frac{100}{1}$	21%	8.6%

Solvency ratios

Solvency			
Solvency	Total assets : Total liabilities 29 005 000 : 5 930 000 28 594 250 : 11 031 750	4.89 : 1	2.59 : 1
Net assets	Total assets – Total liabilities 29 005 000 – 5 930 000	23 075 000	17 562 500

	28 594 250 – 11 031 750		

Liquidity ratios

Liquidity			
Current ratio	Current assets : Current liabilities 4 005 000 : 2 930 000 5 594 250 : 3 531 750	1.37 : 1	1.58 : 1
Acid test ratio Or quick ratio	(Current assets – Inventories) : Current liabilities (4 005 000 – 2 050 000) : 2 930 000 (5 594 250 – 1 980 000) : 3 531 750	0.67 : 1	1.02 : 1
Working capital	Current assets - Current liabilities 4 005 000 - 2 930 000 5 594 250 - 3 531 750	1 075 000	3 531 750
Stock turnover rate	Cost of sales Average trading stock 6 000 000 , (2 050 000 + 1 980 000) x 0.5	2.98 times or 3 times	
Stock holding period	Average trading stock x 365 Cost of sales 1 , (2 050 000 + 1 980 000)*0.5 x 365 days 6 000 000	122.58 days Or 122 days 14hrs	
Average debtors collection period	Average debtors x 365 Credit sales 1 (1 089 500 + 970 000) x 0.5 0.8 x 12 000 000)	39.5 days or 39 days 12 hrs	
Average creditors payment period	Average creditors x 365 Cost of sales 1 (450 000 + 460 000) x 0.5 6 000 000	27,68 days Or 27 days 16hrs	

Risk ratios and indicators

Risk			
Debt to equity ratio	Non current liabilities : Ordinary shareholders equity 3 000 000 : 23 075 000 7 500 000 : 17 562 500	0.13 : 1	
ROCE Return on capital employed	Given below		
Net income before tax + Interest on loans / Average shareholders' equity + Average non-current liabilities x 100/1 3 500 000 / (40 637 000 + 10 500 500) x 0.5 x 100/1 10,500,000 (3,000,000 + 7,500,000) 40,637,000 (23,075,000 + 17,562,500)		14%	

Return on shareholders

Return to shareholders			
Earnings per share	Net income after tax / Number of issued shares 2 512 500 / 100 000 862 500 / 75 000	R25,12 per share	R11,5 per share
Dividend per share	Dividends for the year / Number of issued shares 2 000 000 / 100 000 1 500 00 / 75 000	R20	R20
Return on shareholders equity	Net income after tax / Average shareholders' equity x 100/1 2 512 500 / (23 075 000 + 17 562 500) x 0.5 x 100/1	12%	
Net assets per share	Shareholders' equity / Number of issued shares x 100/1 23 075 000 / 100 000 x 100/1 17 562 500 / 75 000 x 100/1	23 075 %	23 417%

Mark up and margin

Mark up It represents profit on a product. Mark up is added to the cost of sales to obtain the sales value. **Margin** Margin is applied to the sales to obtain the profit per product. **Relationship between mark up and margin,** **If mark-up is** $\frac{A}{B}$

Mark up = $\frac{A}{B}$ Then margin = $\frac{A}{B+A}$	Margin = $\frac{C}{D}$ Then mark-up = $\frac{C}{D-C}$
Mark up = $\frac{25}{100}$ Then margin = $\frac{25}{100+15} = \frac{25}{115}$	Margin = $\frac{30}{100}$ Then mark-up = $\frac{30}{100-30} = \frac{30}{70}$

Calculate the sales and cost of sale and gross profit given a mark-up of 25 % for both years

	2020	**2019**
Sales	?	15 000 000
Cost of sales	8 000 000	?
Gross profit	?	?

SOLUTION

	2020	**2019**
Sales	10 000 000	15 000 000
Cost of sales	8 000 000	10 000 000
Gross profit	2 000 000	5 000 000

COGS X Mark up = Gross Profit
8 000 000 X 0.25 = 2 000 000

Sales x Margin = Gross Profit
15 000 000 x 25/75 = 5 000 000

QUESTION 3 NOV 2020 P1 : INTERPRETATION OF FINANCIAL STATEMENTS (35 marks; 30 minutes)

3.1 Choose the question from COLUMN B that matches a category of financial indicators in COLUMN A. Write only the letter (A–E) next to the question numbers (3.1.1 to 3.1.4) in the ANSWER BOOK.

COLUMN A	COLUMN B
3.1.1 Liquidity 3.1.2 Risk and gearing 3.1.3 Return to shareholders 3.1.4 Operating efficiency	A Is the business managing expenses effectively to increase profitability? B Is the investment in the company better than investing in a fixed deposit? C Will the company be able to pay off its current debts? D Will the company be able to pay off all its debts using existing assets? E How is the company managing loans or borrowed capital?

3.2 SCI-FI GEEKS LTD

The business trades in electronic equipment purchased from China. The information relates to the past two financial years, ended 31 March. The COVID-19 lockdown has negatively affected sales over the current financial year.

REQUIRED:

3.2.1 Liquidity:

The directors are satisfied with the improvement in the current ratio and the acid-test ratio. Explain why you would disagree with them. Quote TWO financial indicators in your response. (6)

3.2.2 Dividends:

The directors changed the dividend policy for the current financial year.

- Comment on the dividend per share over the two years. Quote figures. (2)
- Explain the change in the dividend payout rate and give a reason for this change. Quote figures. (4)
- A shareholder felt that they should be satisfied with the dividends they received, as it is better than last year. Explain why you agree with him. Quote figures. (3)

3.2.3 Comment on the risk and gearing for both years. Quote TWO financial indicators (with figures). (6)

3.2.4 Existing shareholders are dissatisfied that the new shares issued on 1 April 2020 were sold to the CEO, Ida Shark. Give TWO reasons why you consider their feelings to be justified. Quote figures. (6)

3.2.5 The Cash Flow Statement reflected a positive change of R980 000. Provide TWO points why this should still be a concern to directors. Quote figures. (4)

INFORMATION:

A. Financial indicators and additional information:

	2021	**2020**
Mark-up % achieved	60%	60%
% net profit before tax on sales	13,9%	20,3%
Current ratio	2,4 : 1	1,1 : 1
Acid-test ratio	1,0 : 1	0,4 : 1
Stockholding period	102 days	32 days
Average debtors' collection period	46 days	31 days
Average creditors' payment period	60 days	60 days
Earnings per share	58 cents	130 cents
Dividends per share	72 cents	90 cents
Dividend payout rate	136,5%	69%
Debt-equity ratio	0,4 : 1	0,3 : 1
Return on average shareholders' equity	17,7%	31,6%
Return on total capital employed	23,2%	39%
Net asset value per share	332 cents	409 cents
Market price of shares on stock exchange	410 cents	540 cents
Interest rate on loans	13,5%	13,5%
Interest rate on fixed deposits	6,8%	7,8%

B. Share capital:

- On 1 April 2020 the company issued an additional 250 000 shares.
- On 31 March 2021 there were 1 250 000 shares in issue.

C. Extract from the Cash Flow Statement on 31 March:

	2021	**2020**
Cash flows from operating activities	**(148 080)**	**910 000**
Cash generated from operations	1 281 620	
Interest paid	(232 000)	
Taxation paid	(272 700)	
Dividends paid	(925 000)	
Cash flows from investing activities	101 580	(300 000)
Cash flows from financing activities	**1 026 500**	**(100 000)**
Sale of shares	375 000	0
Change in loan	651 500	(100 000)
Cash and cash equivalents: Net change	980 000	510 000
Opening	(330 000)	(840 000)

Closing	**650 000**	**(330 000)**

SOLUTION

3.1

3.1.1	**C**
3.1.2	**E**
3.1.3	**B**
3.1.4	**A**

3.2 SCI-FI GEEKS LTD

3.2.1 The directors are satisfied with the improvement in the current ratio and the acid-test ratio. Explain why you would disagree with them. Quote TWO financial indicators in your response.

- The stock holding period increased (from 32 days) to 102 days (or 70 days)
- Average debtors' collection period increased (from 31 days) to 46 days (15 days)
- Current ratio increased (from 1,1 :1) to 2,4 : 1 / by 1,3 : 1
- Acid-test ratio increased (from 0,4 : 1) to 1 : 1 / by 0,6 : 1

Any ONE valid explanation; part marks for incomplete / unclear explanation

- Too much liquid assets (cash) tied up in stock reflects that there is an over-investment in stock / the difference in current & acid-test rations reflects stock piling.
- High stock volumes create security problems
- Stock can easily become obsolete due to advancements in technology (can't be sold)
- The business has relaxed / neglected its collection policies / lockdown during Covid-19 and this impacts on the debtors / stock / cash flow of the business.

3.2.2 Comment on the dividend per share over the two years. Quote figures.

The DPS dropped from 90 cents to 72 cents / by 18 cents / by 20%

Explain the change in the dividend payout rate. Quote figures.

The dividend pay-out rate increased from 69% (90/130) to 136,5% or 72/58 (accept 124,1%) / or a 97,8% increase from the previous year

Give a reason for this change.

- Directors attempted to please the shareholders for the low profitability
- Compensation for using funds retained in previous financial years.
- No plans for growth / expansions (no need to retain additional funds)

A shareholder felt that they should be satisfied with the dividends they received as it is better than last year. Explain why you agree with him

- The drop in the market price from 540 cents to 410 cents (reflects a dividend yield DPS/MP of 17,7% this year compared to 16,7% last year) / If the policy was maintained at 69% of EPS, they would have received 40 cents.
- EPS dropped from 130c to 58c (by 72 cents / 55%) but DPS dropped from 90c to 72c (by 18 cents / 20%)
- The dividend pay-out rate increased from 69% (90/130) to 136,5% or 72/58 (accept 124,1%) / or a 97,8% increase from the previous year.
- The dividend pay-out rate increased.

3.2.3 Comment on the risk and gearing for both years. Quote TWO financial indicators (with figures).

Debt/equity ratio increased (from 0,3 : 1) to 0,4: 1 (or by 0,1 : 1)

ROTCE decreased (from 39%) to 23,2% (or 15,8%)

- Increased borrowing not effectively used to increase / improve profitability.
- Although still positively geared (ROTCE exceeds interest rate), the drop in profitability / downward trend is a concern.
- Although there is low financial risk, the company is more reliant on own capital.

3.2.4 Existing shareholders are dissatisfied that the new shares issued on 1 April 2020 were sold to the CEO, Ida Shark. Give TWO reasons why you consider their feelings to be justified. Quote figures.

- Ethical reasons e.g. This is a very low price and the CEO is exercising undue influence over the issue price / receiving preferential treatment / against the Companies Act or King Code / lack of transparency
- Market-related reasons e.g. the company is losing out on additional funding as shares could have been sold at a price in that range, or on the stock exchange
- The selling price of these shares (250 000) is 150 cents each (R375 000 in total) / market price of 410c exceeds NAV of 332c.

3.2.5 The Cash Flow Statement reflected a positive change in R980 000. Provide TWO points why this should still be a concern to directors. Quote figures.

- Cash flow from operating activities is negative R148 080
- Additional shares issued, R375 000
- Financing activities increased by R1 026 500
- Large increase in loan, R651 500 / high interest payment R232 000
- Very high payment for dividends, R925 000
- Cash from investing activities, R101 580

FINANCIAL STATEMENTS

Financial statements (or financial reports) are formal records of the financial activities and position of a business, person, or other entity.

Relevant financial information is presented in a structured manner and in a form which is easy to understand. They typically include four basic financial statements accompanied by a management discussion and analysis:

1. **A balance sheet** or statement of financial position, reports on a company's assets, liabilities, and owners equity at a given point in time.

2. **An income statement**—or profit and loss report, or statement of comprehensive income, or statement of revenue & expense—reports on a company's income, expenses, and profits over a stated period. A profit and loss statement provides information on the operation of the enterprise. These include sales and the various expenses incurred during the stated period.

   An Income statement is a financial report that provides a summary of a company's revenues, expenses, and profits/losses over a given period of time. An **income statement** shows a company's ability to generate sales, manage expenses, and create profits. It is prepared based on accounting principles that include revenue recognition, matching, and accruals.

3. **A statement of changes in equity** or statement of equity, or statement of retained earnings, reports on the changes in equity of the company over a stated period.

4. **A cash flow statement reports** on a company's cash flow activities, particularly its operating, investing and financing activities over a stated period. It is prepared on cash basis.

5. **Notes to the financial statement**

THE STATEMENT OF COMPREHENSIVE INCOME

Statement of Comprehensive income for the year ended 28 February 2021		
	Note	**R**
Sales (Sales less returns)		**280 000**
Cost of sales		**120 000**
Gross Profit		**160 000**
Other operating income		**20 000**
Rental income		10 000
Provision for bad debts- decrease		500
Discounts received		3 000
Profit on sale of fixed assets		1 500
Dividend income from investments		5 000
Gross operating income		**180 000**

Operating expenses		**99 800**
Freight on sales		1 500
Audit fees		12 000
Accounting fees		13 800
Directors fees		12 000
Salaries and wages		40 000
Stationery		500
Loss on sale of property		1 500
Provision for bad debt – Increase		250
Bad debts written off		350
Discounts allowed		1 100
Depreciation		2 450
Insurance		170
Motor vehicle running cost		8 400
Repairs and maintenance		5 780
Operating profit		**80 200**
Interest expense		**5 200**
Profit before tax		**75 000**
Income tax		**10 250**
Net profit after tax		**64 750**

The statement of financial position

Statement of financial position as at 28 February 2021

	Notes	R
Assets		
Non current assets		**xxxx**
Fixed/Tangible assets		xxxx
Financial assets (look for a Fixed deposit)		xxxx
Current assets		**xxxx**
Inventories		xxxx
Trade and other payables		xxxx
Cash and cash equivalents		xxxx
Total assets		**xxxx**
Equity and liabilities		
Shareholders equity		**xxxx**
Ordinary share capital		xxxx
Retained income		xxxx
Non current liabilities		**xxxx**
Ordinary share capital		xxxx
Retained income		xxxx
Current liabilities		**xxxx**
Current portion of mortgage loan		xxxx
Trade and other payables		xxxx

Total equity and liabilities		**xxxx**

The notes on financial statements

1 Interest income

Interest received from bank accounts	xxx
Interest on overdue debtors	xxx
Interest on fixed deposit account	xxx
	xxx

Interest expense

Creditors overdue accounts	xxx
Interest on loan	xxx
Interest on overdraft	xxx
	xxx

Property plant and equipment

Tangible / Fixed assets	**Land and buildings**	**Motor Vehicles**	**Plant and Equipment**	**Total**
	R	**R**	**R**	**R**
Carrying value at the beginning of the year	**xxxx**	**xxxx**	**xxxx**	**xxxx**
Cost	xxxx	xxxx	xxxx	xxxx
Accumulated depreciation		(xxxx)	(xxxx)	(xxxx)
Movement				
Additions at cost	xxxx	xxxx	xxxx	xxxx
Disposals at carrying value		(xxxx)	(xxxx)	(xxxx)
Depreciation for the year		(xxxx)	(xxxx)	(xxxx)
Carrying value	**xxxx**	**xxxx**	**xxxx**	**xxxx**
Cost	xxxx	xxxx	xxxx	xxxx
Accumulated		(xxxx)	(xxxx)	(xxxx)

Inventories

Closing trading stock	xxxx
Consumables on hand	xxxx
	xxxx

Trade and other receivables

Trade debtors	xxxx
Provision for bad debts	(xxxx)
Net debtors	xxxx
Expenses prepaid	xxxx
Income accrued	xxxx
	xxxx

Cash and cash equivalents

Bank account balances	xxxx
Fixed deposit balances	xxxx
Savings balances	xxxx
Petty cash balance	xxxx
Cash float	xxxx
	xxxx

Ordinary share capital
Authorised

Number of authorised ordinary shares	**xxxx**
Issued	
xxxxx ordinary shares in issue at the beginning of the year	Xxxx
xxxxx Ordinary shares issued during the year at Rxxx each	Xxxx
xxxxx Ordinary shares repurchased during the year	(xxxx)
	Xxxx

Retained income

Balance at the beginning of the year	**xxxx**
Net profit after tax for the year	xxxx
Repurchase of ordinary shares	xxxx
Dividends on ordinary shares	**xxxx**
Interim dividend	xxxx
Final and recommended dividends	xxxx
Balance at the end of the year	**xxxx**

Worked example

The following information relates to Zondi Distributors (Pty) Ltd

Pre-adjustment trial balance of Lebombo Distributors as at 31 December 2020

Ordinary share capital - 40000 shares of R5 each		200,000.00
Accumulated profit		83,400.00
Land and buildings (at cost)	526,480.00	
Vehicles (at cost).	80,000.00	
Equipment (at cost)	18,000.00	
Accumulated depreciation: Vehicles (1 January 2020)		22,400.00
Accumulated depreciation: Equipment (1 January 2020)		3,420.00
Fixed deposit: FNB Bank Ltd (1 January 2020).	100,000.00	
Trade inventory	17,000.00	
Trade receivables	10,400.00	
Bank.	6,200.00	
Petty cash	200.00	
Cash float	1,000.00	
Trade payables		17,600.00
VAT control		1,500.00

Long-term borrowing: Bean Ltd		50,000.00
Allowance for credit losses		600.00
Sales		763,580.00
Cost of sales	330,800.00	
Sales returns	2,400.00	
Wages	4,000.00	
Salaries	50,000.00	
Municipal rates	3,000.00	
Discounts allowed	760.00	
Vehicle licences	2,000.00	
Motor vehicle running expenses	7,000.00	
Bad debts	1,100.00	
Packaging materials	9,400.00	
Insurance	4,500.00	
Water and electricity	4,200.00	
Telephone expenses	2,800.00	
Advertising	4,000.00	
Rental income		31,200.00
Settlement discount received		1,300.00
Interest on investment		10,000.00
Bad debts recovered		240.00
	1,185,240.00	**1,185,240.00**

Additional information:

1. The telephone account of R330 for December 2020 has not yet been paid.
2. Equipment of R4 000 (cost price) was purchased on 1 July 2020
   Depreciation must be provided as follows:
   Motor Vehicles: 20% per annum on the diminishing balance method.
   Plant and equipment: 10% per annum on the diminishing balance method.
3. The directors recommended the payment of first and final dividend at 50 cents per share.
4. Packaging material on hand at 31 December 2020 to the value of R1 960.
5. The long-term borrowing was obtained on 1 October 2020. According to the agreement,
   interest is payable biannually at a rate of 18% per annum.
6. Advertisements includes an amount of R800 paid for January 2021
7. Rental income includes an amount in respect of January 2021 Rental income was earned evenly throughout the year.
8. Interest on the fixed deposit has not yet been received for the last two months of the financial year. Interest is calculated at a rate of 12% per annum.
9. Insurance includes an amount of R1 500 paid for the period 1 November 2020 to 31 October 2021
10. The account of Loose-Ends Ltd, a debtor who owes the entity R400, must be written off
    as irrecoverable.
11. It was determined that on 31 December 2020, the allowance for credit losses should amount to R500.
12. Zondi Distributors (Pty) Ltd uses a perpetual inventory system.

As a bookkeeper for Zondi Distributors (Pty) Ltd

You are required to :

Prepare the comprehensive income statement for the financial year ended 31 December 2021
Prepare retained earnings note as at 31 December 2020
Prepare the balance sheet or financial position as at 31 December 2020;
Prepare notes for the property plant and equipment;

Zondi Distributors (Pty) Ltd

Statement of profit or loss and other comprehensive income for the year ended 31 December 2020

Sales (763,580-760-2,400)	**760,420.00**
Cost of sale (330,800-1,300)	**329,500.00**
Gross profit	**430,920.00**
Other income	**41,040.00**
Rental income (31,200-2,400)	28,800.00
Credit losses recovered	240.00
Interest income (10,000+2,000)	12,000.00
	471,960.00
Distribution, administrative and other expenses	**101,398.00**
Wages	4,000.00
Salaries	50,000.00
Municipal rates	3,000.00
Vehicle licences	2,000.00
Vehicle expenses	7,000.00
Bad debts (1,100+400-100)	1,400.00
Packaging material (9,400-1,960)	7,440.00
Insurance (4,500-1,250)	3,250.00
Water and electricity	4,200.00
Telephone expenses (2,800+330)	3,130.00
Advertising (4,000-800)	3,200.00
Depreciation	12,778.00
Operating profit	**370,562.00**
Interest expense	2,250.00
Net profit for the year	**370,562.00**

Zondi Distributors (Pty) Ltd
Statement of financial position as at 31 December 20.1

Assets		**R**
Non-current assets		**685,882.00**
Property, plant and equipment		585,882.00
Fixed deposit: FBC Bank		100,000.00
Current assets		**39,910.00**
Inventories		18,960.00

Trade and other receivables (10 400 – 400 – 500 + 2 000)		11,500.00
Prepayments R (1250 + 800)		2,050.00
Cash and cash equivalents (6 200 + 1000 + 200)		7,400.00
Total assets		**725,792.00**
Equity and Liabilities		
Equity		**631,712.00**
Ordinary share capital		200,000.00
Income		431,712.00
Non-current liabilities		**50,000.00**
Long-term borrowings		50,000.00
Current liabilities		**44,080.00**
Trade and other payables R (17 600 + 1500 + 2 250 + 330)		21,680.00
Income received in advance		2,400.00
Dividend		20,000.00
Total equity and liabilities		**725,792.00**

Accumulated profit / Retained earnings

	R
Retained earning at the beginning of the year 1 January 2020	83,400.00
Dividend declared	(20,000.00)
Net profit after tax for the year	368,312.00
Retained income 31 December 2020	**431,712.00**

Property plant and equipment

	Land and Buildings	**Vehicles**	**Plant and Equipment**	**Total**
Carrying amount 1 January 2020	**526,480**	**57,600**	**10,580**	**594,660**
Cost	526,480	80,000	14,000	620,480
Accumulated depreciation	-	-22,400	-3,420	-25,820
Addition	**-**	**-**	**4,000**	**4,000**
Depreciation for the year	**-**	**-11,520**	**-1,258**	**-12,778**
Carrying amount 31 December 2020	**526,480**	**46,080**	**13,322**	**585,882**
Cost	526,480	80,000	18,000	624,480
Accumulated depreciation		-33,920	-4,678	-38,598

Worked example

Govender Electronics (Pty) Ltd

Given below is a preadjusted trial balance on 30 June 2020

10,000 Ordinary shares of R360 rand each		3 600,000
Retained income		890,000
Loan from Green Bank		220,000
Land and buildings at cost	3,341,850	
Vehicles at coat	1,040,000	
Equipment at cost	380,000	
Accumulated depreciation : vehicles		374,400
Accumulated depreciation : equipment		73,500
Inventories	960,000	
Debtors	273,200	
Provision for bad debts		6,800
Creditors		104,360
Bank	46,814	
Sars (income tax)	142,000	
Sales revenue		6,073,200
Cost of sales	3,318,000	
Debtors allowances	100,800	
Audit fees	105,000	
Directors fees	1,080,000	
Dividends on shares	180,000	
Interest income		5,000
Water and electricity	208,858	
Repairs income		209,500
Rental income		112,000
Salaries and wages	324,000	
Sundry expenses	168,238	
	11,668,760	**11,668,760**

Additional information

1 The credit note for the return of 4, sold for R6 300 each, was omitted from the debtors allowances journal for June in error. The goods are sold at a mark-up of 80%.

2 Sundry expenses were prepaid by R 6 400.

3 Edward Mkhize a debtor his account has been written off as irrecoverable. R 11 600 has been received from him. The amount was entered in the debtors control column in the cash receipts journal in error.

4 The provision for doubtful debts to be adjusted to 4%

5 A new director was introduced on the 1 of May 2020 and his remuneration has not been provided for.

6 The other two existing directors have been paid. All three directors earn the same monthly fees.

7 Rent has been received for 14 months.

8 The loan statement from Green Bank reflected the following

Balance 1 July 2019	**R400,000**
Repayment 5 April 2020	R180,000
Interest capitalised	R ?
Balance 30 June 2020	**R250,000**

Depreciation rate

- Motor vehicles 20% p.a on diminishing balance method
- Equipment 10% on the straight-line method
- A computer was taken by one of the directors for personal use at R1600 cash. No entries have been made in respect of the disposal of this asset.

HP Computer Date purchased : 1 January 2017		Cost price: R50,000 Depreciation: 10% p.a on cost	
Date	Depreciation calculation	Current depreciation	Accumulated depreciation
30 June 2017	50,000 x10% x 6/12	2,500	2,500
30 June 2018	50,000 x10%	5,000	7,500
30 June 2019	50,000 x10%	5,000	12,500
31 March 2020	R ?	R ?	R ?

- Income tax is calculated at 28% of the net income.
- A final dividend of R27 per share was declared.

Required

Calculate the profit or loss on disposal of the computer.

Prepare the income statement for Govender Electronics (Pty) Ltd for the year ended 30 June 2020

1 Calculation of profit or loss on disposal

Accumulated depreciation to June 2019	12,500
Depreciation current 50,000 x 0.1 x 9/12	3,750
Total Depreciation	16,250
Carrying amount (Cost R50 000 – Acc Dpn R16,250)	33,750
Sold	1,600
Loss on sale of asset	**32,150**

Statement of comprehensive income for year ended 30 June 2020

Sales (6 073 200+100,800+12,600)	**5,947,200**
Cost of sales (331,800+14,000)	**(3,304,000)**
Gross Profit	**2,643,200**
Other operating profit	**317,100**
Rental income (112,000- 16,000)	96,000
Repairs income	209,500
Bad debts recovered	11,600
Gross operating profit	**2,960,300**
Operating expenses	**2,960,300**

Audit fees	105,000
Directors' fees (1080,000+90,000)	1,170,000
Municipal rates	208,858
Salaries and wages	324,000
Sundry expenses (168,238-6400)	161,838
Provision for bad debts – increase (10,384-6800)	3,584
Depreciation (133,120+3,750+33,000)	169,870
Loss on sale of asset	32,150
Operating profit	**785,000**
Interest income	5,000
Profit before interest expense	**790,000**
Interest expense (250,000+400,000+90,000)	(30,000)
Profit before tax	**760,000**
Income tax	(212,800)
Net profit for the year	**547,200**

Workings

Depreciation for the year

Vehicles (1 040,000-374,400)x0.20 = 133,120

Equipment (380,000-50,000)x0.1 = 33,000

Equipment sold = 3,750

Directors fees

Fees per month 1 080,000/24 = 45,000
New directors fees 45,000 x 2 = 90,000

Provision for bad debts
Debtors balance 136,600 – 25,200 +

QUESTION 4 NOV 2019 : BALANCE SHEET AND AUDIT REPORT (70 marks; 45 minutes)

4.1 Choose an explanation in COLUMN B that matches the term in COLUMN A. Write only the letters (A–E) next to the question numbers (4.1.1 to 4.1.5) in the ANSWER BOOK.

COLUMN A	COLUMN B
4.1.1 Internal auditor 4.1.2 Memorandum of incorporation (MOI)	A. A appointed by shareholders to manage a company B. the body responsible for registration of all companies

4.1.3 Limited liability 4.1.4 Director 4.1.5 Companies and Intellectual Property Commission (CIPC)	C. employed by a company to ensure good internal control procedures D. indicates that a company has a legal personality of its own E. the document that establishes the rules and procedures of a company

4.2 VISIV LTD

The financial year ended on 28 February 2019.

REQUIRED:

4.2.1 Calculate:
Amounts for (i) and (ii) in the Fixed Assets Register (5)

- Profit/Loss on sale of asset (2)
- Fixed assets carrying value on 28 February 2019 (4)

4.2.2 Calculate the correct net profit after tax for the year ended 28 February 2019. Indicate (+) for increase and (–) for decrease. (9)

4.2.3 Refer to Information A–H. Prepare the following on 28 February 2019:

- Retained Income Note (9)
- Statement of Financial Position (Balance Sheet).

NOTE: Show work Certain figures are provided in the ANSWER BOOK. (27)

INFORMATION:

A. Fixed assets:

A delivery vehicle was sold on 31 October 2018 but no entries were made to record this transaction.

Details of vehicle sold:

Delivery Vehicle X43
Date purchased: 1 March 2016
Date sold: 31 October 2018 **Sold for:** R195 000 (cash)

Depreciation rate: 25% p.a. (diminishing-balance method)

	COST	DEPRECIATION	CARRYING VALUE
28 February 2017	R400 000	R100 000	R300 000
28 February 2018		75 000	225 000
31 October 2018		**(i)**	**(ii)**

B **List of balances/totals on 28 February 2019 (before taking into account all adjustments below):**

Ordinary share capital	R8 152 000
Retained income (1 March 2018)	865 300
Mortgage loan: Prati Bank	1 758 000
Fixed assets (carrying value)	10 190 000
Fixed deposit: Prati Bank (balancing figure)	**?**
Trading stock	1 102 000
Net trade debtors	1 090 000
Bank (favourable)	**?**
SARS: Income tax (provisional tax payments)	155 000
Creditors' control	1 906 800

C. Net profit before tax, R822 700, was calculated before correcting the following:

- Provision for bad debts must be increased by R65 000.
- R9 800 of an advertising contract applies to the next financial year.
- A tenant paid rent of R334 000 for the period 1 March 2018 to 31 March 2019. Rent was increased by R3 000 per month from 1 January 2019.
- Depreciation and profit/loss on the vehicle sold must be recorded.
- A further R43 000 is owed for income tax

D. Ordinary shares:

DATE	**DETAILS**
1 March 2018	2 000 000 shares in issue; total book value R7 600 000
31 May 2018	360 000 shares repurchased at R4,10 each
1 October 2018	800 000 new shares issued
28 February 2019	2 440 000 shares in issue

E. Dividends:

- Interim dividends were paid in September 2018, R295 200.
- Final dividends of 20c per share were declared on 28 February 2019.

F. A creditor with a debit balance of R7 600 must be transferred to the Debtors' Ledger.

G. A cheque for R75 000, dated 30 April 2019, was issued to a supplier in February.

H. After processing all adjustments:

- The current ratio is 0,8 **:** 1.
- The current liabilities totalled R2 900 000.
- The current portion of the loan is the balancing figure.

SOLUTION

4.1.1	C
4.1.2	E
4.1.3	D
4.1.4	A
4.1.5	B

4.2.1

Motor Vehicle Account			
Balance b/d	400 000	31 October Disposal	400 000
	400 000		400 000

Motor Vehicle Disposal Account			
31 October Motor Vehicle	400 000	Bank	195 000
Profit and loss (Profit on disposal)	7 500	Accumulated Depreciation	212 500
	407 500		**407 500**

Accumulated Depreciation Motor Vehicle			
31 October Disposal	212 500	Balance b/d	175 000
		Motor Vehicle Depreciation	37 500
	212 500		**212 500**

Motor Vehicle Depreciation			
Accumulated Depreciation MV	37 500	Profit and loss	37 500

4.22

Correction of net profit for the year ended 28 February 2019	
Net profit before adjustments	822 700
Increase in provision for bad debts	-65 000
Prepaid advertisement	+9 800
Profit on disposal motor vehicle	+7 500
Rent prepaid ((334 000 – 9000)/13) + 3000	-28 000
Depreciation on motor vehicles	-37 500
Income tax (155 000 + 43 000)	-198 000
Corrected net profit after tax	**511 500**

Calculation of March 2019 rent

Let F = Original monthly rent fee

334 000 = 3 (F+3 000) + 10R

334 000 = 3F + 9 000 + 10F

334 000 = 13F + 9000

334 000 - 9000 = 13F

325 000 = 13F

25 000 = F

March 2019 rent = 25 000 + 3 000 = **28 000**

4.2.3

Retained earnings note/ Appropriation account	**R**
Balance as at 1 March 2018	**865 300**
Net profit after tax	511 500
Shares repurchased 360 000XR0.30	(108 000)
Ordinary share dividends	**(783 200)**
Interim dividend	295 200
Final dividend 2 440 000 x 0.20	488 000
Balance as at 28 February 2019	**485 600**

4.2.4

Statement of financial position as at 28 February 2019	
Assets	**R**
Non current assets	**10 624 000**
Fixed assets	9 965 000
Fixed deposit	659 000
Current assets	**2 320 000**
Inventory	1 102 000
Trade and other receivables (1 090 000 – 65 000 + 9 800 + 7 600)	1 042 400
Cash and cash equivalents	175 600
Total Assets	**12 944 000**
Equity and Liabilities	
Ordinary share equity	**8 637 600**
Ordinary share capital	8 152 000
Retained profit	485 600
Non current liabilities	**1 406 400**
Mortgage loan (1 758 000 – 351 600)	1 406 400
Current liabilities	**2 900 000**
Trade and other payables (1 906 800 + 28 000 + 7600 + 75 000)	2 017 400
SARS Income tax	43 000
Dividends payable	488 000

Current portion of loan (**Balancing figure)**	351 600
Total Equity and Liabilities	**12 944 000**

- Trade and other receivables R1 090 000 – R65 000 + R9 800 + R7 600
- Mortgage loan R1 758 00 – R351 600
- Trade and other payables R1 906 800 + R28 000 + R7 600 + R75 000

QUESTION 4 May/June 2019: FINANCIAL STATEMENTS

4.3 MVVS LTD

The information relates to the financial year ended 31 March 2019.

	2019	**2018**
	R	**R**
Ordinary share capital	9 300 000	4 800 000
Mortgage loan: Sapphire Bank	1 430 200	1 658 000
Land and buildings	12 500 000	12 500 000
Vehicles	1 377 000	750 000
Equipment	**?**	398 000
Accumulated depreciation on vehicles	**?**	475 000
Accumulated depreciation on equipment	**?**	117 500
Provision for bad debts	**?**	30 100
Trading stock	364 200	
Debtors' control	578 000	
Sales	10 563 280	
Cost of sales	6 236 000	
Rent income	99 500	
Directors' fees	1 262 100	
Water and electricity	218 000	
Telephone	75 600	
Audit fees	104 000	
Sundry expenses	61 001	
Salaries and wages	1 280 000	
Employer's contributions (medical, pension and UIF)	316 000	
Bad debts	22 300	
Consumable stores	53 200	
Interest income	**?**	
Insurance	79 500	
Depreciation (on equipment sold)	1 750	
Interest on loan	**?**	
Bad debts recovered	6 000	
Ordinary share dividends (interim)		

REQUIRED:

4.3.1 Complete the Statement of Comprehensive Income (Income Statement) for the year ended 31 March 2019. (53)

4.3.2 Complete the following notes to the Balance Sheet:

- Fixed/Tangible Asset Note (8)
- Ordinary share capital(6)

INFORMATION:

Figures extracted from the Pre-adjustment Trial Balances on 31 March:
Adjustments and additional information:

A. A credit invoice for R36 720 (after deducting a 10% trade discount) issued on 31 March 2019, was not recorded. Goods are marked up at 70% on cost.

B. The physical stock count on 31 March 2019 revealed the following on hand:
- Trading stock, R334 500
- Consumable stores, R3 400

C. Debtor S Magnum was declared insolvent. His estate paid R2 000, which was 20% of his debt. The difference must be written off as a bad debt.

D. R1 800 was received from a debtor, J Misting, whose debt had previously been written off. The bookkeeper incorrectly credited the amount to the Debtors' Control Account. Correct the error.

E. Adjust the provision for bad debts to R28 500.

F. Insurance includes an annual premium of R51 000 paid for the period 1 January 2019 to 31 December 2019.

G. An employee was left out of the Salaries Journal for March 2019. The following details are applicable:

- Net salary of the employee, R9 100
- The deductions by the employer totalled 30% of the gross salary
- Employer's contributions were R2 200

H. Interest on loan is capitalised. A fixed monthly repayment (including interest) of R25 400 was paid for the financial year.

I. Fixed assets and depreciation:

(i) Vehicles:
Details for the three vehicles are as follows:

	Cost Price	**Accumulated depreciation 31 March 2018**	**Date purchased**
1	R350 000	R315 000	1 October 2013
2	R400 000	R160 000	1 April 2016
3	R627 000		

Vehicles are depreciated at 20% p.a. on cost.

(ii) Equipment:

- Equipment was sold for R9 600 cash on 31 August 2018. Only the following entries in respect of this sale were processed:

Cost price	28 000
Accumulated depreciation at the date of disposal	21 500
Depreciation for the current financial year	1 750

Depreciation on the remaining equipment is calculated at R92 500 after taking all of the above into account.

J Interest income is the missing figure in the Income Statement.

K Income tax is calculated at 28% of the net profit. The net profit before tax was R691 000.

L Shares and dividends:

- The company has an authorised share capital of 8 000 000 shares.
- The company had 1 200 000 shares in issue on 1 April 2018.
- 150 000 shares were repurchased on 30 November 2018. EFT payments totalling R825 000 were made for these shares.
- 850 000 additional shares were issued on 30 September 2018.

SOLUTION

4.3

4.3.1

Statement of Comprehensive Income (Income Statement) for the year ended 31 March 2019	
	R
Sales (10 563 280 + 36 720)	**10 600 000**
Cost of sales (6 236 000 + 24 000)	(6 260 000)
Gross profit	**4 340 000**
Operating income	**112 000**
Rent income	99 500
Bad debts recovered	7 800
Provision for bad debts adjustment	1 600
Profit on sale of asset	3 100
Gross operating income	**4 452 000**
Operating expenses	**(3 710 000)**
Directors' fees	1 262 100
Water and electricity	218 000
Telephone	75 600
Audit fees	104 000
Sundry expenses	61 001

Salaries and wages (1 280 000 + 9 100 + 3 900)	1 293 000
Employer's contributions	318 200
Bad debts (22 300 + 8 000)	30 300
Consumable stores	49 800
Insurance (79 500 – 38 250)	41 250
Depreciation (34 999 + 80 000 + 41 800) + (92 500 + 1 750)	251 049
Trading stock deficit (364 200 – 24 000 - 334 500)	5 700
Operating Profit	**742 000**
Interest income balancing	26 000
Profit before interest expense	768 000
Interest expense (1 430 200 + 304 800 – 1 658 000)	(77 000)
Net profit before tax	**691 000**
Income tax	(193 480)
Net profit after tax	**497 520**

4.3.2 NOTES TO THE BALANCE SHEET

Property plant and equipment

	Land and buildings	**Vehicles**	**Equipment**
Carrying value at beginning of financial year	12 500 000	750 000	398 000
Cost	12 500 000	750 000	398 000
Accumulated depreciation		(475 000)	(117 500)
Movements			
Additions at cost		627 000	
Disposals at carrying value			(6 500
Depreciation		(156 799)	(94 250)
Carrying value at end of financial year	12 500 000		
Cost	12 500 000	1 377 000	370 000
Accumulated depreciation		(631 799)	(190 250)

Ordinary share capital

Authorised:		
8 000 000 shares		
1 200 000	shares in issue at beginning	4 800 000
(150 000)	shares re-purchased (ASP: R4.00)	(600 000)
850 000	shares issued during year	5 100 000
1 900 000	shares in issue at end	9 300 000

Authorised:		
8 000 000 shares		

1 200 000	shares in issue at beginning	4 800 000
(850 000)	shares issued	5 233 500
150 000	shares repurchased	(733 500)
1 900 000	shares in issue at end	9 300 000

QUESTION 1 P1 NOVEMBER 2020 : FIXED ASSETS AND STATEMENT OF COMPREHENSIVE INCOME (60 marks; 45 minutes)

The information relates to Robbie Ltd for the financial year ended 28 February 2021.

REQUIRED:

1.1 Refer to INFORMATION B(a) for fixed assets.

Calculate the following:

1.1.1 The missing amounts denoted by (i) to (iii) on the Fixed Asset Note (11)
1.1.2 Profit/Loss on the sale of equipment on 1 October 2020 (2)
1.2 Refer to INFORMATION B(e) for trading stock.

Calculate the trading stock deficit. (4)

1.3 Prepare the Statement of Comprehensive Income for the financial year ended 28 February 2021.(43)

INFORMATION:

A. Extract from the Pre-adjustment Trial Balance on 28 February 2021:

	R
Mortgage loan: Sufi Bank	1 005 500
Debtors' control	123 000
Trading stock	?
Provision for bad debts (1 March 2020)	7 030
Sales	?
Cost of sales	6 966 000
Salaries and wages	1 468 120
Directors' fees	3 330 000
Audit fees	91 000
Repairs	476 000
Rent income	173 000
Interest income	25 000
Interest on loan	?
Bad debts	19 200
Advertising	25 680
Sundry expenses	452 310

Ordinary share dividends	86 400

B. Adjustments and additional information:

(a) Fixed assets:

Vehicles:

- The business owns two vehicles on 28 February 2021. The second vehicle was purchased on 1 November 2020.
- Vehicles are depreciated at 15% p.a. on cost.

Equipment:

- Depreciation is 20% p.a. on the diminishing-balance method.
- Unused equipment was sold for R40 000 on 1 October 2020. Accumulated depreciation on the equipment sold was R36 600 on 1 March 2020.

Extract of the Fixed Asset Note:

	Vehicles	**Equipment**
Cost (1 Mar. 2020)	460 000	360 000
Accumulated depreciation (1 Mar. 2020)	(396 750)	(187 595)
Carrying Value (1 March 2020)	**(i)**	**172 405**
Additions (at cost)	510 000	0
Disposals (at carrying value)	0	(iii)
Depreciation	(ii)	(31 281)
Carrying Value (28 February 2021)		
Cost (28 Feb. 2021)	970 000	285 000
Accumulated depreciation (28 Feb. 2021)		

(b) The business maintains a mark-up of 120% on cost. Note that trade discounts of R648 000 were granted to special customers.

(c) The account of debtor B Melta, R800, must be written off.

(d) Provision for bad debts must be adjusted to 5% of outstanding debtors.

(e) Trading stock is valued on the weighted-average method. The Ledger Account and records reflect that 280 units should be on hand. However, the physical stock count reflects only 262 units on hand. The stock records are as follows:

	UNITS	UNIT PRICE	TOTAL
Stock at beginning of year	200	R3 600	R720 000
Purchased during the year	1 840	R4 100	R7 544 000
Returns: damaged units	40	R4 100	R164 000
Available for sale	**2 000**		**R8 100 000**
Stock units per records	280	?	?

(f) 30% of the audit fees is still outstanding.

(g) The monthly rent income did not change during the year. During February 2021 the tenant paid R9 000 for repairs to the premises, and deducted this from his rent for February

2021. Repairs are the responsibility of the company, and this was not recorded. The rent for March 2021 was received in advance.

(h) The company has four directors earning the same fee. One director resigned on 31 May 2020 and received his fees up to this date. Another director is still owed fees for January and February 2021.

(i) Advertising consists of a contract with a newspaper for the entire financial year. Payments are monthly, however instalments were paid for 11 months only. NOTE: The monthly rate decreased by R240 from 1 November 2020.

(j) The net profit after tax was accurately calculated at R1 054 000. The income tax rate is 32%.

SOLUTION

1.1.1

(i) Calculate: Carrying value of the vehicle on hand on 1 March 2020		
	Workings	**Answer**
	460 000 – 396 750	63 250
(ii) Calculate: Depreciation on vehicles for the year		
	Workings	**Answer**
	(510 000 x 15% x 4/12) 460 000 x 15% = 69 000; CV is 63 250. Depreciation is therefore 63 250 – R1,00 = 63 249	**(25 500 + 63 249)** **88 749**
(iii) Calculate: Carrying value of equipment sold		
	Workings	**Answer**
	360 000 – 285 000 -41 080 75 000 – 36 600 – 4 480 OR: 75 000 – (36 600 + 4 480) OR: 360 000 – 285 000 – 41 080 - 360 000 + 285 000 + 41 080	33 920

1.1.2

Calculate: Profit/Loss on the sale of equipment	
40 000 – 33 920 OR – 40 000 + 75 000 – 41 080	6 080

1.2

Calculate: Trading stock deficit	
(280 – 262) x 4 050 (280 x 4 050) – (262 x 4 050) 1 134 000 1 061 100	R72 900

1.2 STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 28 FEBRUARY 2021

Sales 15 325 200 – 648 000 OR (6 966 000 X 1,2) + 6 966 000 – 648 000 6 966 000 x 2,2	14 677 200
Cost of sales	(6 966 000)
Gross profit 6 966 000 x 1,2 8 359 200 – 648 000	7 711 200
Other income	175 000
Profit on sale of asset*	6 080
Rent income 173 000 + 9 000 – 14 000	168 000
Provision for bad debts adjustment 7 030 – 6 110	920
Gross operating profit	**7 886 200**
Operating expenses	**(6 286 200)**
Salaries and wages	1 468 120
Depreciation 31 281 + 88 749	120 030
Trading stock deficit	72 900
Directors' fees 3 330 000 + 180 000	3 510 000
Audit fees 91 000 + 39 000	130 000
Repairs 476 000 + 9 000	485 000
Bad debts 19 200 + 800	20 000
Advertising 25 680 + 2 400 – 240	27 840
Sundry expenses	452 310
Operating profit	**1 600 000**
Interest income	25 000
Profit before interest expense	**1 625 000**
Interest expense	**(75 000)**
Net profit before tax	**1 550 000**
Income tax for the year	(496 000)
Net profit after tax	**1 054 000**

COST ACCOUNTING

Cost accounting

The systematic recording and analysis of the costs of material, labour, and overhead incident to production.

Manufacturing or Production cost

The ate cost directly attributable to the production of goods and services. These are namely:

- Direct materials
- Direct labour and
- Factory overheads

Manufacturing account or production cost statement

PMB Manufacturers (Pty) Ltd has the following information. Prepare cost of production statement or manufacturing account for the six months ended 31 June 2019

Raw materials	70,000
Beginning RM inventory	5,000
Ending RM inventory	6,000
Direct labour	50,000
Direct expenses	4,000
Manufacturing overhead	30,000
Beginning WIP inventory	10,000
Ending WIP inventory	15,000

PMB Manufacturers
Production cost statement for the six months ended 31 June 2019

	R
Direct material cost	70 000
Opening inventory materials	5 000
	75 000
Closing inventory material	6 000
Raw materials consumed in production	**69 000**
Direct labour	50 000
Direct expenses	4 000
Prime cost	**123 000**
Manufacturing overheads	30 000
	153 000
Opening WIP	10 000
	143 000
Closing WIP	15 000
Cost of production of finished goods	**128 000**

Contribution per unit

It selling price per unit less variable costs per unit

Break even point

The break even point is the production level where total revenues equals total expenses

$$\text{BEP units} = \frac{\text{Fixed costs}}{\text{Selling price – Variable cost per unit}} = \text{break even units}$$

Or

$$\frac{\text{Fixed costs}}{\text{Contribution per unit}} = \text{Break even units}$$

$$\text{Break even sales} = \frac{\text{Fixed costs}}{\text{Contribution per unit}} \times \text{SP}$$

QUESTION 1 NOV 2019 : MANUFACTURING (40 marks; 20 minutes

Sihle Sangweni owns two separate factories that manufacture products according to orders received. There is no work-in-progress stock. The year-end is 28 February.

1.1 Indicate whether the following statements are TRUE or FALSE. Write only 'true' or 'false' next to the question numbers (1.1.1 to 1.1.3) in the ANSWER BOOK.

1.1.1 Wages of factory cleaners is a direct labour cost.

1.1.2 Delivery costs of finished goods to retailers are a selling and distribution cost.

1.1.3 Depreciation on office equipment is an administration cost. (3 x 1) (3)

1.2 DESKS FACTORY

REQUIRED:

1.2.1 Complete the Factory Overhead Cost Note. (8)

1.2.2 Calculate the total cost of production of finished goods. (5)

1.2.3 Sihle wants to produce an additional 1 500 desks, while maintaining the selling price and costs.

Calculate the additional profit he can expect. (4)

1.3 CHAIRS FACTORY

REQUIRED:

1.3.1 Provide a calculation to confirm the break-even point for 2019. (4)

1.3.2 Comment on the break-even point and the production level achieved. Quote figures. (4)

1.3.3 Raw material consists of wood only. In 2019 the cost is R120 per square metre (m2) and 1,2 m2 of wood is needed to make one chair.

During the year, 22 000 m2 wood was dispatched to the factory. Sihle feels that the wood raw material was not well controlled.

- Provide a calculation to support his opinion. (4)
- Identify TWO possible causes of this problem. Provide a solution for EACH.(4)

1.3.4 Give TWO reasons for the increase in direct labour cost. Provide a solution for EACH. Note that wages and salaries increased by 5% in the current financial year. (4)

INFORMATION:

A. DESKS FACTORY

Extract of pre-adjustment amounts on 28 February 2019

	R
Indirect labour	296 500
Depreciation of factory plant	166 000
Advertising	24 500
Water and electricity	248 000
Rent expense Insurance allocated to sales department	345 600 12 600
Factory sundry expenses	107 700

Adjustments to factory overheads for desks:

• Water and electricity for February 2019, R18 000, must be taken into account. 80% is allocated to the factory. The balance is an administration cost.

• Rent must be allocated according to floor area:

Factory: 810 m2 Office: 180 m2 Sales department: 90 m2

• 75% of insurance must be allocated to the factory. The balance applies to the sales department

A. INFORMATION FOR BOTH FACTORIES

COSTS		DESKS2019		CHAIRS (Unit costs)	
		Amount	Per unit	2019	2018
Variable	Direct material	R3 060 000	R340	R165	R124
	Direct labour	?	R160	R90	R70
	Selling and distribution	R720 000	R80	R50	R60
	Total variable costs		R580	R305	R250
Fixed	Factory overheads			R76	R75
	Administration	R360 000	R40	R20	R18

SELLING PRICES			
Per unit	R750	R390	R370

UNITS			
Produced and sold	9 000	16 000	15 000
Break-even point	8 471	18 071	12 400

SOLUTION

1.1.1	False
1.1.2	True
1.2.3	True

1.1 Desks factory

Factory Overhead Cost	
Indirect labour	296 500
Depreciation on factory plant	166 000
Water and electricity (248 000 + 18 000) x 80% Or -53 000 + 198 400 + 14 400	212 800
Factory rent 345 600x 810/1080 or – 86 400	259 200
Insurance 12 600 x 75/25 or x3 or 50 400-12 600	37 800
Factory sundry expenses	107 700
	1 080 000

Calculate the total cost of production of finished goods.

R 3 060 000 + 1 440 000 + 1 080 000 = R5 580 000

OR

9 000 X (340 + 160 + 120) = R5 580 000

Sihle wants to produce an additional 1 500 desks. Calculate the additional profit he can expect.

1500 X 170 R255 000

Provide a calculation to confirm the break-even point for 2019.

<u>R1 216 000 + R320 000</u>

390 – 305

OR 7 047 690 – 5 511 655 – 1 536 000 OR 0

Comment on the break-even point and the production level achieved. Quote figures.

Comment on BEP , Figures , Comment on production

Reponses for four marks:

- Produced 16 000 units but BEP is 18 071(or see 1.3.1) units so they will make a loss
- Produced 2 071 less than BEP so they will make a loss.
- Production increased from 15 000 to 16 000 units (by 1 000) and BEP increased from 12 400 to 18 071 units (by 5 671).
- In 2018 they made a profit on 2 600 units.

Sihle feels that wood raw materials was not well controlled. Provide calculation		
Meters	Actual size : 22 000 m , Budget 16 000 m x 1.2 = 19 200 m Or wastage = 2 800m	
Units	Expected 22 000/1.2 = 18 334 , Actual 16 000 Or 2 334 fewer chairs made	
Total cost	Expected R2 640 000 , Actual R2 304 000 OR Extra cost R336 000	
Unit cost	Expected 1.2x 120 =R 144 , Actual R165 or Extra unit cost R21 per extra unit	
Production	DMC increased by 33% (R165 –R124; 41÷124) Units produced increased by 7% (1 000 ÷ 15 000)	
Identify two possible causes of this problem. Provide solution for each		
	Possible causes	Solution for each
	Wastage / unskilled worker	Train workers, supervise regularly Use technology (stencils / templates)
	Damage (fire / water)	Secure storage / check deliveries
	Theft of wood	Internal controls / stock counts / supervision / buy in smaller quantities / install cameras
	Poor quality wood	Source other suppliers / check deliveries

Give TWO reasons for the increase in direct labour cost. Provide a solution for each		
	Reasons	**Solution for each**
	Load shedding	Generator or solar power

	Workers dissatisfied with increase/ protests	Engagement / Communicate with union
	Inflation / wage increase / bonus	Improve productivity
	Overtime	Restrict overtime / more workers
	Inefficient / slow workers	Pay per unit produced / improve monitoring procedures / training programme

QUESTION 2: JUNE 2018 MANUFACTURING (45 marks; 30 minutes

2.1 Choose ONE cost account for each of the following descriptions. Write only the cost accounts next to the question numbers (2.1.1 to 2.1.4) in the ANSWER BOOK**.**

direct labour cost; direct/raw materials cost; factory overheads cost; administration cost; selling and distribution cost

2.1.1 Bad debts written off during the financial year

2.1.2 Pension fund contributions paid on behalf of the workers in the production process

2.1.3 Transport costs paid for raw materials purchased

2.1.4 Depreciation on office equipment (4 x 1) (4

2.2 TIGHT-FIT MANUFACTURERS

The information relates to Tight-Fit Manufacturers, a business that

manufactures denim jeans, for the financial year ended 31 March 2018.

REQUIRED:

2.2.1 Calculate:

The value of the closing stock of raw materials of fabric using the weighted-average method (4)
The value of direct/raw materials issued for production (3)
The correct factory overhead costs (6)

2.2.2 Complete the Production Cost Statement on 31 March 2018. (12)

2.2.3 The business purchases raw materials from an overseas supplier,

although there are numerous local suppliers. Give TWO reasons why the business should support local suppliers. (2)

INFORMATION:

A. Stock balances on 31 March:

	2018	**2017**
Work-in-process	**?**	R147 500
Finished goods	R118 000	R231 000

B. Raw materials (fabric):

Raw materials, consisting of metres of fabric, are issued by the storeroom to the factory.

Storeroom stock records:

	METRES	**TOTAL AMOUNT R**
Stock on 1 April 2017	5 000	535 000
Purchases:	18 700	2 072 000
July 2017	6 200	620 000
October 2017	4 800	528 000
January 2018	7 700	924 000
Total available for production	23 700	2 607 000
Stock on 31 March 2018	3 900	?

C. Figures provided by the bookkeeper on 31 March 2018:

Wages of factory workers (direct labour)	R3 522 000
Factory overhead cost (see Information D below)	R746 670
Administration cost	R655 700
Selling and distribution cost	R413 900

D. Adjustments must be made to factory overhead cost in respect of the following:

- Insurance of factory plant and equipment paid was R69 600 and incorrectly debited to the Administration Cost Account. Included in this is a new annual premium of R17 400 paid on 1 January 2018.
- Rent is allocated according to the floor space. However, the bookkeeper correctly allocated only R14 820 to the administration section.

FACTORY	**ADMINISTRATION OFFICE**	**TOTAL FLOOR AREA**
520 m2	130 m2	650 m2

E. Details from the Income Statement for the year ended 31 March 2018

Sales	R9 747 000
Cost of sales	6 518 000
Gross profit	3 229 000

2.3 BREAK-TIME MANUFACTURERS

Break-Time Manufacturers is a manufacturing business that produces lunch boxes for school children.

REQUIRED:

2.3.1 Calculate the following for the year ended 30 April 2018:

- Direct labour cost
- Break-even point (2) (4)

2.3.2 Explain why the owner should be concerned about the break-even point. Quote figures. (3)

2.3.3 The owner is concerned about the direct labour cost.

- Explain why the owner would NOT be satisfied with the direct labour cost per unit. Quote figures.
- Give ONE solution to this problem. (3) (2)

INFORMATION ON 30 APRIL:

	2018		**2017**	
	TOTAL COST	PER UNIT	TOTAL COST	PER UNIT
Direct labour cost (basic and overtime)	**?**	R7,56	R1 646 400	R5,60
Total fixed costs	R3 102 500	R9,36	R1 989 000	R6,77
Total variable costs	R6 464 250	R19,50	R4 704 000	R16,00
Selling price per unit	R28,00		R24,50	
Number of units produced and sold	331 500 units		294 000 units	
Break-even point	**?**		234 000 units	

SOLUTION

2.1.1	Selling and distribution cost
2.1.2	Direct labour cost
2.1.3	Direct/raw materials cost
2.1.4	Administration cost

2.2 TIGHT-FIT MANUFACTURERS

Calculate: Value of the closing stock of raw materials	
$\frac{2\ 607\ 000}{23\ 700} \times 3\ 900$	429 000

Calculate: Value of direct/raw materials issued for production	
2 607 000 – 429 000 OR (23 700 – 3 900) x 110	2 178 000

Calculate: Correct factory overhead costs	
746 670 + 56 550 + 59 280	862 500

2.2.2 Production Cost Statement for the year ended 31 March 2018.

Direct materials cost	2 178 000
Direct labour cost	3 522 000
Prime cost	**5 700 000**
Factory overhead cost	862 500
Total manufacturing costs	**6 562 500**
Work-in-process at beginning of year	147 500
	6 710 000
Work-in-process at end of year	(305 000)
Cost of production of finished goods	**6 405 000**

2.2.3

Give TWO reasons why the business should support local suppliers.

Reasons: Any TWO relevant reasons □ □

• No import charges will be paid
• Less transport costs
• Prices more stable / prices not influenced by fluctuations in exchange rates.
• Creates more employment opportunities to people from the country / enhances GDP of the
country / helps small or new businesses / improves standard of living
• No delays in the case of emergency orders or returns / more convenient to transport goods
• Money stays in the country / improves exchange rate
• Less crime if employment increases
• Goodwill of the community (Ubuntu

3 BREAK-TIME MANUFACTURERS

2.3.1

Calculate the direct labour cost for the year ended 30 April 2018	
331 500 x R7,56	R2 506 140

Calculate the break-even point for the year ended 30 April 2018.	
$\frac{R3\ 102\ 500}{R28 - R19{,}50}$	365 000 units

2.3.3

Explain why the owner should be concerned about the break-even point. Quote figures.

Compare BEP with level of production

- The business produced and sold 331 500 units. This is below the break-even point of 365 000 units (33 500 units less) see 2.3.1
- The BEP has increased by 131 000 units (56%) while the number of units produced and sold increased by 37 500 units (13%).

Explain why the owner would NOT be satisfied with the direct labour cost per unit.
Quote figures.

- Trend: The increase in the labour cost is R1,96 per unit (R5,60 to R7,56) / 35% increase /
  DLC per unit went up by 35% while units produced went by 13%
- Explanation: This exceeds the inflation rate / workers have been inefficient / production
- volume did not increase as much as the DLC per unit 3

- Set production targets of production (during normal hours) / time and motion studies.

- Better supervision to ensure workers are on duty during normal working hours/ Set limits
- on overtime hours and ensure foreman controls this.
- Reconsider conditions of service e.g. minimum normal hours, overtime rate.
- Have plans for disruption due to power cuts, strikes etc.
- Engage in skills training to improve efficiency of workers.
- Use machines more extensively
- Negotiate affordable / reasonable increases (in line with inflation) in salaries/ wages

INVENTORY VALUATION

Inventory systems

Perpetual inventory system

A perpetual inventory system is an inventory management method that records each sale or purchase of inventory in real-time, through automated software.

The perpetual inventory system involves tracking and updating inventory records after every transaction of goods received or sold through the use of computerised sytems and inventory management software.

Perpetual inventories are the solution to such an issue, giving accurate and updated information about inventory levels, COGS, allows them to check on discrepancies in real-time.

Stock take is continuous .

It discourages pilferage and stock theft since the anomalies can easily be detected .

It is difficulty to manipulate the system.

Periodic inventory system

A periodic inventory system records merchandise transactions periodically, usually at the end of the year.

The main issue that businesses encounter under the periodic inventory system is the fact that inventory information is not up to date and may be unreliable. Stock records and cost of sales will be inaccurate till the day stocktake is done and adjustment done.

Periodic system is less costly

Periodic system attract stock theft and abuse since the anomalies are only discovered after a long period.

Stock valuation methods

We shall focus on three methods only namely

- FIFO- First in first out
- AVCO – Weighted average stock valuation
- Specific identification

FIFO method

(FIFO) method of inventory valuation is based on the assumption that the sale or usage of goods and materials follows the same order in which they are bought. The goods which were purchased first are assumed to have been sold first.

According to FIFO, at the end of a year an inventory would consist of goods most recently placed in inventory.

In an inflationary environment, the cost of goods sold will be at its lowest possible amount.

This would help in maximizing net income within an inflationary environment.

The negative side of that effect is that income taxes will be at their highest.

Merits

- FIFO method saves money and time in calculating the exact cost of the inventory being sold because the cost will depend upon the most former cash flows of purchases to be used first.
- It is a simple concept which is easy to understand.
- It is a practical methodology to use, as sometimes it becomes strenuous to identify the costs of the products sold at the point of sale and FIFO rectifies the matter.
- It is a extensively used and accepted methodology of valuation which increases its comparability and consistency.
- It makes falsification of the income reported in financial statements hard, as under FIFO policy there remains no ambiguity about the values to be used in cost of sales values of profit/loss statement.
- FIFO will result in increased gross and net profits in times inflation.
- It is easily done by an accounting system.

Disadvantages of FIFO method:

- in the times of inflation it results in higher profits, due to which higher tax incur is charged. It can result in increased cash out flows in relation to tax charges.
- FIFO may not be a suitable measure in times of “hyper inflation”. Leads to distortion of cost of sales.
  FIFO pricing valuation method although easy to understand may get clumsy and cumbersome to operate and extract the costs of goods, as substantial amount of data is required thus resulting in clerical errors

Example FIFO method

Date 2021	**details**	**Units**	**Cost / unit**	**Purchases R**	**Sales Units**	**Price**	**Sales R**
1 March	Balance	250	20	5 000			
5 March	Purchases	800	21	16 800			
8 March	Purchases	450	22	9 900			
10 March	Sales				800	50	40 000
12 March	Purchases	300	22.5	6 750			
15 March	Purchases returns	-50					
20 March	Purchases	350	23	8 050			
30 March	Sales				450	51	28 050
Total		**2 100**		**46 500**	**1 350**		**68 050**
Less sales		1 250					
Balance		**750**					

Purchases returns pertain to good purchased on the 12th of March 2021

Required

A Value of closing stock using the FIFO method.

SOLUTION

FIFO means the last stocks purchased constitutes the closing stock

Valuation of stock using FIFO method

Date	Units	Cost/unit	Amount
20 March	350	23	8 050
12 March	250	22.5	5 625
8 March	150	22	3 300
Total	**750**		**16 975**

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Weighted average stock valuation

Average Cost method: the average cost method takes the average of all units available for sale during the accounting period.

The weighted average cost (AVCO) method or standard cost method involves computing the weighted average cost of the inventory held after each inventory acquisition takes place. Any inventory sold or used is then valued at this weighted average figure until another acquisition (purchase) takes place, when a new weighted average cost is computed.

Weighted average method calculations are not cumbersome

Example on computation of closing stock using the weighted average stock valuation method

Date 2021		**Units purchased**	**Cost/ unit**	
15 March	Opening stock	5 400	18	97 200
18 April	Purchases	10 000	20	200 000
01 May	Purchases	15 000	22	330 000
25 June	Purchases	18 000	24	432 000
21 July	Purchases	24 000	26	624 000
Total		**72 400**		**1 683 200**

For the 5 months 62 000 units were sold .

Calculate the closing stock

SOLUTION

Closing stock in units = Purchases less sales = 72 400 + 62 000 = **10 400 units**

Closing stock value

average cost per unit = $\frac{\text{Total purchases value}}{\text{Total units purchased}}$ = $\frac{1\ 683\ 200}{72\ 400}$ = **<u>23.25 per unit</u>**

Closing stock = 23.25 x 10 400 = **R241 785.64**

Specific identification

When an inventory item is sold, the inventory account should be reduced or credited, and cost of goods sold should be increased or debited for the amount paid for each inventory item.

This method works only when a company knows the cost of every individual item that is sold. Specific identification method works well when the quantity of inventory a company has is limited and each inventory item is unique.

The specific identification method can be practiced in businesses such as car dealerships, jewelers, and art galleries

Advantages of the specific identification method

- Both the inventory account and cost of goods sold reflect the actual amounts on hand and sold.
- This method is usually required for high-cost items such as motor vehicles.
- It yields accurate results in terms of stock valuation and cost of sales amount.

Disadvantage

- Recordkeeping can become burdensome for high-volume, lower-priced items.

Calculation of closing stock using specific identification method

Bhima Pty Ltd has the following information

Date		**Units of cars Purchased**	**Cost / Unit**	**Units sold**
1 March	Opening balance	8	235 000	5
15 April	Purchases	5	230 000	4
20 May	Purchases	10	220 000	10
12 June	Purchases	13	225 000	9
30 July	Purchases	15	232 000	5

Calculate the closing stock

SOLUTION

Date		Units of cars unsold	Cost / Unit R	Total amount R
1 March	Opening balance	3	235 000	705 000
15 April	Purchases	1	230 000	230 000
20 May	Purchases	0	220 000	
12 June	Purchases	4	225 000	900 000
30 July	Purchases	10	232 000	2 320 000
Closing stock units / value		**18**		**4 155 000**

Calculation of cost of goods sold

	R	
Opening stock	25,000	
Add purchases	396,950	
Carriage inwards	5,000	
Customs duty	6,250	
Cost of goods available for sale	**433,200**	
Less Closing stock	(30,000)	
Cost of goods sold	**403,200**	

Carriage on purchase and customs duty form part of the cost of goods sold

Goods taken by owner for personal use

- Reduce the purchases and increase the drawings or
- Debt drawings account and credit purchases account.

Goods donated

- Debit donations account and credit purchases account

Goods used as promotional material

- Debit advertising account and credit purchases account

Question

The following information relates to Delux (Pty) Ltd

Balances as at 28 February 2017

	R
Opening stock	50 000
Sales	850 000
Sales returns	50 000
Purchases	420 000
Purchases returns	25 000
Carriage on sales	8 000

Carriage on purchases	5 000
Customs duty	32 000

The business has a product wide mark up of 100%

The owner withdrew goods worth R9 500 at cost.

Goods to the tune of R7 500 was used by the business as promotional material

Physical stock count showed stock on hand as R65 000

Prepare the trading statement for Delux (Pty) Ltd

Delux (Pty) Ltd

Trading statement for the year ended 28 February 2017

Sales(850 000-50 000)	**800 000**
Cost of sales (Note 1)	**400 000**
Gross profit	**400 000**
Note 1	
Opening stock	50 000
Add purchases (420 000 - 9 500 – 7 500 – 25 000)	378 000
Carriage on purchases	5 000
Customs duty	32 000
Goods available for sale	**465 000**
Closing stock	65 000
Cost of goods sold	**400 000**

QUESTION 3 NOV 2019: INVENTORY VALUATION (45 marks; 25 minutes)

George Grande is the majority shareholder and CEO of Grande Ltd. The company supplies hotels with cabinets and lamps.

The periodic system is used. The year-end is 30 September 2019.

REQUIRED:

CABINETS

3.1 Calculate the value of closing stock for cabinets on 30 September 2019 using

the first-in first-out method.(6)

3.2 In 2019, the company decided to extend the target market and to grant trade discounts to increase sales.

3.2.1 Calculate the % mark-up achieved in 2019. (4)

3.2.2 Provide TWO points (with figures) to prove that this decision achieved its aims. (4)

3.2.3 The CEO feels that this decision also negatively affected the company.

- Provide TWO points (with figures) to support his opinion. (4)
- Give the directors advice to solve this problem. Explain TWO points. (2)

LAMPS

3.3 Calculate the stockholding period for lamps (use closing stock). (3)

3.4 George is concerned about the control of lamps. An investigation revealed that the store manager was supplying local boarding houses with lamps without documentation.

- Calculate the number of missing lamps. (5)
- Give TWO suggestions to solve this problem. (4)

TELEVISION SETS

3.5 During April 2019, while George was in hospital, Bruce Swann (the chief financial officer) decided to include television sets in their product range. He was able to secure bulk discounts from Roseway on two TV set models, namely LYN and KYA.

Calculate the value of the closing stock of TV sets on 30 September 2019 using the specific identification method. (7)

3.6 An employee of Roseway told George that Bruce received a 10% 'commission' from Roseway for buying excess stock. George wants to discuss this at the next board meeting.

Explain THREE different concerns that George would have about this problem. (6)

INFORMATION:

A. Stock records of cabinets and lamps:

	CABINETS			**LAMPS**	
	UNITS	**UNIT PRICE**	**TOTAL**	**UNITS**	**TOTAL**
Stock balances					
1 Oct. 2018	370	R800	R296 000	600	R108 000
30 Sep. 2019	280		?	265	R59 625
Purchases: 2019					
January	800	R920	R736 000	1 200	R240 000
April	1 200	R990	R1 188 000	1 800	R432 000
July	250	R1 100	R275 000	800	R210 000
Total	**2 250**		**R2 199 000**	**3 800**	**R882 000**
Returns	**20**	R1 100			
Sales				**3 675**	
Cost of sales					**R930 375**

B. Information relating to cabinets:

	2019	**2018**

Sales	R3 480 000	R3 375 000
Cost of sales	R2 170 500	R1 950 000
Units sold	2 320	2 500
Selling price per unit	R1 500	R1 400
% mark-up achieved	?	73%
Customers on record	37	26

C. Stock records of television sets:

	MODELS	UNITS	UNIT PRICE	TOTAL
Purchases				
May 2019	LYN	800	R6 000	R4 800 000
	KYA	950	R7 200	R6 840 000
July 2019	LYN	500	R6 000	R3 000 000
	KYA	500	R7 200	R3 600 000
TOTAL		**2 750**		**R18 240 000**
Sales	LYN	430	R8 400	R3 612 000
	KYA	540	R10 080	R5 443 200

SOLUTION

3.1 Calculation of cabinets closing stock

230 units x R1 100	= R253 000
50 units x R 990	= R49 500
Value of closing stock	=R302 500

3.2.1 Calculation of mark up achieved in 2019

Mark up = Gross Profit / Cost of sales = $\frac{3\ 480\ 000 - 2\ 170\ 500}{2\ 170\ 500}$ x 100% = 60.3%

3.2.2 Provide TWO points (with figures) to prove that this decision achieved its aims.

Sales increased to R3 480 000 (from R3 375 000) / by R105 000 / by 3,1%
Number of customers increased to 37 (from 26) / by 11 / by 42%

3.2.3 The CEO feels that this decision also negatively affected the company. Provide TWO points (with figures) to support his opinion.

Gross profit decreased to R1 309 500 (from R1 425 000) / by R115 500 / by 8,1% / Cost of sales increased to R2 170 500 (from 1 950 000) / by R220 500 / by 11,30%
Average units per customer dropped to 63 (from 96) (2 500/26) (2 320/37) / by 33 / by 34%

Give the directors advice to solve this problem. Explain TWO points.

Restrict (be selective with) trade discounts to good customers only
Find a cheaper supplier (to compensate for keeping selling prices low)

Increase marketing / advertising in areas outside the current areas targeted
Provide other incentives such as after-sales services, maintenance or free deliveries

Calculate the stockholding period for lamps using closing stock instead of average stock

$$\frac{\text{Closing stock}}{\text{Cost of sales}} \times 365 \text{ days} = \frac{59\ 625}{930\ 375} \times 365 \text{ days} = 23.4 \text{ days}$$

or

$$\frac{\text{Closing stock units}}{\text{Cost of sales units}} \times 365 \text{ days} = \frac{265}{3\ 675} \times 365 \text{ days} = 26.3 \text{ days}$$

Give TWO suggestions to solve this problem.

- Divide duties / delegate to different employees
- Threaten strong disciplinary action (in future) / recover cost from culprit
- Increase supervision at regular intervals / random physical inspection of stock
- Change to the perpetual inventory system to record stock
- CCTV as an internal control measure
- Insist on proper documents for all stock supplied

Television Sets

3.5 Calculate the value of the closing stock of TV sets on 30 September 2019 using the specific identification method.

LYN : (1 300 – 430) x R 6 000 = **R5 220 000**

KYA : (1 450 – 540) x R 7 200 = **R6 552 000**

LYN + KYA = R5 220 000 + R6 552 000 = **R 11 772 000**

Explain THREE different concerns George would have about this problem.

- Directors engaging in fraud and corruption / bribes / conflict of interests
- Unethical behaviour of CFO places the company placing at risk
- Image of the company negatively affected / will affect the share price and further investments from potential investors
- High stock value is tied up in stock / Obsolete / Affects liquidity
- Shareholders may want to sell their shares
- It will negatively affect the audit report
- Business will lose goodwill as it is unethical

QUESTION 2 JUNE 2019 : INVENTORY VALUATION (40 marks; 25 minutes)

2.1 **CONCEPTS**

Choose the correct term from those given in brackets. Write only the term next to the question numbers (2.1.1 to 2.1.3) in the ANSWER BOOK.

2.1.1 The most recent purchases will be considered as closing stock in the (FIFO/weighted-average) stock valuation method.

2.1.2 Merchandise purchased is recorded in a Trading Stock Account in the (perpetual/periodic) inventory system.

2.1.3 Carriage on purchases is recorded as an (asset/expense) in the periodic inventory system. (3 x 1)

2.**2** **PHOTO-FIX TRADERS**

The information relates to Photo-fix Traders for the financial year ended 30 April 2019. The business is owned by Tom Samuels and sells two models of cameras (Grand and De-Lux) and photo frames.

- The stock of cameras is valued using the specific identification method.
- Photo frames are valued using the weighted average method.

REQUIRED:

2.2.1 Calculate the value of closing stock of cameras on 30 April 2019. (9)

2.2.2 Calculate the value of closing stock of photo frames. (8)

2.2.3 The owner suspects that photo frames are being stolen. Provide a calculation to confirm his suspicions. (5)

2.2.4 Tom is thinking of employing an assistant at a wage of R3 500 per month to control the stock of photo frames. Explain why this is NOT a
good idea. Provide TWO points with figures/calculations. (6)

INFORMATION:

The following information is in respect of the year ended 30 April 2019:

A. CAMERAS: STOCK, BOUGHT AND SOLD

	BOUGHT			UNITS SOLD
	UNITS	UNIT COST	TOTAL	
GRAND MODEL				
Opening stock	20	R5 500	R110 000	14
Purchases	240	R5 750	R1 380 000	170

DE-LUX MODEL				
Net purchases:	**270**		**R1 104 000**	**235**
September 2018	180	R4 000	R720 000	140
Returns	(30)	R4 000	(R120 000)	
January 2019	120	R4 200	R504 000	95

A. PHOTO FRAMES: STOCK, BOUGHT AND SOLD

	UNITS	AMOUNTS
Opening stock	60	R7 200
Purchases	720	R108 000
Returns	30	R4 500
Closing stock	80	**?**
Sales	657	

1 2.3 MANAGEMENT OF INVENTORIES

The information relates to Lyle Furnishers for the financial year ended28 February 2019. The business sells cupboards, tables and chairs. No stock went missing during the year.

REQUIRED:

Provide ONE different problem (with figures) relating to EACH product and ONE solution to EACH problem. (9)

INFORMATION:

	CUPBOARDS	TABLES	CHAIRS
Opening stock (units)	200	160	1 300
Purchases (units)	2 500	3 050	6 000
Selling price per unit	R1 750	R850	R350
Credit sales (units)	800	2 400	2 100
Returns by customers (units)	(500)	(10)	0
Cash sales (units)	1 000	600	2 250
Closing stock (units)	400	200	2 950
Cash received from cash sales	R1 750 000	R470 000	R787 500

SOLUTION

2.1

2.1.1	**FIFO**
2.1.2	**Perpetual**
2.1.3	**Expense**

2.2 Phot Fix Traders

2.2.1

Stock valuation using specific identification method					
Grand model	**Purchased**	**Sold / Returned**	**Balance**	**Unit price**	**Closing stock value**
Opening stock	20	14	6	R5 500	R33 000
Purchases	240	170	70	R5 750	R402 500
Delux Model					
Sept 2018	180	170	10	R4 000	R40 000
Jan 2019	120	95	25	R4 200	R105 000
Total value of closing stock					**R 580 500**

2.2.2 B Photo frame :

Sock valuation using weighted average method

$$\frac{R7\ 200 + R108\ 000 - R4\ 500}{60 + 720 - 30} \times 80 = R11\ 808$$

2.2.3

The owner suspects that photo frames are being stolen. Provide a calculation to confirm his suspicions.

Total purchases less units sold less closing stock balance = stocks stolen
750 unit – 657units – 80 units = 13

2.2.4

Tom is thinking of employing an assistant at a wage of R3 500 per month to control the stock of photo frames. Explain why this is NOT a good idea. Provide TWO points with figures/calculations.		
	Explanation	**Figures**
1	**It is not worthwhile to employ the assistant** **OR:** **Wages greatly exceed the cost of the missing units**	**Wages** **R42 000 p a / R 3 500 pm** **Cost of units missing:** **13 x R147,60 = R1 918,80**

2	**Missing items are relatively insignificant** **OR:** **Units missing are a very small % of units available**	**Units missing = 13** **Units available = 750 one mark** **% missing = Less than 2%** **OR:** **Units sold p.a. = 657** **Units sold per day = 1,8 or 2**

2.3

Product	Problem	Solution
Cupboards	High returns, 500 or 500 / 1 800 (27,7%) Or 1 000 cupboards missing	Possible change to new supplier Ensure high quality ordered Order as per customer specifications Check quality before accepting stock delivered Improve security
Tables	Missing money, R40 000 (510 000 – 470 000) Or 20 tables missing Credit sales much higher than cash sales (liquidity issues) 2 400 / 600 or 1 800 units more 2 400 / 3 000 (80%); 600 / 3 000 (20%)	Division of duties/ banking of money Improve physical security Promote cash sales by providing incentives such as cash discount
Chairs	Slow selling item / too much stock on hand (1 300 and 2 950) Purchases much higher than sales (6 000/4 350)	Change to a different type of chair. Advertise more to increase sales Buy stock according to sales. Reduce mark-up%

QUESTION 4 NOV 2020 : STOCK VALUATION (35 marks; 30 minutes

4.1 Give ONE word/term for each of the following statements. Write only the word/term next to the question numbers (4.1.1 to 4.1.4) in the ANSWER BOOK.

periodic system;	FIFO; perpetual system;
specific identification;	weighted average

4.1.1 This method is most suitable for inexpensive goods purchased regularly.

4.1.2 The closing stock balance is recorded at the most recent prices paid.

4.1.3 Individual stock items are valued at the cost price on the purchase invoice.

4.1.4 The cost of sales is recorded for every sales transaction.

4.2 LOTUS ACCESSORIES

The owner is Alex Lotus. The business uses the first-in first-out method to value gas lamps. They decided to sell gas stoves as well, expecting a demand due to increased load shedding. The specific identification method is used to value these stoves.

The financial year-end is 30 April each year.

REQUIRED:

4.2.1 Calculate the following for the gas lamps on 30 April 2021:

- Value of closing stock (using FIFO) (6)
- Stockholding period in days (using closing stock) (6)

4.2.2 Alex suspects that the stock of gas lamps are not well controlled.

Calculate the number of gas lamps missing. (4)

4.2.3 An investigation revealed that Alex's brother (employed at the store) orders gas lamps using the business ordering system, and sells them privately to his friends.

What should Alex say to his brother when dealing with this matter? Provide TWO points. (4)

4.2.4 Calculate the closing stock value for gas stoves on 30 April 2021 (using the specific identification method). (5)

4.2.5 Alex thinks he should stop selling gas stoves as they are causing a liquidity problem and the profit is low.

- Provide figures to support his opinion. (2)

Explain TWO points to convince him NOT to discontinue trading in gas stoves. (4)

INFORMATION:

A. STOCK RECORDS FOR GAS LAMPS:

	UNITS	UNIT PRICE	AMOUNT
		R	R
Stock balance on 1 May 2020	**230**		**R12 650**
Purchases during the year:	**2 750**		**R193 500**

July 2020	650	R60	39 000
September 2020	800	R68	54 400
January 2021	1 100	R75	82 500
March 2021	220	R80	17 600
Returns (from March 2021)	**40**	**?**	**?**
Available for sale	**2 940**		
Stock balance: 30 April 2021	**270**	**?**	**?**
Total sales	**2 180**	**R140**	**R305 200**

B.

STOCK RECORDS FOR GAS STOVES:

PURCHASES:

Month	Model	Units	Unit price	Amount
August 2020	B-Lite	80	R495	R39 600
October 2020	B-Lite	80	R495	R39 600
	Smart	100	R700	R70 000
February 2021	B-Lite	120	R495	R59 400
	Smart	60	R700	R42 000

Sales:

Model	Units sold	Selling price	Amount
B-Lite	132	R790	R104 280
Smart	54	R980	R52 920

Gross profit and mark-up:

Model	Cost of sales	Gross profit	Mark-up
B-Lite	R65 340	R38 940	60%
Smart	R37 800	R15 120	40%

SOLUTION

4.1

4.1.1	Weighted average
4.1.2	FIFO
4.1.3	Specific identification
4.1.4	Perpetual system

4.2 LOTUS ACCESSORIES

4.2.1

Calculate: Value of closing stock for gas lamps (using FIFO)	
Workings	**Answer**
220 – 40) (270 – 180) (180 x R80) + (90 x R75) R14 400 three marks If adds up to 270 R 6 750 two marks	R21 150
Calculate: Stockholding period in days of gas lamps (using closing stock)	
Workings	**Answer**
Using totals: $\frac{21\,150}{12\,650 + 193\,500 - 3\,200 - 21\,150} \times 365$ Or $\frac{270}{2\,180} \times 365$ Or $\frac{270}{(230 + 2\,750 - 40 - 270)} \times 365$ OR: $\frac{270}{(230 + 2\,770 - 40 - 270)} \times 365$	42,5 days 45,2 days 36,9 days 36,6 days

4.2.2

Alex suspects that the stock of gas lamps are not well controlled. Calculate the number of gas lamps missing.		
Workings		Answer
230 + 2 750 – 40 2 940 – 2 180 – 270	230 + 2 770 – 40 2 960 – 2 180 – 270	490 Or 510

4.2.3

What should Alex say to his brother when dealing with this matter? Provide TWO points.

- His actions are unethical / illegal / theft / compromises business profitability
- Tell him he can face dismissal / disciplinary action
- He must reimburse Alex for the loss
- It is a conflict of interest / he is taking advantage of being a family member / enriching himself at the expense of the business and he must stop this practice
- He should not be expected to be treated differently and he will be subject to the rules and procedures of the business
- All stock movements must be recorded / declared in advance
- Output VAT not paid over to SARS (which is a criminal offence)

4.2.4

Calculate the closing stock value for gas stoves on 30 April 2021 (using the specific identification method).

Workings	Answer
(148 x R495) + (106 x R700)	R147 460

4.2.5

Alex thinks he should stop selling gas stoves as they are causing a liquidity problem and the profit is low. Provide figures to support his opinion.

Possible responses:

- Too much cash tied up in stock, R147 460 see 4.2.4
- Total profit on gas stoves is low R54 060 (R38 940 + R15 120)
- Low turnover rate / only 186 units sold, of 440 available / 42,3%.
- Too much stock on hand, 254 units.

Explain TWO points to convince him NOT to discontinue trading in gas stoves.

- He is achieving a 60% profit on B-Lite and a 40% profit on Smart.
- He could reduce the mark-up to increase sales (recognising the state of the economy and his customers).
- These stock items are durable and can be sold in the future.
- The trend is to move towards gas because of load shedding – demand will increase in the future.
- Customers may not be aware that he is selling these products / he must advertise more extensively
- A variety of stock will attract more customers
- Gas is cheaper than electricity

CREDITORS & DEBTORS RECONCILIATION

Debtors / Creditors Reconciliation

- Reconcile the Debtors or Creditors Control account with the Debtors ledger
- A record of all transactions of the debtor or Creditors is shown in the debtors or creditors ledger
- A debtors or creditors list is prepared at the end of the month

Reasons for Differences

The creditor or debtor may have prepared the statement on a different date from the date on which the business receiving the statement.

Payments not yet reflecting in the bank statement.

Misallocated payments

Incorrect double entry

Invoices omitted/entered incorrectly

Credit/Debit notes omitted/ entered incorrectly

Worked example

You are the bookkeeper for Sugar (Pty) Ltd and the creditor Nand Café has sent you the statement..

Statement of account received from Nand Cafe

Date	Details	Debit	Credit	Balance
Feb 24	Balance			45 200
26	Invoice 098	14 800		60 000
March 1	Invoice 121	26 960		86 960
4	Invoice 145	20 000		106 960
5	Invoice 430	5 000		111 960
	Payment		56 400	55 560
	Invoice 680	18 520		74 080
	Invoice 790	39 548		113 629

Statement in Sugar (Pty) Ltd

Date	Details	Folio	Debit	Credit	Balance
March 1	Balance				60 000
	Invoice 121	CJ		25 880	85 880
	Payment	CPJ	56 400		29 480
	Invoice 145	CJ		20 000	47 480
	Invoice 680	CJ		18 520	66 000
	Payment EFT92	CPJ	23 200		44 800

Upon investigation the following facts were established.

1 Invoice 121 was incorrectly captured in Nand Café books
2 Invoice 430 was for the director of Sugar business for personal use
4 EFT payment had not reflected in the creditors bank statement.
5 Sugar (Pty) Ltd had not received invoice for the goods purchased.

Required

1. Correct the creditors account in the books of Sugar (Pty) Ltd
2. Prepared the creditors reconciliation account as at 31 March

Correction of creditors ledger account

Balance as per statement	**44 800**
Goods not yet invoiced	39 548
Corrected balance	**84 348**

Creditors reconciliation statement as at 31 March

Balance as per the creditors statement	**113 628**
Invoice incorrectly entered (25 880 - 26 960)	(1 080)
Invoice for directors personal purchases	(5 000)
Payment not yet reflecting in creditors bank account	(23 200)
Balance as per the ledger accounts	**(84 348)**

QUESTION 1 Nov 2020 P2 : CREDITORS' RECONCILIATION

INFORMATION:

A. Creditors' Ledger Account in the books of Ekasi Traders

		Thembeka Suppliers (CL6)				
				Debit	**Credit**	**Balance**
April 2021	1	Balance	b/d			R81 000
	12	Invoice 220			97 200	178 200
		EFT		40 500		137 700
	18	Debit Note 702		10 300		127 400
		Invoice 289			49 100	176 500
		Invoice 333			30 000	206 500
	24	Debit Note 877			9 700	216 200
	25	Journal voucher 585		6 400		209 800
	31	Cheque and discount		92 600		117 200

B. Statement of account from Thembeka Suppliers

Ekasi Traders		**225 Crocodile Road**			**25 April 2021**
			Debit	Credit	Balance
2021 April	1	Balance			R81 000
	12	Invoice 220	97 200		178 200
		Receipt 742		40 500	137 700
	18	Credit Note 791		13 100	124 600

		Invoice 333	30 000		154 600
	22	Invoice 395	12 500		167 100
	24	Credit Note 888		9 700	157 400

C. Errors, omissions and other information:

(a) Invoice 289 was incorrectly reflected in the account of Thembeka Suppliers in the Creditors' Ledger. These goods were purchased from Thami Suppliers.

(b) Credit Note 791 was recorded incorrectly on the statement of account. This relates to the correct entry for Debit Note 702 in the Creditors' Ledger.

(c) Invoice 395 on the statement of account was for goods ordered by Ekasi Traders.

(d) Thembeka Suppliers also purchased goods on credit from Ekasi Traders. Ekasi Traders has transferred a debit balance from the Debtors' Ledger (Journal voucher 585). Thembeka Suppliers will include this on the next statement.

(e) The transaction on 24 April 2021 is for merchandise returned to Thembeka Suppliers.

(f) The statement of account reflects transactions up to 25 April 2021.

SOLUTION

		Creditors' Ledger Account of Thembeka Suppliers in the Books of Ekasi Traders	**Statement of Account from Thembeka Suppliers**
	Balance	117 200	157 400
(a)	Invoice 289 incorrectly reflected	– 49 100	
(b)	Credit note recorded incorrectly		(13 100 – 10 300) + 2 800
(c)	Purchases invoice wrongly posted	+ 12 500	
(d)	Goods purchased on credit		– 6 400
(e)	Merchandise returned by thembeka	(– 9 700 – 9 700) –19 400	
(f)	Transaction reflects transaction upto 25/04/21		– 92 600
		61 200	61 200

1.2.2

What should the owner say to Bradley regarding this incident? Explain TWO points.
➢ He should not take advantage of his position in management / abuse of authority / possible conflict of interest ➢ This can be viewed as wrong (i.e. unethical or devious)

- Against business policy i.e. all transactions must be authorised and documented / compromising internal controls
- He must pay back the money / he could open an account with the business and purchase the goods
- He could negotiate with the owner in advance to get a special price or at cost
- He could be liable for disciplinary action (warning) and could tarnish his good reputation
- Suspension / warning of dismissal / demotion will be considered (if caught again).

BANK RECONCILIATION STATEMENT

Bank reconciliation statement is a report or statement prepared by the business to match the bank transactions recorded in the books of accounts with the bank statement.

For the purposes of learning this topic bank account or cash book refers to the statement of account in the hands of the company and bank statement refers to the transactions kept by the bank on behalf of the business. It is the same record maintained by the different organisations. The bank account shows the receipts and the payments relating to the business.

Reasons for bank reconciliation

Bank account or cash book and the bank statement balances may disagree due to a number of reasons listed below :

- Cheques issued by the business but not yet presented for payment
- Cheques deposited into bank but not yet cleared or credited by the Bank
- Amount directly deposited by customers/debtors in the bank account
- Difference in cheque deposited and cheque credited date
- Errors committed in recording transactions by the Bank
- Errors committed in recording transactions by the firm
- Bank charges charged by the Bank
- Dishonour of cheques deposited with the bank
- Interest and dividend received by the bank on behalf of the business
- Direct payments made by the bank on behalf of the customer
- Date of cheque issued towards payment and date on which it is debited is different
- Cheque issued or received is not presented to the bank for clearing

Items for updating the cash book and which are not for reconciliation

- Amount directly deposited by customers/debtors in the bank account
- Errors committed in recording transactions by the firm
- Bank charges charged by the Bank
- Interest and dividend received by the bank on behalf of the business
- Interest on overdraft
- Dishonoured cheques deposited with the bank
- Stopped/ cancelled cheque.
- Direct deposit into our bank account
- Stop/ debit orders made directly by the bank (Insurance, Municipal rates etc.)
- Replaced cheque [old cheque was stopped (CRJ) and a new cheque is issued

Items for reconciliations only

- Cheques issued by the business but not yet presented for payment
- Cheques deposited into bank but not yet cleared or credited by the Bank
- Difference in cheque deposited and cheque credited date
- Errors committed in recording transactions by the Bank
- Direct payments made by the bank on behalf of the customer
- Date of cheque issued towards payment and date on which it is debited is different
- Cheque issued or received is not presented to the bank for clearing
- Outstanding deposits
- post-dated cheques issued (as payee can't redeem payment until date falls due).

WORKED EXAMPLE

The following information relates to Predestine (Pty) Ltd

Bank reconciliation statement on 28 Feb 2016

Balance as per bank statement		**61 875**
Outstanding deposit		50 100
Outstanding cheques :	No 620	3 300
	No 621	1 575
	No 1800	15 375
	No 1847	54 750
Balance as per bank account		**36 975**

Cheque No 620 was issued to a customer who destroyed it by mistake before presenting it to the bank. Cheque number 621 was returned by the customer there was inconsistence between the value of the cheque in figures and the value of the cheque in words.

The comparison with March 2016 revealed that the following items did not appear in the Cash Journal.

March 2016 had the following totals

Cash Journal R 166 650

Cash Payments Journal R133 320

Bank statement on March 2016

Details	**Date**	**Debit**	**Credit**
Deposit	02 March 2016		50 100
Cheque 1847		54 750	
Stop order - insurance		3 600	
Stop order – loan repayment		3 150	
Dishonoured cheque		6 780	
Service fee		2 100	

Interest			330
Cheque 1238		2 025	
Debit order - monthly rental		7 650	

Information :

The bookkeeper entered cheque 1238 in the cash payment journal as R2 295

A cheque issued to a creditor for purchase of computers for R42 150 was recorded in the cash payments journal on 27 March 2016 but has not yet been presented to the bank.

A deposit made on 31 March 2021 to the tune of R44 250 did not appear in the bank statement by 31 March 2016

Bank statement balance as at 31 March was R65 775

Required

1. Updated cashbook as on 31 March 2016
2. Bank reconciliation statement as on 31 March 2016

SOLUTION

1 Updating the Cash Receipts Journal and Cash Payments Journal

	Cash Receipts Journal	**Cash Payments Journal**
Journal total	166 650	133 320
Cheque accidentally destroyed	3 300	
Cheque returned by customer	1 575	
Insurance		3 600
Loan repayment		3 150
Rent income		6 780
Bank charges		2 100
Interest earned	330	
Municipal rates		7 650
Creditors control – overstatement of payment error	270	
	172 125	**156 600**

Correction of bank balance as at 31 March 2016

Bank balance as per the accounts	**36 975**
Total receipts	172 125

Total payments	156 600
Balance as at 31 March	**52 500**

or

	Debits	**Credits**
Opening balance	36 975	
Cash Receipts Journal	166 650	
Cash Payments Journal		133 320
Cheque accidentally destroyed	3 300	
Cheque returned by customer	1 575	
Insurance		3 600
Loan repayment		3 150
Rent income		6 780
Bank charges		2 100
Interest earned	330	
Municipal rates		7 650
Creditors control – overstatement of payment error	270	
31 March 2016 Balance c/d (balancing figure)		**55 200**
	209 100	**209 100**

2 Bank reconciliation statement as at 31 March 2016

		R
Balance as per bank statement		**65 775**
Add deposit not yet credited by the bank		44 250
Less Outstanding cheque		(15 375)
Outstanding cheque		(42 150)
Balance as per bank account		**52 500**

QUESTION 2 NOV 2019: RECONCILIATION (30 marks, 20 minutes)

The information relates to Klonex Traders.

REQUIRED:

2.1 The owner, Ben Joseph, realises that many people are now using electronicfunds transfers (EFTs) instead of cheques.

2.1.1 State THREE advantages of EFTs. (3)

2.1.2 Janet, the bookkeeper, has been assigned the duty of processing andcontrolling all EFTs.

Explain TWO reasons why the internal auditor is concerned about this. (4)

2.2 Show changes in the Cash Journals for June 2019 (11)

2.3 Calculate the correct Bank Account balance on 30 June 2019 (4)

2.4 Prepare the Bank Reconciliation Statement on 30 June 2019. (8)

INFORMATION:

A. Extract: Bank Reconciliation Statement on 31 May 2019

Outstanding deposit		R9 500
Outstanding cheques		
No.	**Date**	
321	10 December 2018	R1 500
427	14 May 2019	R1 400
444	27 May 2019	R4 670
516	28 May 2019	R7 950
Favourable balance on Bank Account		**R9 200**

- NOTE:The outstanding deposit appeared on the June Bank Statement.
- Cheque 321 was issued for the owner's club fees. It was never deposited.
- Cheque 427 did not appear on the June Bank Statement. It was lost and a newcheque will be issued in July.
- Cheque 444 did not appear on the June Bank Statement.
- Cheque 516 appeared on the June Bank Statement with the correct amount ofR5250.

*Insurance appeared twice in error. This will be rectified next month.

B. Bank Statement balance on 30 June 2019: …?

Provisional totals in the Cash Journals on 30 June 2019 before receiving the Bank Statement:

- Cash Receipts Journal: 27 470
- Cash Payments Journal: R32 400

Entries in the Cash Journals NOT on the June Bank Statement:

- Deposit, R9 675
- EFT 14 (30 June 2019), R3 800
- Cheque 522 (12 August 2019), R4 580

C Entries on the June 2019 Bank Statement NOT in the Cash Journals:

DATE	DETAILS	R
15	Debit order: Micro Insurance*	1 125
	Debit order: Micro Insurance*	1 125
16	Unpaid cheque (debtor, B Marais)	1 200
25	M Malan (EFT by tenant)	2 800
30	Interest income	130
30	Service fees	175

*Insurance appeared twice in error. This will be rectified next month.

Bank Statement balance on 30 June 2019: …?

SOLUTION

1 Advantages of EFT

- No carrying of bulk cash.
- EFT can be done using a phone in the comfort of your house.
- Less paperwork.
- Increases efficiency and productivity.
- Manage cash flow easily.
- Improves safety and control.
- Eliminate the risk associated with lost, stolen, or misdirected cheques.
- It is not bound by operational timing.
- There are no physical barriers.
- You may obtain a statement from the bank.
- Services can be offered at a miniscule cost.

Reasons the internal auditors are concerned

- There is no segregation of duties to enable balances and checks to be done
- The is risk and she may be tempted to make unauthorised payments.
- She may be negligent in performing her duties.
- Lack of supervision can result in abuse / payments not made on time

- If Janet is absent, there may not be any continuity.

Cash receipts journal		Cash payments journal	
Provisional total	27 470	Provisional total	32 400
Cheque 321	1 500	Micro insurance	1 125
Cheque 427	1 400	Unpaid cheque	1 200
Cheque 516	2 700	Service fees	175
EFT by tenant	2 800		
Interest income	130		
Total	36 000	Total	34 900

Bank account			
	R		**R**
Balance b/d	**9 200**	**Total payments**	**34 900**
Total receipts	**36 000**	**Balance c/d**	**10 300**
	45 200		**35 200**

Bank reconciliation statement as at 30 June 2019		
	Debit	**Credit**
	R	R
Balance as per bank statement		12 550
Outstanding deposit		9 675
Incorrect entry		1 125
Cheque 444 outstanding	4 670	
Cheque 522 outstanding	4 580	
EFT 14	3 800	
Balance as per bank account	10 300	
	23 350	**23 350**

OR

Bank reconciliation statement as at 30 June 2019	
	R
Balance as per bank account	10 300
Cheque 444 outstanding	4 670
Cheque 522 outstanding	4 580
EFT 14	3 800
	23 350
Less Outstanding deposit	(9 675)
Incorrect entry	(1 125)
Balance as per bank statement	**12 550**

1.3 QUESTION JUNE 2019 BANK RECONCILIATION

The following information relates to Thandeka Traders for May 2019.

REQUIRED:

1.3.1 Calculate the correct Bank Account balance on 31 May 2019. Indicate whether this is favourable or unfavourable. (9)

1.3.2 Prepare the Bank Reconciliation Statement on 31 May 2019. The bank statement balance is the missing figure. (7)

1.3.3 Refer to Information B(iii).

State TWO internal control measures that the business can use to ensure that this will not happen in the future.(4)

INFORMATION:

A. Before the bank statement was received, the Bank Account showed a favourable balance of R19 400 on 31 May 2019.

B. Extract from the Bank Reconciliation Statement on 30 April 2019:

Outstanding deposit (dated 23 April 2019):	R31 560
Outstanding payments:	
Cheque 654 (dated 23 November 2018)	R2 350
EFT (electronic funds transfer)	R15 400
Cheque 705 (dated 30 June 2019)	R9 450

NOTE:

(i) Cheque 654 does not appear in the May Bank Statement.

(ii) The EFT payment of R15 400 appears in the May Bank Statement.

(iii) The outstanding deposit of R31 560 does not appear in the May Bank Statement. An investigation shows that this is cash paid by a debtor and has never been deposited. The amount must be written off.

C. The following items must also be taken into account:

(i) Items appearing in the May Bank Statement but not in the journals:

- Bank charges, R1 060
- A deposit of R4 500 made by another business. The bank will correct this error in June 2019.
- Interest on favourable balance, R313

(ii) Items appearing in the journals but not in the May Bank Statement:

- A deposit of R21 343 made on 31 May 2019
- Cheque 797 (dated 15 June 2019), R14 350

(iii) An EFT payment appeared correctly in the Bank Statement as R5 678. The Cash Journal shows this EFT as R6 578.

SOLUTION

1.3

1.3.1

Correction of bank account balance	
Provisional balance	**19 400**
Cheque 654	+2 350
Theft of cash	-31 560
Bank charges	-1 060
Interest income	+313
Correction EFT (6 578 – 5 678)	+900
Correct bank balance	**-9 657**

1.3.2

Bank reconciliation statement as at 31 May 2019	
Bank as per bank statement	**-2 700**
Outstanding deposit	+21 343
Outstanding cheque 705	(9 450)
Outstanding cheque 797	(14 350)
Debit deposit erroneously credited	(4 500)
Balance as per bank statement	**(9 657)**

Or

Bank reconciliation statement as at 31 May 2019		
	Debit	**Credit**
Bank as per bank statement	**2 700**	
Outstanding deposit		21 343
Outstanding cheque 705	9 450	
Outstanding cheque 797	14 350	
Debit deposit erroneously credited	4 500	
Balance as per bank statement		**9 657**
	31 000	**31 000**

State TWO internal control measures that the business can use to ensure that this will not happen in the future.

- Encourage debtors to use EFTs and internet banking.
- Get other people to handle matters concerning cash (Division / Rotation of duties)
- SMS notifications from the bank for all transactions.

- Use security companies to collect/transit the money
- Check deposits daily / Check deposits to receipts

CASHFLOW STATEMENTS

Cashflow statement is a financial statement that shows how changes in balance sheet accounts and income affect cash and cash equivalents, and breaks the analysis down to operating, investing, and financing activities. It also reconciles beginning and ending cash and cash equivalents account balances.

Objectives of cashflow statements

1. Indicates the sources of finance during the year. Examples of sources of finance include cash raised from operations, sales of property plant and equipment, acquisition of loans, investments and issue of shares or introduction of capital.

2. Indicates how the cash has been expended or utilized. Cash may be expended in the following ways; payment of loans, interest, dividends, acquisition of investments, repurchase of capital.

3. Reconciliation of the opening cash equivalents balance to the closing cash equivalents balance.

Steps in the preparation of cashflow statement

1. Reconciliation of net profit before tax and cash generated from operations.

2. Preparation of the cashflow statement,

Reconciliation of net profit before tax and cash generated from operations.

Net profit before tax	**25 000**
Depreciation	1 000
Interest expense	1 500
Operating profit before changes in working capital	**27 500**
Cash effects to changes in working capital	**4 000**
Decrease or **(increase)** in inventories	(2 800)
(Decrease) or **increase** in payables	5 600
Decrease or (increase) in receivables	1 200
Cas generated from operations	**31 500**

Reconciliation adjustments

- **Depreciation**

  Depreciation is a noncash item we add it back. Noncash item means that there is no cashflow involved.

- **Loss and profit from disposal of non current assets**

  Both loss on disposal and profit on disposal are non cash items. Loss on disposal is added back to the net profit and profit on disposal id deducted from the net profit .

- **Interest expense**

  The interest is added back because it has to be shown under cashflow from operating activities in the cashflow statement. Adding it back prevents deducting it twice from the same figure that is in the income statement and cashflow.

- **Inventory**

  Increase in inventory is a cash outflow and decrease in inventory represent a cash inflow. All cash outflows carry a negative sign or minus sign. Decrease in inventory is prima facie evidence that we sold stocks hence it's a cash inflow.

- **Receivables**

  Increase in receivables is a cash outflow and decrease in receivables represent a cash inflow. If debtors decrease it means they paid us off hence it's a cash inflow.

- **Payables**

  Increase in payables is a cash inflow and a decrease in payables is a cash out flow. If payables decrease it means we paid them off hence a cash outflow.

Three Sections of the Statement of Cash Flows:

- **Operating Activities:** The principal revenue-generating activities of an organization. Cash flow from operations typically includes the cash flows associated with sales, purchases, and other expenses.

  Include
  - Cash generated from operation
  - Dividend paid
  - Interest paid
  - Income tax paid

- **Investing Activities:** Any cash flows from the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

  Typically, we have
  - Proceeds from sale of fixed assets
  - Proceeds from sale of investment
  - Purchase of fixed assets
  - Acquisition of investments

- **Financing Activities:** Any cash flows that result in changes in the size and composition of the contributed equity capital or borrowings of the entity.
  - Proceeds from issue of shares
  - Redemption or repurchase of share

- Proceeds from acquisition of a loan
- Loan repayments

Statement of cashflow for the year ended 28 February 2021

Cash effects of operating activities	**Note**	**xxxx**
Cash generated from operations		xxxx
Interest paid		(xxxx)
Dividends paid		(xxxx)
Income tax paid		(xxxx)
Cash effects of investing activities		**xxxx**
Purchase of property plant and equipment or fixed assets		(xxxx)
Proceeds from sale of property plant and equipment or FA		xxxx
Proceeds from sale of investments		xxxx
Acquisition of investments		(xxxx)
Cash effects of financing activities		**xxxx**
Proceeds from issue of shares		xxxx
Repurchase of shares		(xxxx)
Loan repayment		(xxxx)
Loan acquisition		xxxx
Net change in cash and cash equivalents		**xxxx**
Cash and cash equivalents beginning or the year		xxxx
Cash and cash equivalents end of the year		xxxx

Compliance Bookkeepers (Pty) Ltd provided you with the following information.

Income statement extract for the year ended 31 December 2020

	R
Interest on loan	7 600
Depreciation on computers	4 800
Net profit before tax	180 000
Income tax SARS	50 400
Net profit after tax	129 600

Compliance Bookkeepers (Pty) Balance sheets at the given dates

	31 December 2020	**31 December 2019**
	R	**R**

Computers at carrying amount	32 800	31 200
Land and buildings @ cost	200 000	160 000
Fixed deposit Time Bank	8 000	5 600
Inventories	36 800	30 400
Trade and other receivables	8 600	15 800
Bank	101 000	50 400
Petty cash	800	700
Cash float	600	500
Ordinary share capital	152 400	112 400
Retained income	110 000	66 000
Debenture loan	44 000	52 000
Trade and other payables	82 200	64 200

The old computer was sold at its carrying value during the financial year. Its cost R7 000 Accumulated depreciation R4 400.

Retained income

Balance 1 January 2020	66 000
Net profit after tax	129 600
Dividends	85 600
Balance on 31 December 2020	110 000

Breakdown of trade and other payables

	31 December 2020	**31 December 2019**
	R	R
Trade creditors	22 000	28 400
Accrued expenses	1 200	1 600
Income tax	5 400	8 200
Shareholder for dividends	53 600	26 000
	82 200	**64 200**

Required

i. Reconciliation between net profit after tax and cash generated from operations for the year ended 31 December 2020
ii. Cash flow statement for the year ended 31 December 2020

Reconciliation between net profit after tax and cash generated from operations for the

year ended 31 December 2020

	R
Net profit before tax	180 000
Adjustments in respect of:	
Depreciation	4 800
Interest expense	7 600
Operating profits before changes in working capital	192 400
Cash effects in changes in working capital	(6 000)
Change in inventory – Increase (36,800-30,400)	(6 400)
Change in receivables- Decrease (15,800 – 8 600)	7 200
Change in payables – Decrease (30,000 – 23,200)	(6 800)
Cash generated from operations	**186 400**

Compliance Bookkeepers (Pty)

Cash flow statement for the year ended 31 December 2020

		R
Cash effects from operating activities		**67 600**
Cash generated from operations		186 400
Interest paid		(7 600)
Dividend paid		(58 000)
Income tax paid		(53 200)
Cash effects of investing activities		**(48 800)**
Purchase of fixed assets		(49 000)
Proceeds from sale of fixed assets		2 600
Investments placed		(2 400)
Cash effects from financing activities		**32 000**
Proceeds of shares issued		40 000
Long term loans repaid		(8 000)
Net cash and cash equivalents		**50 800**
Cash and cash equivalents at the beginning of year		51 600
Cash and cash equivalents at end of year		**102 400**

Cash and cash equivalents

	Net cash	31 December 2020	31 December 2019

Bank	50 600	101 400	50 400
Petty cash	100	800	700
Cash float	100	600	500

Dividend Paid calculation

	R
Dividend declared for the financial year	85 600
Balance at the beginning of the year	26 000
Balance at the end of the year	53 600
Dividend paid	58 000

or

Shareholders for Dividends account			
Dividend paid – bank	58 000	Balance b/d	26 000
Balance c/d	53 600	Dividend declared IS	85 600
	111 600		111 600

Income tax paid

SARS Income tax			
Bank- Income tax paid	53 200	Balance b/d	8 200
Balance c/d	5 400	Income tax for 2020 -IS	50 400
	58 600		58 600

Or

	R
Income tax for the financial year	50 400
Balance at the beginning of the year	8 200
Balance at the end of the year	5 400
Income tax paid	53 200

Workings
Rambo Jumbo (Pty) Ltd

Profit and loss extract for the year ended 30 June 2020

Interest on loan	5 760
Net profit before tax	600 000
Income tax	180 000
Net profit after tax	420 000

Depreciation for the year ended 30 June 2020 was charged as follows

Depreciation equipment	8 000
Depreciation motor vehicles	14 400

The balance sheets as at :

	30 June 2020	**30 June**
Assets		
Land and buildings	700 000	590 000
Equipment at carrying value	59 200	73 600
Vehicles at carrying value	149 200	110 000
Fixed deposit : Gold bank	77 600	61 600
Inventories	29 600	23 880
Trade and other receivables	27 400	36 800
Bank	66 000	44 000
Petty cash	4 400	8 000
Total assets	**1 113 400**	**947 880**
Equity and liabilities		
Ordinary share capital	260 160	180 160
Retained income	470 000	226 000
Long term loan	104 000	304 800
Trade creditors	158 400	140 800
Accrued expenses	3 000	2 000
SARS : Income tax	19 840	14 920
Shareholders for dividends	96 000	75 200
Accrued Interest	2 000	4 000
Total equity and liabilities	**1 113 400**	**947 000**

Retained income

Balance as at	226 000
Net profit after tax	420 000
Dividends	176 000
Balance as at 30 June 2020	470 000

Equipment with a carrying amount of R 6 400 was sold during the year at its carrying value.

Required

Prepare

a) **Reconciliation between net profit before tax and cash generated from operations.**

b) **Cashflow statement for the year ended 30 June 2020.**

SOLUTION

a) Reconciliation between net profit before tax and cash generated from operations for the year ended 30 June 2020 for Rambo Jumbo (Pty) Ltd

	R
Net profit before tax	600 000
Depreciation for the year	22 400
Interest	5 760
Adjustment for	
Inventory – Increase	(5 720)
Trade receivables - Decrease	9 400
Trade payables – Increase	17 600
Accrued expenses - Increase	1 000
Cash generated from operations	650 440

b) Rambo Jumbo (Pty) Ltd Cashflow statement for the year ended 30 June 2020.

		R
Cash effects of operating activities		**312 400**
Cash generated from operations		650 000
Income tax paid		(175 080)
Interest paid		(7 760)
Dividend paid		(155 200)
Cash effects of investing activities		**(173 000)**

Acquisition of investments		(16 000)
Purchase of fixed assets		(163 600)
Proceeds from disposal of fixed assets		6 400
Cash effects of financing activities		**(120 800)**
Issue of ordinary shares		80 000
Loan repayment		(200 800)
Net cash and cash equivalents		**18 400**
Cash and cash equivalents 1 July 2019		**52 000**
Cash and cash equivalents 30 June 2020		**7 400**

Workings

Income tax - SARS

Bank – income tax paid	175 080	Balance b/d 1 July 2019	14 920
Balance c/d 30 June 2020	19 840	Taxation - IS	180 000
	194 920		**194 920**

Dividends for shareholders

Bank – dividend paid	155 200	1 July 2019 Balance b/d	75 200
30 June 2020 Balance c/d	96 000	Dividends declared - IS	176 000
	251 200		**215 200**

Interest account

Bank – Interest paid	7 760	1 July 2019 Balance b/d	4 000
30 June 2020 Balance c/d	2 000	Interest charge - IS	5 760
	9 760		**9 760**

Purchase of fixed assets

Land and buildings 700,000 590,000 **= 110,000**

Equipment 149,200 – 110,000 + 14,400 **= 53,600**

Total 110,000 – 53,000 **= 163,600**

Proceeds from sale of fixed assets

The motor vehicle was sold for the same value as the carrying amount as given in details **6,400**

Dark and Lovely (Pty) Ltd has the following financial information;

Extract from the income statement for the year ended 31 December 2020

Interest expenses	26 250
Net profit before tax	562 500
Income tax	157 500
Net profit after tax	405 000

Balances sheet as at :

	31 /12/2020	**31/12/2019**
	R	R
Fixed assets	2 846 250	1 638 750
Fixed deposit	225 000	150 000
Inventories	690 000	585 000
Trade and other payables	258 750	321 750
Bank	415 800	487 500
Cash on hand	19 350	25 500
	4 455 150	**3 208 500**
Ordinary share capital	2 250 000	1 522 500
Retained income	372 750	251 250
Mortgage loan	900 000	1 050 000
Trade creditors	711 000	283 500
Income tax owing	13 500	18 000
Accrued dividend	189 000	60 750
Interest owing	18 900	22 500
	4 455 150	**3 208 500**

Fixed assets

	Land and buildings	**Computers**	**Office equipment**
Cost	1 065 000	461 250	675 000
Accumulated depreciation		135 000	427 500
Carrying amount 1 January 2021	**1 065 000**	**326 250**	**247 500**
Movements			
Additions at Cost	922 500	225 000	?
Disposal at carrying value			54 000
Depreciation for the year			48 000
Carrying value 31 December 2020	**1 987 500**	**483 750**	**375 000**

Cost	1 987 500	686 250	80 7000
Accumulated depreciation		(202 500)	(432 000)

Office equipment R97 500 at cost was sold at its carrying value.

Retained income

Balance as at 1 January 2020	251 250
Net profit after tax	405 000
Dividends for the year	283 500
Balance as at 31 December 2020	372 750

SOLUTION

Dark and lovely (Pty) Ltd

Reconciliation between net profit before tax and cash generated from operations

Net profit before tax	**562 500**
Depreciation	115 500
Interest	26 250
Operating profit before changes in working capital	**704 250**
Cash effects of changes in working capital	**385 500**
Increase in inventory	(105 000)
Decrease in trade receivables	63 000
Increase in trade payables	427 500
Cash generated from operation	**1 089 750**

Dark and lovely (Pty) Ltd

Cash flow statement for the year ended 31 December 2020

	R
Cash effects of operating activities	**742 650**
Cash generated from operations	1 089 750
Dividend paid	(155 250)
Interest paid	(29 850)
Income tax paid	(162 000)
Cash effects from investing activities	**1 398 000**
Purchase of fixed assets	(1 377 000)
Acquisition of investment	(75 000)

Proceeds from disposal of fixed assets	54 000
Cash effects of financing activities	**577 500**
Proceeds from issue of shares	727 500
Loan repayment	(150 000)
Net cash and cash equivalents	**(77 850)**
Cash and cash equivalents 1 January 2020	**513 000**
Cash and cash equivalents 31 December 2020	**435 150**

Workings

Office equipment account

Balance b/d	675 000	Disposal	97 500
Bank	229 500	Balance c/d	807 000
	904 000		**904 000**

Office equipment disposal account

Office equipment	97 500	Accumulated depreciation	43 500
		Bank	54 000
	97 500		**97 500**

Office equipment accumulated depreciation account

Disposal account	43 500	Balance b/d	427 500
Balance c/d	432 000	Profit and loss	48 000
	475 500		**475 000**

Dividends for shareholders account

Bank	155 250	Balance b/d	60 750
Balance c/d	189 000	Retained income - Dividend declared	283 500
	344 250		**344 250**

SARS - Income tax account

Bank	162 000	Balance b/d	18 000
Balance c/d	13 500	Income statement	157 500
	175 500		**175 500**

Interest payable account

Bank	29 850	Balance b/d	22 500
Balance c/d	18 900	Income statement	26 250
	48 750		**48 750**

QUESTION 5 NOV 2019: CASH FLOW STATEMENT AND INTERPRETATION (75 marks; 45 minutes)

5.1 Three financial statements are provided as options in which each of the following items would appear. Choose the financial statement and write only the letter (A–C) next to the question numbers (5.1.1 to 5.1.4) in the ANSWER BOOK, e.g.

5.1.5 D

A Statement of Financial Position (Balance Sheet)
B Statement of Comprehensive Income (Income Statement)
C Cash Flow Statement

5.1.1 Profit on sale of a fixed asset
5.1.2 Amount due to shareholders for final dividends payable
5.1.3 Total amount spent on the repurchase of shares
5.1.4 Total income tax amount for the current financial year (4 x 1) (4)

5.2 SUNSET LTD

The financial year ended on 28 February 2019.

REQUIRED:

5.2.1 Calculate the following figures for the 2019 Cash Flow Statement:

- Income tax paid (4)
- Dividends paid (4)
- Proceeds of shares issued (6)
- Fixed assets purchased (5)

5.2.2 Calculate financial indicators for the year ended 28 February 2019:

- % operating profit on sales (4)
- Net asset value per share (4)
- Debt-equity ratio (4)

INFORMATION FOR SUNSET LTD:

A. Information from Income Statement on 28 February 2019:

Sales	R8 725 000
Gross profit	3 525 000
Depreciation	408 000
Operating profit	2 033 900
Interest expense	441 000
Income tax	477 900
Net profit after tax	1 138 000

B. Information from Balance Sheet on 28 February:

	2019	2018
Fixed assets (carrying value)*	R11 835 100	R10 658 000
SARS: Income tax	18 000 CR	63 000 Dr
Shareholders' equity	8 625 000	10 065 000
Ordinary share capital	7 724 000	9 300 000
Loan: Funza Bank	3 500 000	2 800 000
Shareholders for dividends	372 000	195 000

***NOTE:** Fixed assets were sold at carrying value, R490 000.

C. Share capital and dividends:

SHARE CAPITAL		NUMBER OF SHARES	DETAILS OF SHARES
2018	1 March	1 500 000	In issue at R6,20 per share
	30 April	300 000	Repurchased at R6,90 per share
2019	1 January	40 000	New shares issued
	28 February	1 240 000	In issue

DIVIDENDS			DIVIDENDS PER SHARE
Final	2 March 2018	Paid	13 cents
Interim	31 August 2018	Paid	35 cents
Final	28 February 2019	Declared	30 cents

5.3 HORIZON LTD and OPTIMA LTD

Refer to Information D to F.
Mike Mbele owns shares and is a director in both these companies.

He recently invested another R420 000 in each company by buying shares on the JSE at market value as follows:

HORIZON LTD	OPTIMA LTD
R8,40	R4,00

REQUIRED:

NOTE: Provide figures, financial indicators or calculations in EACH case to support your comments and explanations.

5.3.1 **Purchase of shares:**

- Explain why directors should be interested in the price of their companies' shares on the JSE.
- Calculate the number of additional shares in Horizon Ltd that Mike was able to buy on the JSE in 2019**.**
- Comment on the price that Mike paid for these shares and give TWO reasons why he might have been satisfied to pay this price.

5.3.2 Dividends and earnings:

- Explain your opinion on which company has the better dividend pay-out policy.
- Compare and comment on the % return on equity earned by EACH company.
- Mike feels that the earnings per share (EPS) of Optima Ltd is much better than that of Horizon Ltd. Explain why he feels this way.

5.3.3 Refer to the Cash Flow Statements.

The poor economy has negatively affected Horizon Ltd more than Optima Ltd.

- Explain TWO decisions taken by the directors of Horizon Ltd in response to the state of the economy, and how these decisions will affect the company in future. (6)
- Explain TWO decisions taken by the directors of Optima Ltd that affect risk and gearing. Quote and comment on TWO financial indicators. (8)

D. Shareholding of Mike Mbele in two companies:

	HORIZON LTD	OPTIMA LTD
Number of shares bought in 2017	580 000 shares	1 430 000 shares
Total shares issued by each company	1 240 000 shares	2 600 000 shares
Additional shares bought by Mike	**?**	105 000 shares
Mike's % shareholding before buying additional shares	46,8%	55,0%

E. Financial indicators and additional information on 28 February 2019:

	HORIZON LTD	OPTIMA LTD
Earnings per share (EPS)	97 cents	83 cents
Dividends per share (DPS)	65 cents	80 cents
Debt-equity ratio	0,1 **:** 1	0,7 **:** 1
% return on average equity	6,2%	18,2%

% return on average capital Employed	9,4%	15,1%
Net asset value (NAV)	750 cents	445 cents
Additional information:		
Interest rate on loans	12,0%	12,0%
Interest on investments	6,5%	6,5%

F Extracts from Cash Flow Statements for year ended 28 February 2019

	HORIZON LTD	OPTIMA LTD
Cash flows from **investing** Activities	R2 700 000	(R2 730 000)
Purchase of fixed assets	0	(1 580 000)
Sale of fixed assets	1 800 000	0
Change in investments	900 000	(1 150 000)
Cash flows from **financing** Activities	(2 670 000)	4 000 000
Proceeds of new shares issued	0	200 000
Shares repurchased	(1 070 000)	0
Cash effects of long-term loan	(1 600 000)	3 800 000

SOLUTION

5.1.1	**B**
5.1.2	**A**
5.1.3	**C or A**
5.1.4	**B**

5.2 SUNSET LTD

5.2.1

Income tax paid

R477 900 – R63 000 – R 18 000 = R396 900

Dividend paid

R195 000 + 420 000
OR -195 000 – R792 000 + R 372 000 = R615 000

Proceeds of share issue

R9 300 000 – R1 860 000 – R7 724 000 = R284 000

Fixed assets purchased

R10 658 000 – R490 000 – R408 000 – R11 835 100 = R2 075 100

Calculate financial indicators for the year ended 28 February 2019

R2 033 900 X 100 = 23.3%
R8 725 000

Net asset value per share

R8 625 000 X 100 = 695,6 CENTS
R1 240 000

Debt equity ratio

3 500 000 : 8 625 00 0.4 : 1

5.3 Horizontal Limited

5.3.1 Explain why directors should be interested in the price of their companies' shares on the JSE.

Any ONE valid comment ✓✓
Responses for 2 marks:

- It shows public confidence in the company.
- It can be compared to other companies / an external indicator.
- Shareholders will want to have capital growth on their investment.
- Directors will be judged on the performance of the shares as this reflects the performance of the company.

Calculate the number of additional shares in Horizon Ltd that Mike was able to buy on the JSE in 2019.

R420 000/R8.40 = 50 000 Shares

Comment on the price that Mike paid for these shares and provide TWO reasons why he might have been satisfied to pay this price.

Compare price paid to NAV✓
HORIZON Ltd: JSE Price exceeds NAV by 90 cents (R8,40 – R7,50)
Valid reasons for HORIZON:

- He wants to be the majority shareholder
- More influence over decisions by board of directors

• JSE price reflects public demand for the shares
• Potential for high returns in future

5.3.2

Explain your opinion on which company has the better dividend pay-out policy. Quote figures.

Choice of company: Either Horizon Ltd OR Optima Ltd
Reason: Either retaining funds OR rewarding shareholders
Figures: Horizon Ltd pays out 67% (65c of 97c earned)
While Optima Ltd pays out 96% (80c of 83c earned)

Compare and comment on the % return on equity earned by EACH company. Quote figures.

Horizon Ltd earns 6,2%
Optima earns 18,2%
Comparison (may be implied)
Compare to interest rate (6,5%)

Mike feels that the earnings per share (EPS) of Optima Ltd is much better than that of Horizon Ltd. Explain why he feels this way. Quote figures or calculations.

Quote EPS of Horizon Ltd 97 cents
Quote EPS of Optima Ltd 83 cents
Compare EPS of both companies to:
Share value **OR** to number of shares owned **OR** % ROSHE **OR** Net Profit

Identify figures for any one comparison below

Horizontal Ltd	Optimal Ltd
Cost of shares is high 750c or 840c (Earnings yield is 12.9% or 11.5%)	Cost of shares is low 445c or 400c (Earnings yield is 18.7% or 20.8%)
EPS is earned on 580 000 shares	EPS is earned on 1 430 000 shares
% ROSHE is 6.2%	% ROSHE is 18.2%
NP after tax is R1 202 800 (97c x 1 240 000 shares)	NP after tax is R2 158 000 (83C X 2 600 000 shares)

5.3.3

Explain TWO decisions taken by the directors of Horizon Ltd in response to the state of the economy, and how these decisions will affect the company in future

Decisions: TWO valid decisions

• Sold fixed assets R1 800 000 / No new fixed assets bought (R0)
• Investments reduced R900 000
• Loan repaid R1 600 000

Effect on Horizon Ltd in future:
Any one valid comment: ✓✓

• The infrastructure / size of the company is decreasing which will affect future profit
• The reduced infrastructure / size of the company could lead to cost savings (or increased profit)

• Saving on interest / less risk

Explain TWO decisions taken by the directors of Optima Ltd that affect risk and gearing. Quote and comment on TWO financial indicators.

Decisions: Two valid decisions

- Loan increased R3 800 000
- Shares issued R200 000

Quote and comment on TWO financial indicators that affect risk and gearing.

- Quote indicators with figures: Debt-equity ratio: 0,7 : 1; ROTCE 15,1%;
- Comments on: increased risk / positive gearing (ROTCE exceeds interest rate)

QUESTION 5:JUNE 2019 CASH FLOW AND INTERPRETATION (75 marks; 45 minutes)

5.1 Choose a term from the list below that answers the specific following questions. Write only the term next to the question numbers (5.1.1 to 5.1.4) in the ANSWER BOOK.

gearing; return on equity; solvency; liquidity; profitability

5.1.1 Is the business able to pay off all its debts?
5.1.2 Can the business pay off short-term debts in the next financial year?
5.1.3 Will shareholders be satisfied with the benefit that they receive for investing in the company?
5.1.4 To what extent is the company financed by loans or borrowed capital? (4)

5.2 KULFI LTD

Information for the financial year ended 28 February 2019 is provided.

Where financial indicators are required to support your answer, quote the financial indicator and actual figure/ratio/percentage and trends.

REQUIRED:

5.2.1 Prepare the Retained Income Note to the Balance Sheet. (12)

5.2.2 Calculate the following amounts for the Cash Flow Statement. Show workings.

- Income tax paid (4)
- Dividends paid (4)

5.2.3 Complete the following sections of the Cash Flow Statement:

- Cash effects of investing activities (9)
- Net change in cash and cash equivalents (4)

5.2.4 Calculate the following financial indicators on 28 February 2019:

- Acid-test ratio (4)
- Debt-equity ratio (4)
- % return on average shareholders' equity (ROSHE) (5)

5.2.5 The shareholders are satisfied with the improvement in the liquidity position. Quote THREE financial indicators (with figures) to support this statement.(6)

5.2.6 The company increased the share capital by R840 000, and the loan by R550 000.

- Explain how this affected the gearing and risk of the company. Quote TWO financial indicators. (5)
- Explain what the directors have done with this cash inflow. State TWO

5.2.7 The directors decided to decrease the dividend pay-out percentage.

- Provide calculations to show the change in the pay-out rate.
- Give ONE reason why many shareholders were satisfied with the change in policy. Quote figures. (2)

5.2.8 On 1 March 2018 Martha owned 475 000 shares in the company. She did not purchase any shares from the shares issued on 1 May 2018.

- Explain how the repurchase of the shares benefited Martha's shareholding. Quote figures. (4)

INFORMATION:

A. Share capital:

- There were 900 000 ordinary shares in issue on 1 March 2018.
- An additional 100 000 ordinary shares were issued on 1 May 2018.
- On 1 October 2018 the company repurchased 60 000 shares at R9,00 per share. The average share price at the time was R8,04.

B Dividends

- Interim dividends of 25 cents per share were paid on 15 September 2018.
- Final dividends were declared on 28 February 2019.

B. Extract from Income Statement for the year ended 28 February 2019:

	R
Depreciation	123 600
Interest expense	143 000
Income tax (at 30% of the net profit)	293 100

D Extract from Balance Sheet on 28 February 2019:

	2019	2018
	R	R
Fixed assets (carrying value)*	8 775 720	8 430 720
Fixed deposit: Flay Bank	150 000	100 000
Current assets	**996 480**	**684 300**
Inventories	448 000	281 000
Trade and other receivables **(Note 1)**	288 300	378 300
Cash and cash equivalents	260 180	25 000
Shareholders' equity	**?**	**7 341 500**
Ordinary share capital	7 557 600	7 200 000
Retained income	?	141 500
Loan: Home Bank	**1 400 000**	**850 000**
Current liabilities	**553 600**	**923 520**
Trade and other payables **(Note 2)**	553 600	781 000
Bank overdraft	0	142 520

*** Old equipment was sold at carrying value, R111 800, for cash.**

Note 1: Trade and other receivables:	**2019**	**2018**
Debtors' control	288 300	367 000
SARS: Income tax	0	11 300

Note 2: Trade and other payables:	**2019**	**2018**
Creditors' control	325 000	421 000
Shareholders for dividends	206 800	360 000

SARS: Income tax	21 800	0

C. The following financial indicators were calculated on 28 February:

	2019	**2018**
Current ratio	1,8 **:** 1	0,7 **:** 1
Acid-test ratio	**?**	0,4 **:** 1
Debtors' collection period	28 days	39 days
Creditors' payment period	60 days	60 days
Debt-equity ratio	**?**	0,1 **:** 1
Return on shareholders' equity (ROSHE)	**?**	10.2%
Return on total capital employed (ROTCE)	12,9%	14,4%
Earnings per share (EPS)	71 cents	83 cents
Dividends per share (DPS)	47 cents	80 cents
Net asset value per share (NAV)	837 cents	816 cents
Market value per share	840 cents	807 cents
Interest rate on loans	13,5%	13,5%

SOLUTION

5.1

5.1.1	**Solvency**
5.1.2	**Liquidity**
5.1.3	**Return on equity**
5.1.4	**Gearing**

5.2 Kulf Ltd

5.2.1 Retained income

Balance on 1 March 2018	**141 500**
Net profit after tax 293 100 x 70/30 or 977 – 293 100	683 900
Funds used for repurchase of shares 60 000 x 0,96	(57 600)
Ordinary share dividends	**(456 800)**
Interim 1 000 000 x 25c	250 000
Final	206 800
Balance on 28 February 2019	**311 000**

5.2.2

Calculate: Income tax paid
293 100 – 11 300 – 21 800 = 260 000

Or

SARA tax payable account			
Balance b/d	11 300	Profit and loss	293 100
Bank	260 000		
Balance c/d	21 800		
	293 100		293 100

Calculate: Dividends paid
(456 800 – 206 800) 360 000 + 250 000 = 610 000

or

Dividends payable account			
		Balance b/d	360 000
Bank	610 000	Appropriation account	206 800
Balance c/d	206 800	Appropriation account	250 000
	816 800		816 800

5.2.3

Cash effects of investing activities	**(518 600)**
Fixed assets purchased 8 775 720 + 123 600 + 111 800 – 8 430 720	(580 400)
Proceeds from sale of fixed assets	111 800
Increase in fixed deposit	(50 000)

Net change in cash and cash equivalents	**377 700**
Cash and cash equivalents (beginning of year)	(117 520)
Cash and cash equivalents (end of year)	260 180

5.2.4

Calculate: Acid test ratio
<u>Current assets – stock</u> Current liabilities (288 300 + 260 180) : 553 600 = 0,99: 1 or 1 : 1
Calculate: Debt-equity ratio
<u>Debt</u> Equity 1 400 000 : (311 000 + 7 557 600) (0,17 : 1)
Calculate: % return on average shareholders' equity (ROSHE)
<u>Net profit after tax</u> x 100 = <u>683 900</u> = 9% Average shareholders capital ½ (7 341 500 + 868 600**)**

The shareholders are satisfied with the improvement in the liquidity position. Quote THREE financial indicators (with figures) to support this statement. **THREE valid indicators**
Current ratio increased from 0,7 : 1 to 1,8 : 1 Acid test ratio increased from 0,4 : 1 to 1 : 1 Debtors collection period improved from 39 days to 28 days

Explain how this affected the gearing and risk of the company. Quote TWO financial indicators.
Debt/equity ratio moved from 0,1 : 1 to 0,2 : 1 ROTCE decreased from 14,4% to 12,9% The company is lowly geared (not making extensive use of loans) Increasing the loan has caused the company to be negatively geared as the interest rate is 13,5%. The business is not making effective use of the money borrowed to increase profitability.

Explain what the directors have done with this cash inflow. State TWO points.
Fixed assets purchased; R580 400 Addressed the overdraft; - R142 520 to + R260 180 Increased investment by R50 000 Dividends paid; R610 000 Decreased creditors balances, R227 400; more stock purchased, R167 000 Shares repurchased, R540 000

Provide calculations to show the change in the pay-out rate.
In 2018: 80/83 x 100 = 96,4% of EPS was distributed as dividends OR: retained 3,6% In 2019: 47/71 x 100 = 66,2% of EPS was distributed as dividends OR: retained 33,8%

Give ONE reason why many shareholders were satisfied with the change in policy. Quote figures.
Cash earnings from dividends decreased by 33 cents per share because the company is retaining money for capital growth. Market price of shares increased (807c to 840c) probably due to higher retained income (R141 500 to R311 000) Market price of shares increased (807c to 840c) probably due or NAV (816c to 837c)

Explain how the repurchase of the shares benefited Martha's shareholding. Quote figures.
Majority shareholding must be mentioned to get two marks Part-mark for explanation for unclear or incomplete answers After the repurchase, she once again became the majority shareholder. 475 000 / 940 000 = 50,5%

QUESTION 2: FINANCIAL INDICATORS AND CASH FLOW STATEMENT (40 marks; 35 minutes)

2.1 Choose the correct word(s) from those given in brackets. Write only the word(s) next to the question numbers (2.1.1 to 2.1.3) in the ANSWER BOOK.

2.1.1 The (directors' report/audit report) gives an explanation of the operations of the company during a financial year.

2.1.2 The (independent/internal) auditors are responsible for monitoring the financial control measures of a company on a regular basis.

2.1.3 In the event of bankruptcy, the shareholders are normally not responsible for the debts of the business. This is because of (limited/unlimited) liability. (3 x 1) (3)

2.2 USANDA LIMITED

The financial year ended on 28 February 2021.

REQUIRED:

2.2.1 Calculate the following figures for the 2021 Cash Flow Statement:

- Income tax paid (4)
- Dividends paid (4)

2.2.2 Prepare the following sections of the Cash Flow Statement:

- Cash effects for financing activities (11)
- Net change in cash and cash equivalents (4)

2.2.3 Calculate the following financial indicators for the year ended 28 February 2021:

- % operating profit on sales (2)
- Acid-test ratio (4)
- % return on average shareholders' equity (ROSHE) (4)
- Dividend payout rate (%) (4)

INFORMATION:

A. Extract: Statement of Comprehensive Income for the year ended 28 February 2021:

Sales	R17 800 000
Operating profit	2 262 100
Interest on loan (capitalised)	270 000
Net profit before tax	1 777 000
Net profit after tax	1 243 900

B. Extract: Statement of Financial Position:

	28 February 2021	29 February 2020
Fixed assets (carrying value)	**R13 650 600**	**R13 590 000**
Current assets	**659 500**	**1 067 500**
Inventories	276 500	373 200
Trade and other receivables	262 300	539 600
Cash and cash equivalents	120 700	154 700
Shareholders' equity	**9 891 400**	**11 985 000**
Ordinary share capital	9 555 000	11 220 000
Retained income	336 400	765 000
Loan: VBC Bank (see E)	?	2 080 000
Current liabilities	**611 900**	**592 500**
Trade and other payables	252 100	185 700
Bank overdraft	0	90 000
SARS: Income tax	19 800	69 300
Shareholders for dividends	340 000	247 500

C. Share capital:

Dates	Number Of Shares	Details Of Shares
1 March 2020	1 650 000	In issue
30 October 2020	50 000	Additional shares issued
27 February 2021	335 000	Shares repurchased at R9,50 each
28 February 2021	1 365 000	In issue

D. Dividends and earnings:

- An interim dividend was paid on 31 August 2020.
- A final dividend of 20 cents per share was declared on 28 February 2021.
- Total dividends for the year amounted to R835 000.
- Earnings per share (EPS) on 28 February 2021 was 74 cents.

E. Loan: VBC Bank

- The balance on 1 March 2020 was R2 080 000.
- Monthly instalments of R35 000, including interest, were paid.
- Interest capitalised amounted to R270 000.

SOLUTION

2.1

2.1.1	**Directors' report**
2.1.2	**Internal**
2.1.3	**Limited**

2.2 USANDA LIMITED

2.2.1

Calculate: Income tax paid	
69 300 + 533 100 – 19 800 – 69 300 – 533 100 + 19 800 (69 300) + (533 100) + 19 800	R582 600
Calculate: Dividends paid	
247 500 + (835 000 – 340 000) – 247 500 – 835 000 + 340 000 (247 500) + (835 000) + 340 000	R742 500

2.2.2

CASH EFFECTS OF FINANCING ACTIVITIES	**(2 652 500)**
Proceeds from shares issued 9 555 000 + 2 345 000 – 11 220 000 OR –9 555 000 – 2 345 000 + 11 220 00	680 000
Funds used to repurchase shares 335 000 x R9,50	**(3 182 500)**
Change in loan / Loan repayment 2 080 000 – 1 930 000 or 270 000 – 420 000	**(150 000)**
NET CHANGE IN CASH AND CASH EQUIVALENTS	**56 000**
Cash (opening balance) 154 700 – 90 000	**64 700**
Cash (closing balance)	**120 700**

2.2.3 Calculate financial indicators for the year ended 28 February 2021:

% operating profit on sales	
<u>2 262 100</u> x 100 17 800 000 1	12,7% Or 12.7
Acid-test ratio	

383 000 : 611 900 (659 500 – 276 500) or (262 300 + 120 700)	0,6 :1 Or 0,63 : 1
% return on average shareholders' equity (ROSHE)	
1 243 900 x 100 ½ (11 985 000 + 9 891 400)	11,37% Or 1,4%
Dividend payout rate (%)	
50 cents x 100 74 cents 1 OR R835 000 x 100 R1 243 900 1	67,6% Or 67,1%

QUESTION 6: BUDGETING (40 marks; 25 minutes)

The financial year-end of Carpets Galore (Pty) Ltd is 31 October 2019. Thembi Tsomi is the sole shareholder and director.

6.1 Indicate amounts in the appropriate blocks for the Cash Budget and Projected Income Statement for three months ending 31 January 2020.

- •A printer costing R40 800 will be bought for cash on 30 November 2019. Depreciation will be R680 per month.
- •On 1 January 2020, R48 000 will be paid for a 12-month insurance contract.
- •A loan of R100 000 will be received from Viva Bank on 31 December 2019. This will be repaid in equal instalments over 20 months, commencing on 31 January 2020. Interest at 12% p.a. is paid monthly and is not capitalised. (11)

6.2 Refer to Information A: Debtors' Collection Schedule.
Thembi is preparing projections for the period commencing 1 November 2019. Thembi does not grant discount for early payment.

Calculate the % of debtors:

•Who settle their accounts in the 2nd month following the credit sales transaction month

•Written off as bad debts at the end of the 3rd month following the credit sales transaction month (3) (4)

6.3 Refer to Information B: Projected Income Statement for September and October.

6.3.1 Office workers are unhappy with the increase that Thembi gave them on 1 October 2019. Explain what she should say to them. Provide TWO points. Quote figures or a calculation. (6)

6.3.2 Thembi pays her son, Jacob, to deliver and install carpets for customers. She budgets R2,80 per metre for this. Comment on the control of this expense. Quote figures or a calculation. (4)

6.3.3 A new competitor commenced trading in the area on 1 September 2019.

- Provide figures to illustrate the impact on sales in September.
- Explain THREE decisions that Thembi took in October in response to the new competitor. Quote figures or a calculation. (2) (6)

6.3.4 Stock sold is replaced in the same month. 50% of the stock is bought on credit. Creditors are paid in the month following the purchases month to receive a 5% discount.

Calculate the actual amount payable to creditors in November 2019. (4)

INFORMATION:

A. Debtors' Collection Schedule for the period ending 31 January 2020:

	CREDIT SALES	COLLECTIONS		
		NOV. 2019	DEC. 2019	JAN. 2020
August	R80 000	R17 600		
September	90 000	67 500	R19 800	
October	100 000		75 000	R22 000
November	120 000			90 000
			R94 800	**R112 000**

B. Information identified from the Projected Income Statement:

	SEPTEMBER 2019		OCTOBER 2019	
	Projected	**Actual**	**Projected**	**Actual**
Metres sold	**5 000 m**	**3 800 m**	**5 000 m**	**6 000 m**
Selling price per metre	R100	R100	R100	R88
Cost price per metre	R60	R60	R60	R60
Sales: cash	R400 000	R310 000	R400 000	R132 000
: credit	90 000	70 000	100 000	396 000
Total sales	490 000	380 000	500 000	528 000
Cost of sales	(300 000)	(228 000)	(300 000)	(360 000)
Gross profit	190 000	152 000	200 000	168 000
Director's fees	50 000	50 000	50 000	40 000
Wages: Office workers	9 200	9 200	9 200	11 040
Salary: Salesperson	20 000	20 000	20 000	0
Commission: Salesperson	0	0	0	52 800

Advertising	5 000	5 000	5 000	5 000
Packing materials	2 500	1 900	2 500	2 550
Delivery and installationof carpets	14 000	14 000	14 000	16 800
Staff training	15 000	0	15 000	40 000

SOLUTION

	Cash Budget				Projected Income Statement		
	Nov 2019	Dec 2019	Jan 2020		Nov 2019	Dec 2019	Jan 2020
Printer bought	40 800						
Depreciation						680	680
Insurance			48 000				4 000
Loan received		100 000					
Loan repayments			5 000				
Interest			1 000				1 000

6.2 Calculate the % of debtors who settle their accounts in the 2nd month following the credit sales transaction month

$\frac{67\,500}{90\,000}$ or $\frac{75\,000}{100\,000}$ or $\frac{90\,000}{120\,000}$ x 100 = 75%

Calculate the % of debtors written off as bad debts at the end of the 3rd month following the credit sales transaction month.

R2 700/90 000 x 100 = 3%

Or

100 000 – 100 00 x 100 = 3%

Or

100% - 75% - 22% = 3%

The office workers are unhappy with the increase that Thembi gave them on 1 October 2019. Explain what she should say to them. Provide TWO points. Quote figures or a calculation.

They received a (large) increase of 20% (unbudgeted; which is more than inflation) (1 840 / 9 200 = 20%)

Sales target (under by R110 000) / GP target (under by R32 000) not reached but increase in wages (20%) granted

The director took a R10 000 drop in pay / reduced from R50 000 to R40 000 / by 20%

They received training costing R40 000 (R25 000 over budget) which will benefit them in future

6.3.2 Thembi pays her son, Jacob, on a part-time basis to deliver and install carpets for customers. She budgets R2,80 per metre for this. Comment on the control of this expense. Quote figures or a calculation.

Comment on poor control / ethics in September

Comment on good control in October

Expected responses for September:

He was overpaid in September (even though he did not meet target)

Figures: R14 000 / R10 640 / R3 360

Expected responses for October:

He was paid correctly (although it was over-budget; due to improved sales)

Figures: R 16 800 / R14 000 / R2 800

6.3.3 A new competitor commenced trading in the area on 1 September 2019. Provide figures to illustrate the impact on sales in September.

Compare budgeted Sales to actual Sales

Sales budget was R490 000 and the actual was R380 000 / R110 000 under the budgeted amount / 22,4% drop from expected

OR: Compare expected metres to actual metres Two marks

Sales dropped from 5 000m2 budgeted to 3 800m2 actual / 1 200m2 under budget / 24% less than expected.

Explain THREE decisions that Thembi took in October in response to the new competitor. Quote figures or a calculation.

Promoted credit sales R296 000 above budget (R326 000 increase in actual) with incentives as opposed to cash sales (e.g. discount or extended payment period)

Reduced the selling price per m to R88 per m (from R100) / Reduced mark up from 67% to 47%

Spent R40 000 on training but budgeted only R15 000 / Training increased to R40 000 in October (over-budget by R25 000)

Changed the salary structure of the salesman from a fixed salary of R20 000 pm to a commission of R52 800/10% of sales

6.3.4 Calculate the amount she will actually have to pay the creditors in November 2019.

R360 000 x 50% x 95% = R171 000

QUESTION 3 NOV 2019 : MANUFACTURING (40 marks; 25 minutes)

3.1 Choose the correct term from those given in brackets. Write only the term next to the question numbers (3.1.1 to 3.1.4) in the ANSWER BOOK.

3.1.1 Wages paid to the factory cleaner is considered to be (direct/indirect) labour.

3.1.2 Bad debts must be shown as a (selling and distribution/ factory overhead) cost.

3.1.3 Rent paid for the factory building is regarded as a (fixed/variable) cost.

3.1.4 Carriage on purchases of raw materials is regarded as a/an (direct material/indirect material) cost. (4)

3.2 ZINZI MANUFACTURERS

Information is provided for the financial year ended 31 December 2018. The business manufactures leather jackets according to orders received. There is no work-in-progress stock.

REQUIRED:

3.2.1 Raw material stock:
Calculate:

- The value of the closing stock using the first-in-first-out stock valuation method (5)
- The direct material cost (4)

3.2.2 Refer to Information C.

Calculate the correct factory overhead cost for the year. (8)

3.2.3 The owner is concerned about the increase in the following:

- Total fixed cost per unit
- Direct labour cost per unit
- Provide evidence (figures) to justify his concern. In each case, also give a possible reason for the increase in EACH unit cost, apart from normal inflation. (6)

3.2.**4 Break-even:**

- Calculate the break-even point on 31 December 2018. (4)
- Explain whether or not there was any improvement in the trends of

- the level of production and the break-even point from one year to the next. Quote figures.
- The owner cannot understand why he is making a better profit this year. Explain how this happened. Provide TWO points. Quote figures. (5)

INFORMATION:

A. Raw material:

Stock balance:	Metres	Cost per metre	Total amount
1 January 2018	920	R65	R59 800
31 December 2018	1 195	?	?

B. Purchases for the year:

Date	Metres	Cost per metre	Total amount
February 2018	5 200	R75	R390 000
May 2018	2 480	R80	R198 400
September 2018	930	R90	R83 700
TOTAL	8 610		R672 100

C. Factory Overhead Costs:

- The bookkeeper calculated the factory overhead cost at R84 330. He did not take into account the following expenses:

Insurance	R31 200
Rent expense	R114 000
Water and electricity for the administration section	R7 110

- 60% of the insurance relates to the factory.
- The rent must be allocated between the factory, sales and administration in the ratio 5 : 2 :1.
- 15% of the water and electricity expense relate to the office. 50% must be allocated to the factory.

D.

	2018		2017
	TOTAL AMOUNT	**PER UNIT**	**PER UNIT**
Fixed costs:	R264 000	R44	R36
Factory overheads			R26
Administration			R10
Variable costs:		R165	R150
Direct materials			R94
Direct labour	R330 000	R50	R38

Selling and distribution			R18

E. Additional information:

	2018	2017
Number of jackets produced and sold	6 000 units	7 560 units
Break-even point	**?**	3 888 units
Selling price per jacket	R300	R220
Inflation rate	5%	

SOLUTION

3.1

3.1.1	Indirect
3.1.2	Selling and distribution
3.1.3	Fixed
3.1.4	Direct material

3.2.1

Calculate: The value of the closing stock using the first-in-first-out stock valuation method
930 x 90 = 83 700 265 x 80 = 21 200 Then R83 700 + R21 200 = **104 900**
Calculate: Direct material cost
(390 000 + 198 400 + 83 700) = R672 100 R59 800 + R672 100 – R104 900 = **R627 000**

3.2.2

Factory overhead cost	
Total b/f	84 330
Insurance (31 200 x 60%)	18 720
Rent expenses (114 000 x 5/8)	71 250
Water and electricity (7 110 x 50/15)	23 700
	198 000

3.2.3

Provide evidence (figures) to justify his concern. In each case, also give a possible reason for the increase in EACH unit cost, apart from normal inflation.	
Evidence	Reason
Total fixed cost per unit	Changes in economies of scale

Increased by R8 per unit (22%) (from R36 to R44)	Fewer units produced
Direct labour cost per unit Increased by R12 per unit (32%) (from R38 to R50)	More overtime worked due to strikes Inefficiency / Poor supervision of workers / Surplus workers not gainfully employed / Hours lost due to load shedding

3.2.4

Calculate the break-even point on 31 December 2018
$\dfrac{\text{Fixed cost}}{\text{SP/Unit – VC/Unit}} = \dfrac{\text{R } 264\ 000}{300 - 165}$ = 1 955.6 units or 1 956 or 1 955
Explain whether or not there was any improvement in the trends of the level of production and the break-even point from one year to the next.
Production decreased from 7 560 – 6 000 (1 560 units / 20,6%) The BEP decreased from 3 888 units to 1 956 units (1 932 / 49,7%) OR: for four marks 6 000 – 1 956 = 4 044 units In 2018 production exceeds BEP by 4 044 units while in 2017 production exceeds BEP by 3 672 units
The owner cannot understand why he is making a better profit this year. Explain how this happened. Provide TWO points.
Comparing BEP to production Comparing selling price • The business is making a profit on more units this year (4 044 this year; 3 672 last year), 372 units more see BEP calc above • The selling price per jacket increased from R220 to R300 (R80 more per jacket) OR: For two marks only if first bullet not provided: • A decrease in BEP by 1 932 units

QUESTION 6. JUNE 2019 : BUDGETING (30 marks; 20 minutes)

You are provided with information relating to Cimpiwe Clothing Shop.

REQUIRED:

6.1 Refer to Information A.

Identify TWO items in the Cash Budget that will not appear in a Projected Income Statement. (2)

6.2 Calculate the missing amounts indicated by (i) to (iii) in the Cash Budget for June and July 2019.(7)

6.3 Calculate the total purchases for April 2019. (2)

6.4 Complete the Debtors' Collection Schedule for July 2019. (8)

6.5 Refer to Information F.

6.5.1 Comment on the following:

- Effect of the advertising on sales (3)
- Payment to creditors (2)

6.5.2 Sales strategy:

- Identify TWO strategies (except advertising) that the business used to achieve sales targets for May 2019. Quote figures. (4)
- Explain whether these were good strategies, or not. Provide ONE point with figures (2)

INFORMATION:

A. Extract from the Cash Budget

	JUNE 2019	**JULY 2019**
CASH RECEIPTS		
Cash sales	186 000	285 000
Cash from debtors	533 430	**?**
Rent income	**(i)**	9 180
Interest on fixed deposit	1 800	2 200
CASH PAYMENTS		
Salaries and wages	73 400	73 400
Fixed deposit: Protea Bank	0	**(ii)**
Cash purchases of trading stock	**?**	**(iii)**
Payment to creditors	192 000	**?**
Insurance	3 250	3 250
Drawings	21 600	21 600
Sundry expenses	96 360	98 700

A. Cash sales are 25% of total sales.

Collections from debtors:

- 30% in the month of sales less 5% discount
- 65% in the following month
- Provision is made for 5% bad debts.

B. Budgeted purchases of trading stock:

April	?
May	R484 000
June	R496 000
July	R760 000

- 40% of trading stock is bought on credit.
- Creditors are paid two months after the transaction month.

C. Rent increased by 8% in July 2019.

D. The business has a fixed deposit of R360 000. An additional amount is budgeted to be invested on 1 July 2019. Interest (not capitalised) at 6% p.a. is receivable at the end of each month.

E. Cimpiwe is concerned about the following items for May 2019:

	BUDGETED (R)	ACTUAL (R)	VARIANCE (R)
Cash sales	172 000	140 000	– 32 000
Credit sales	516 000	552 000	+ 36 000
Collection from debtors	475 000	380 000	– 95 000
Advertising	36 000	64 800	+ 28 800
Payments to creditors	180 000	105 000	– 75 000
Delivery expenses	0	19 000	– 19 000
Packing materials	3 000	2 500	– 500

SOLUTION

6.1

Identify TWO items on the Cash Budget that will not appear in a Projected Income Statement.
Any TWO Cash from debtors Fixed deposit: Protea Bank Cash purchases of trading stock Payment to creditors Drawings

6.2

(i) Calculate: Rent income, June 2019
9 180 x 100/108 = 8 500
(ii) Calculate: Fixed deposit: Protea Bank, July 2019
400 x 100/6 x 12 = 80 000 $\frac{400 \times 12}{6\%}$
(iii) Calculate: Cash purchases of trading stock, July 2019
760 000 x 60% = 456 000

6.3

Calculate the total purchases for April 2019.
192 000 = 480 000 40%

6.4

Debtors' Collection Schedule			
	Credit sales	**June**	**July**
May	**576 000**	**374 400**	
June	**558 000**	**159 030**	**362 700**
July	**855 000**		**243 675**
Total		**533 430**	**606 375**

6.5.1 Effect of advertising on sales

Advertising was over budget by R28 800 (80%)

Total sales increased by R4 000 (0,6%), due to an increase in credit sales.

Effect on sales: The large increase in advertising was not effective / did not achieve the desired effect on sales.

Payment to creditors

Creditors were underpaid by R75 000 (while purchases increased; if this trend continues, creditors will decrease credit limits, stop supplying on credit, may incur interest charges).

6.6.2 Identify TWO strategies (except advertising) that the business used to achieve sales targets for May 2019. Quote figures.

Increased the credit sales, R36 000; (R412 000 more than cash sales)
Introduced delivery service, R19 000

Explain whether these were good strategies, or not. Provide ONE point with figures.

Not effective:

• Collection from debtors was poor (business will face cash challenges in respect of future collections) – less than budget by R95 000 or 20%

• Cash flow problems impacted on payments to creditors – paid R75 000 less than budget

• Delivery service impacted on cash flow – paid R19 000 which was not budgeted

• Small increase in total sales by R4 000

OR

Effective:

• Increase in credit sales was R36 000 – increase in number of customers

• Increase in sales was R4 000 – increase in number of customers

QUESTION 2: COST ACCOUNTING (MANUFACTURING) (50 marks; 40 minutes)

2.1 PERFECT FIT MANUFACTURERS

The business produces formal shirts. The financial year ended 28 February 2021.

REQUIRED:

2.1.1 Prepare the Production Cost Statement. (14)

2.1.2 Calculate:

Gross profit earned on sale of shirts (5)

Mark-up % achieved on shirts (2)

INFORMATION:

A. Stock on hand:

	28 February 2021	**1 March 2020**
Work-in-progress	?	R230 000
Finished goods	400 shirts, valued using FIFO method	900 shirts at R380 = R342 000

B. The bookkeeper calculated the costs below. Some errors were made.

Direct material cost	R1 575 000
Selling and distribution cost	R385 000
Administration cost	R256 400
Direct labour cost	?
Factory overhead cost	R518 800

C. Errors and omissions:

- Payment to Quick Deliveries, R75 000 for carriage on raw materials, was incorrectly allocated to selling and distribution cost.
- The entire insurance amount of R25 200 was transferred to the Administration Cost Account. Two-thirds (2/3) of this expense should be allocated to the factory.
- The Factory Overhead Cost Account included an amount of R117 600 for water and electricity. The bookkeeper had incorrectly allocated this expense to factory, administration, and selling and distribution in the ratio 6 : 3 : 1. The correct ratio is 5 : 4 : 1.

D. Prime cost: R2 550 000 (after adjustments)

E. Production and sales for the year:

7 600 shirts were produced at a unit cost of R420 each.

8 100 shirts were sold for R4 860 000.

2.2 LEATHER MANUFACTURERS

Leather Manufacturers is owned by Tello Andrews. They produce leather purses and leather jackets. The financial year ends on 28/29 February each year.

REQUIRED:

PURSES

2.2.1 Calculate the break-even point for purses for the year ended 28 February 2021. (4)

2.2.2 Comment on the level of production achieved and the break-even point for purses for 2021. Quote figures. (4)

2.2.3 Apart from inflation and wage increases, give TWO other possible reasons for the increase in the direct labour cost per unit for purses. (4)

2.2.4 Give TWO reasons for the decrease in the direct material cost per unit for purses. (2)

JACKETS

2.2.5 Although Tello was aware that importing leather for the jackets would increase the direct material cost per unit, he thought that this would improve the quality of the jackets.

Explain why the direct material cost per unit for jackets would probably increase if raw material were imported. State TWO points. (2)

Provide figures to prove that Tello was correct about the effect this decision would have on the cost of the jackets. (2)

2.2.6 Calculate the % increase in the selling price of the jackets. (3)

2.2.7 Explain the impact of the increase in the selling price of jackets on the sales and profit. Quote figures or calculations. (4)

2.2.8 Tello wants to increase profits on jackets by an additional R250 000 in the next financial year. Assuming the cost structure remains the same, calculate the total number of additional units he must produce to achieve this target. (4)

INFORMATION:

	Purses		**Jackets**	
	2021	**2020**	**2021**	**2020**
Direct material cost per unit	R100	R125	R360	R180
Direct labour cost per unit	R135	R105	R280	R240
Selling and distribution cost per unit	R20	R30	R60	R45
Total variable cost per unit	**R255**	**R260**	**R700**	**R465**
Total fixed costs	R936 000	R836 000	R1 706 250	R2 000 000
Number of units produced and sold	24 000	22 000	3 631	6 350
Break-even number of units	?	20 900	3 750	5 000

Selling price per unit	R295	R300	R1 170	R780

SOLUTION

2.1 PERFECT FIT MANUFACTURERS

2.1.1 PRODUCTION COST STATEMENT

FOR THE YEAR ENDED 28 FEBRUARY 2021

Direct material cost 1 575 000 + 75 000	**1 650 000**
Direct labour cost	900 000
Prime cost	**2 550 000**
Factory overhead cost 518 800 + 16 800 – 19 600	**516 000**
Total manufacturing cost	**3 066 000**
Work-in-progress (beginning)	230 000
	3 296 000
Work-in-progress (end)	**(104 000)**
Total cost of production 7 600 x R420	**3 192 000**

2.1.2

Calculate: Gross profit earned on sale of shirts.	
Workings	Answer
4 860 000 – (342 000 + 3 192 000 – 168 000 OR: (900 x 220) + (7 200 x 180)	1 494 000
Calculate: Mark-up % achieved on shirts	
Workings	**Answer**
$\frac{1\ 494\ 000}{3\ 366\ 000}$ x 100 (342 000 + 3 192 000 – 168 000) OR: 3 366 000 x (100+y/100) = 4 860 000 y = 44,4%	44,4%

2.2 LEATHER MANUFACTURERS

PURSES:

2.2.1

Calculate the break-even point for purses for the year ended 28 February 2021.	
Workings	**Answer**
Break even units = $\frac{\text{Fixed Costs}}{\text{SP- VC}}$ = $\frac{\text{R936 000}}{\text{R295 – R255}}$	23 400 units

2.2.2 Comment on the level of production achieved and the break-even point for purses for 2021. Quote figures.

Expected responses for 4 marks:

- The business produced 600 units more than break-even / profit on 600 units / R24 000 extra profit
- BEP compared to production reflects a profit on 600 units in 2021 compared to a profit on 1 100 units in 2020 / this is a decrease in profits on 500 units (1100 – 600) in 2021 compared to 2020

Expected response for 2 marks in total:

Production increased by 2 000 units (24 000 – 22 000) / to 24 000 units / by 9% and/or BEP increased by 2 500 units (23 400– 20 900) / to 23 400 / by 12%

2.2.3 **Apart from inflation and wage increases, provide TWO other possible reasons for the increase in the direct labour cost per unit for purses**.

- Overtime paid at higher rates endorsed or approved / bonus for good performance or extra time / negotiate higher fringe benefits / targets not met during normal time / overtime was needed to meet targets
- Low productivity of workers (not productive or efficient)
- Interruptions (due to malfunctioning machines / load-shedding / COVID-19 lockdown
- Higher qualifications of workers / employed higher-skilled workers
- Poorly trained workers / lack of supervision / time wasted in re-doing work.

2.2.4 Give TWO reasons for the decrease in the direct material cost per unit for purses. 2

- Cheaper (new) or local suppliers used
- Took advantage of bulk discounts / negotiated discounts
- Better supervision / less wastage / better control over issuing / use of material
- Better cutting methods / use patterns or technology / better skilled workers / better training of workers
- Cheaper transport costs / petrol costs / using own transport

2.2.5 Explain why the direct material cost per unit for jackets would probably increase if raw material is imported.

- Additional / increase in transport costs e.g. freight, shipping
- High quality material not available locally
- Custom duties / import duties / taxes
- Better packaging
- Different / weak exchange rate

Provide figures to prove that Tello was correct about the effect this decision would have on the cost of the jackets.

Direct material cost per unit increased (from R180) to R360 / by 100% / by R180 / it doubled.

2.2.6

Calculate the % increase in the selling price of the jackets.	
Workings	**Answer**
1 170 – 780	

$\frac{390}{780}$ x 100	**50%**

2.2.7

Explain the impact of the increase in the selling price of jackets on the sales and profit. Quote figures or calculations.

- Units produced and sold decreased by 2 719 units / (from 6 350) to 3 631 / by 42,8%.
- The BEP dropped by 1 250 units / from 5 000 to 3 750 / by 25%
- Made loss on 119 units in 2021 and profit on 1 350 units in 2020 / sales dropped from R4 953 000 to R4 248 270 / by R704 730 / by 14,2%

For candidates who pick up the reversed figures in BEP/Production:

- OR 1 250 units less / from 5 000 – 3 750 / by 25%
- OR 2 719 units less / from 6 350 – 3 631 / by 42,8%
- OR Made a loss on1 350 units in 2020 and a profit on 119 units in 2020 / sales increased from R3 900 000 to R4 387 500 / by R487 500 / by 12,5%

2.2.8

Tello wants to increase profits on jackets by an additional R250 000 in the next financial year. Assuming the cost structure remains the same, calculate the total number of additional units he must produce to achieve this target.	
Workings	**Answer**
$\frac{250\ 000}{470}$ 1 170 – 700 Accept 4 163 two marks –3 631 one mark (1 706 250 + 250 000) ÷ 470	532 units
OR: 532 + 119 OR: 250 000 + 55 930 470	651 units
OR: Use BEP calculation to calculate the units Accept 4 163 two marks –3 750 one mark (1 706 250 + 250 000) ÷ 470	413 units

QUESTION 3: Nov 2020 BUDGETING

Blossom (Pty) Ltd sells expensive ladies' dresses of high quality. They also repair dresses for customers, but they aim to break even on this service.

Customers are allowed to buy dresses for cash or on credit, but they are required to pay cash for all repairs.

The information relates to the budget period ending 31 May 2021.

REQUIRED:

3.1 Complete the Debtors' Collection Schedule for March to May 2021. (9)

3.2 Calculate the missing amounts indicated by (a) to (d) in the Cash Budget. (14)

3.3 Refer to Information G and H.

Advertising:

Explain the decisions that the directors took regarding the budgeted and actual expenditure for advertising in May 2021. Quote figures or calculations. (4)

The directors ask you for a report on the effect that the advertising decisions have actually had on customers and sales in May 2021.

- Provide TWO points that you would include in your report. Quote figures or calculations. (4)
- Explain how the decline in the national economy has affected the average amount that customers spent in May 2021. Quote figures. (3)

Consumable stores:

Comment on whether the consumable stores have been well controlled or not. Quote figures or calculations. (2)

3.4 Refer to Information F and H.

Rental and customers:

The owners of the property, Propco Ltd, informed the directors of Blossom Ltd of the increase in rent planned with effect from 1 April 2021.

In order to economise on rent, the directors asked the owners, Propco Ltd, for a reduction of the area rented from 1 May 2021. Propco Ltd agreed to this request. Calculate the reduction of the area rented (in square metres).

INFORMATION:

A.

Total sales and cost of sales:

	March	April	May
Sales	R560 000	R630 000	R770 000
Cost of sales	320 000	360 000	440 000

- Goods are sold at a mark-up of 75% on cost.
- Credit sales are expected to be 65% of total sales.

B. Expected debtors' collection based on the past:

- 40% collected in the month of sale, less 6% discount for early payment
- 50% collected in the month following the month of sale
- 8% collected two months after the sale
- 2% regarded as uncollectable two months after the sale

C. Purchases of stock:

- All purchases of stock are on credit.
- Trading stock is replaced in the month of sale. A fixed stock level is maintained.
- Creditors **are paid in full in the month after purchasing stock.**

D. Loan from Janet Bloom:

- Janet Bloom has provided a loan to the business at an interest rate of 9% p.a. Interest is not capitalised and one-third of the loan is repaid to her on 31 December each year.
- As the company was still experiencing cash flow problems owing to the Coronavirus lockdown in 2020, Janet agreed to increase her loan to the business on 1 April 2021.

E. Salaries of sales assistants:

- The sales assistants all earn the same monthly salary.
- They were promised a 5% increase in salaries with effect from 1 April 2021.
- The business employed two sales assistants in March and planned to employ an additional assistant from 1 April 2021.

F. Rent and number of customers:

- The directors secured premises in a local shopping mall from Propco Ltd with enough space to cater for the expected number of customers.
- Rent is charged per square metre according to the floor area. The rent increased by 11% p.a. commencing on 1 April.
- The following figures were identified for planning purposes:

	MARCH	APRIL	MAY
Floor area in square metres (m2)	120 m2	120 m2	?
Rent expense per m2	?	?	?
Expected average sales per customer	R7 000	R7 000	R7 000
Expected number of customers	80 customers	90 customers	110 customers

G. Extract from the Cash Budget:

	March	April	May
Receipts	**R**	**R**	**R**
Cash sales	196 000	(a)	269 500
Cash from debtors	278 369	355 992	?
Fee income (for repairs)	15 000	15 000	15 000
Payments			
Payments to creditors	220 000	320 000	360 000
Salaries of sales assistants (see Information E)	22 400	(c)	?
Wages of repair staff	9 000	10 000	10 000
Consumable stores (for repairs)	4 200	4 200	4 200
Interest on loan	1 365	2 625	2 625
Rent expense (see Information F)	(d)	39 960	39 960
Advertising	10 000	12 000	30 000
Audit fees			60 000

H. Comparison of budgeted figures to actual figures for May 2021:

	BUDGETED	ACTUAL
Number of customers	**110 customers**	**135 customers**

	R	R
Sales	770 000	690 000
Fee income (repair service)	15 000	21 000
Advertising	30 000	42 000
Consumable stores (for repairs)	4 200	5 520
Wages (for repair staff)	12 000	18 000
Audit fees	60 000	48 000
Rent expense	39 960	31 968
Salaries (shop assistants)	35 280	37 044
Delivery expenses	6 930	4 850
Packing material	19 250	13 480

SOLUTION

3.1 debtors' collection schedule for March to May 2021

MONTHS	CREDIT SALES	MARCH	APRIL	MAY
	R	R	R	R
January	**204 750**	**16 380**		
February	**250 250**	**125 125**	**20 020**	
March	**364 000**	**136 864**	**182 000**	**29 120**
April	**409 500**		**153 972**	**204 750**
May	**500 500**			**188 188**
		278 369	**335 992**	**422 058**

3.1 AMOUNTS FOR THE CASH BUDGET

	Workings	Amount
(a)	**Cash sales for April** 630 000 x 35% OR: 630 000 – 409 500 OR: 360 000 x 175/100 x 35% OR: 409 500 x 35/65	**R220 500**
(b)	**Increase in loan from Janet Bloom** (2 625 – 1 365) 1 260 ÷ 0,09 x 12 OR 1260 x 100/9 x 12 OR 1 260 x 12 / 9% OR 350 000 – 182 000 (2 625 / 0,09 x 12) – (1 365 / 0,09 x 12)	**R168 000**
(c)	**Salaries for April 2021** R35 280 One part correct Apply rule 4 22 400 x 3/2 x 1,05 OR: 11 760 x 3	

	22 400 / 2 X 1,05 OR: (11 200 + 22 400) x 1,05 If assumed that extra assistant did not get the 5% increase, then answer will be: 22 400 x 105% 23 520 + 11 200 = 34 720 two marks one mark Be alert to other combinations of figures e.g. R1 120, R23 520, R33 600	**R35 280**
(d)	**Rent expense for March 2021** 39 960 x 100/111 **OR** 39 960 ÷ 111% **OR** 39 960 ÷ 1,11 **OR** 39 960 – 3 960	36 000

3.3

Explain the decisions that the directors took regarding the budgeted and actual expenditure for advertising in May 2021. Quote figures or calculations.
Expected response for 4 marks: ➢ Advertising budget increased by R18 000 / (from R12 000) to R30 000 / by 150%. ➢ Actual expenditure on Advertising exceeded the budget by R12 000 / from R30 000 to R42 000 / by 40%

The directors ask you for a report on the effect that the advertising decisions have actually had on customers and sales in May 2021.

- Customers: The actual was 135 / 25 more (than the 110 expected) / 22,7% more / the business projected an increase of 20 customers / budget for 22,2% increase in customers, but actual increase (April to May) is 50%
- Sales: The actual sales were less than budget by R80 000 (from R770 000) to R690 000 by 10,4%.

Explain how the decline in the national economy has affected the average amount that customers spent in May 2021. Quote figures.

- The average sales were budgeted at R7 000 per customer but this actually dropped to R5 111 per customer (690 000 /135)
- It appears that the increase in advertising has attracted many new customers (25) who do not have the same spending power as the company's traditional customers / sales per customer decreased (they spend R5 111 instead of R7 000 each)
- More customers are repairing dresses rather than buying new ones. Fee income exceeded budget by R6 000 (R21 000 – R15 000) / 40%. Sales of new dresses were R80 000 less than the budget (10,4%).
- Customers might be window-shopping / spending less / more buying on credit

Comment on whether the consumable stores have been well controlled or not. Quote figures or calculations.

- Consumable stores were budgeted at 28% (R4 200 ÷ R15 000) of fee income, while actual amount spent was 26% of actual fee income (R5 520 ÷ R21 000).
- Consumable stores exceeded the budget by 31,4% / by R1 320 (R5 520 – R4 200) while fee income exceeded the budget by 40% / by R6 000 (R21 000 – R15 000)

3.4

Calculate the reduction in the area rented (in square metres).	
Workings	**Answer**
Reduction in rent = R39 960 – R31 968 = R7 992 R39 960 /120 m^2 = R333 Reduction in area = R7 992 ÷ R333 OR: 120 – (R31 968 ÷ 333) OR: 120 x 20% 96 two marks 7 992 / 39 960	**24** m^2

TANGIBLE ASSETS

Fixed Assets

Fixed assets of a business are items of material value. They usually have the following characteristics;

- Are of a long life,
- To be used in the business,
- Not bought with the intention of resale.

Fixed asset register

A business keeps an asset register to record details about its fixed assets. The asset register shows the value of assets, date of acquisition and other details needed to calculate depreciation and taxes.

How to show the effect of acquiring an asset

Debit Fixed Asset
Credit Bank/Creditors control

Depreciation of fixed assets

Fixed assets decrease in value over their useful lives.

Depreciation is the loss of value of an asset which is usually brought into account at the end of the year.

Depreciation is an accounting concept and is a non-cash entry. Depreciation is an expense, but it's noteworthy to remember that for tax purposes, depreciation is a non-deductible expense.

Every business should have a policy for depreciation. This will ensure that all employees act in an accountable and transparent way.

Factors that determine the lifespan of an asset include.

- The current condition of the asset,
- The replacement policy of tangible assets of a business,
- The experience with similar assets in business.

How to show the effect of depreciation

Debit Depreciation
Credit Accumulated depreciation

Example of Depreciation calculation

A company purchases a fixed asset for R100,000 excl VAT on 01 January 20X1. The asset was brought into use on 01 July 20X1. The asset has a useful life of 5 years and management has assessed the residual value at the end of 5 years to be R10,000. For the financial year ended 31 December 20X1, compute the depreciation charge.

Solution

Depreciation = (Cost – Residual Value) / Useful Life x (Number of Months since brought into use / Total number of months in financial year)

= (100,000 – 10,000) / 5 x (6/12)

= R9,000

CORPORATE GOVERNANCE

Ethical conduct, King Code, Professional bodies, Audit reports and internal control

Ethical Behaviour

An ethical behaviour is the **application of moral principles in a given situation**. It means to behave according to the moral standards set by the professions in accounting field and society which we live in. Ethics focuses on dealing with what is good or bad, right or wrong, and a person's duties and obligations. Otherwise, ethics are set of principles held by a group, a profession or society.

Code of ethics:

Basic Principles of Ethics

- **Leadership** Leadership should enforce the code of ethics.
- **Discipline** Employees are expected to follow organisational rules, policies and procedures.
- **Transparency** Business should be conducted without hidden agendas accompanied with lack of information.
- **Accountability** Businesses and managers should take responsibility for their decision.
- **Fairness** Decision making should be based on facts and not emotions and bias.
- **Sustainability** Businesses should consider social, economic and environmental factors in decision making.

Unethical behaviour	Explanation	Examples
Market manipulation	It involves a deliberate attempt to artificially increase or decrease a company's share price.	Churning: When a trader place both buy and sell orders at the same time to increase activity and therefore attract other investors. Painting the tape: When a group of traders create activity or rumours to drive up the price of stock. Cornering: Purchasing enough of a particular stock to gain control of the supply and be able to set the price for it.
illegal insider trading	It involves buying or selling shares while possessing important	Tipping information or using tipped information: To do trading in order to make a profit or avoid losses

	confidential information about a company.	
Price fixing	When companies on the same side in a market conspire to buy or sell a product or service at a fixed price or manipulate the market by controlling supply and demand.	If all cellphone service providers agree to sell airtime at the same rate per unit, higher than reasonable. Or if those same service providers limit the amount of airtime available at certain times, and sell additional at a much higher price (as demand goes up, they control the selling price)
Corporate governance failure	When directors do not act in the best interest of the shareholders.	Accounting fraud: When directors manipulate financial indicators to mislead shareholders. Disclosure violations: When directors do not disclose accurate and complete financial statements
Conflict of interest	When there is a clash between professional obligations and personal interest.	Where an employee tries to perform a duty, but at the same time tries to achieve personal gain. Nepotism: The practice of giving one's relatives unfair advantages when one has power
Bribery and corruption	When someone is guilty of dishonest practices, like bribery.	When a person gives or receives something of value, like cash or gifts, for the purpose of influencing someone's actions or views.

King IV Report

The focus in King IV is clearly on ensuring that the application of the set out policies and principles achieves specifically identified outcomes, including:

- ethical culture
- good performance
- effective control, and/or
- legitimacy

Principles	Explanation
Board of directors	The board of directors must be in control and should fulfil its objectives set out in King IV Report
Ethical leadership and	The governing body should lead ethically and effectively
Corporate citizenship	The governing body should ensure that the organisation is and is seen to be a responsible corporate citizen
Integrated Reporting	King III introduced the concept of the triple bottom-line reporting. This takes profit, planet and people into consideration when reporting on performance.
Risk governance	The directors are responsible for managing and controlling the risks of the company
Stakeholder relationship	The governing body should adopt a stakeholder-inclusive approach that balances the needs, interests, and

	expectations of material stakeholders in the best interests of the organisation over time
Internal Audit	The company should have an effective internal audit department
Compliance	The company should comply with all applicable laws, rules, standards, and codes.
Independent Auditor	The company should appoint an independent auditor. The external auditor is appointed by the audit committee to provide an opinion on the financial statements.

The triple bottom line the organisation operates in according to King iv Report are namely : e**conomic** , **social** and **environmental**

Professional Bodies in South Africa

Only members of professional bodies are allowed to offer accounting , tax and auditing services to the public.

Professional Bodies	**Profession**
South African Institute of Chartered Accountancy (SAICA)	Chartered Accountancy CA
South African Institute of Professional Accountancy (SAIPA)	Professional Accountancy
Independent Regulatory Board of Auditors (IRBA)	Registered Auditors (RA)
Institute of Certified Bookkeepers (ICB)	Certified Bookkeepers
Chartered Institute of Management Accountancy (CIMA)	Management Accountancy (ACMA)
Institute of Internal Auditors South Africa (IIA SA)	Internal Auditors (CIA)

Principles of Code of Professional Conduct

- Professional competence: Members must have the competent skills for the job and act professionally.
- Professional conduct: Members should comply with the laws and regulations of the company and professional bodies.
- Integrity : Members must be honest and truthful and perform their responsibilities to the best of their ability and skill.
- Objectivity: Members must be objective and shun bias.
- Confidentiality: Members should not divulge confidential information without permission from the clients.

Functions of professional bodies

- Set standards: Set requirements for membership in terms of qualifications and training.
- Continuous development: Provide support for continuous development in terms of examinations and study materials.

- To ensure that members comply with IFRS and GAAP.
- Best practice: Inform its members of the best practice through training, training, notices and publications.
- Promoting promotion.
- Public relations: Speak on behalf of the profession.
- Code of professional conduct: They establish and review the professions code of ethics.
- Disciplinary action: Discipline rogue members.

Internal Controls

Segregation of Duties
When work duties are divided or segregated among different people to reduce the risk of error or inappropriate actions.

Physical Controls
When equipment, inventories, securities, cash and other assets are secured physically. This can occur through the use of locks, safes, or other environmental controls. Access is restricted to those with authority to handle them.

Reconciliations
Comparisons are made between similar records maintained by different people to verify transaction details are accurate and that all transactions are properly recorded. Specific examples would include Performing a reconciliation from bank statements to check register/records. Balancing/reconciling cash on hand to sales or transaction activity on the cash register totals.

Policies and Procedures
Established policies, procedures, and documentation that provide guidance and training to ensure consistent performance at a required level of quality. These should be available at all levels of the organization. Departmental and University/Organization wide.

Transaction and Activity Reviews
Management reviews of transaction, operating, and summary reports help to monitor performance against goals and objectives, spot problems, identify trends, etc. Specific examples include: Monthly review of budget statements to actual expenses. Review of telecommunication call activity reports for personal or non-business related phone calls. Review of timecards and overtime hours by employees.

Information Processing Controls
When data is processed, a variety of internal controls are performed to check the accuracy, completeness and authorization of transactions. Data entered is subject to edit checks or matching to approved control files or totals. Numerical sequences of transactions are accounted for, and file totals are controlled and reconciled with prior balances and control accounts. Development of new systems and changes to existing ones are controlled, as is access to data, files and programs.

Objectives of good internal control systems

- To find errors and detect fraud
- To protect the assets of the business
- To ensure that all accounting records are accurate and financial statements are reliable

Inventory / Stock internal control measures

Socks should be counted as there are received from the supplier and compared with the delivery note before signing the delivery note. Stocks must be checked in terms of sizes, quality, brand, model and quantity. All deliveries from suppliers require a count before they go into inventory so that discrepancies between deliveries and purchase orders are immediately remedied.

There must be segregation of duties between the workers who keep custody of the stocks, sell the stocks and receive the stocks.

Security. Stocks must be kept in a secure place. The reason that most businesses keep their inventory in a central location is that this allows them to also keep it secure. Added measures such as locks and security codes can help ensure that only certain trusted personnel have access to inventory

Tracking. The most basic step in inventory control is maintaining a catalogue of exactly what a business has and where it is. Most businesses today rely on electronic inventories of some sort, often using bar-codes and RFID tags to keep close track of items. All inventory locations should be numbered and inventory items identified with those numbers. Tracking systems should be in place.

Periodic stocktake. Periodic stocktake should be conducted in order to detect theft, validate stock balances shown by records, to identify stocks with closer expiry dates in order to sell them at a give away prices or on promotion.

Anti-stock theft measures Having security guards who check customers goods against invoices and receipts.
Use of cameras to identify thieves
Ununiformed security guards to patrol the shop frequently
Security tags supported by an infrared detector system may be put on items like clothes.

Internal controls for cash

- Separation of duties. With proper separation of duties, no single person has control over the entire cash process. The duties which require segregation are Purchasing, recording cash transaction, custodian of cash, receipt and deposit of cash.
- Authorisation. The following activities require authorisation by management , withdrawal of cash, payments,
- Security and supervision. The following activities deposit of cash require constant checking by the supervisor. Large deposits of cash require the involvement of armed security personnel. Conduct the proper background checks on prospective cash handlers. Restrict access of cash to as few people as possible. Lock cash in a secure location like a safe or locked storage facility. Minimize the amount of funds held overnight.

- Use of EFT for most of the payments and all substantial payments because they pause a lessor risk and leave indestructible audit trail.
- Review and reconciliation. Compare receipts to deposit records, record cash receipts when received, count and balance cash receipts daily, perform periodic surprise cash counts.
- Record cash receipts when received.
- Keep funds secured.
- Document transfers.
- Give receipts to each customer.
- Don’t share passwords.
- Give each cashier a separate cash drawer.
- Supervisors verify cash deposits.
- Supervisors approve all voided refunded transactions.
- Cheques and EFT payments should be authorised by at least two people in order to have balances and checks.
- The cash and cheques received must be banked intact the following morning

Internal Auditor

Reviews the internal controls, risk management, governance of a business and provides recommendations on how they can be improved.

Audit procedure

1 Plan Audit – Preparation of audit programme
2 Execute – Field work
3 Reporting - Reporting on the findings

Independent and external auditors

An external auditor is a public accountant who conducts audits, reviews, and other work for his or her clients. An external auditor is independent of all clients, and so is in a good position to make an impartial evaluation of the financial statements and systems of internal controls of those clients. The resulting audit opinions are highly valued by members of the investment community and creditors, who need an independent appraisal of the financial statements of organizations.

The shareholders of a company are responsible for the appointment of the external auditor at an annual general meeting.

External Auditor Responsibilities:

- Evaluating financial statements and assessing accounts for accuracy and compliance.
- Investigating internal systems and operations.
- Assessing risk management approaches.
- Performing audits for other departments, as needed.
- Reporting on errors and fraud.
- Providing feedback reports on findings.

Auditors Report

An auditor's report is a written letter from the auditor containing their opinion on whether a company's financial statements comply with generally accepted accounting principles (GAAP) and are free from material misstatement.

Components of an Auditor's Report

The first paragraph states the responsibilities of the auditor and directors.
The second paragraph contains the scope, stating that a set of standard accounting practices was the guide. The third paragraph contains the auditor's opinion and the basis of the opinion.

The Clean or Unqualified Report

A clean report means that the company's financial records are free from material misstatement and conform to the guidelines set by GAAP and IFSR. It indicate that the company's financial activities and records are correct and acceptable.

Example of unqualified report

In our opinion, the accompanying financial statements give a true and a fair view, in all material respects, the financial position of the company as at 28 February 2021, and its financial performance and its cashflows for the year then ended in accordance with GAAP and International Financial Reporting Standards.

Qualified Opinion

A qualified opinion may be issued in one of two situations: first, if the financial statements contain material misstatements that are not pervasive; or second, if the auditor is unable to obtain sufficient appropriate audit evidence on which to base an opinion, but the possible effects of any material misstatements are not pervasive.

Example of adverse opinion

Basis of our opinion

As discussed in note 5.12 to the financial statements, no provision for impairment has been provided on receivables of the debtors Zinduna Public Limited which has ceased trading. The company has no security for the for this receivable and no cash has been received on this debt.

Qualified opinion

In our opinion, except for the matter described in the Basis for Qualified Opinion, the financial statements give a true and a fair view, in all material respects, the financial position of Indaba Ltd as at 28 February 2021 and its financial performance and its cashflows for the year then ended, in accordance with GAAP and Financial Reporting Standards

Adverse Opinion

An adverse opinion means that the auditor has obtained sufficient audit evidence and concludes that misstatements in the financial statements are both material and pervasive.

Disclaimer of Opinion / Withholding of Opinion

A disclaimer of opinion means that, for some reason, the auditor is unable to obtain sufficient audit evidence on which to base the opinion, and the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. Examples can include when an auditor can't be impartial or wasn't allowed access to certain financial information.

Example of disclaimer

As a consequence of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

The differences between internal and external auditors

Internal auditors	External auditors
➢ They are appointed by management of the company. ➢ Internal audit is not compulsory. ➢ The work is done continuous throughout the year. ➢ Internal auditor is employee of the company. ➢ Internal auditor primary duty is to find the frauds and errors. ➢ Wages and salaries are paid for the services	➢ They are appointed by the shareholders of the company. ➢ External audit is compulsory for public companies. ➢ External audit is done annually at the end of the year. ➢ External auditor is an independent person. ➢ External auditor has to give an opinion on the financial statements whether they are true or false. ➢ Audit fee is paid for the services rendered

QUESTION

4.3 AUDIT REPORT FOR YEAR-END 28 FEBRUARY 2019

The financial statements of Visiv Ltd (see QUESTION 4.2.3) were audited. You are provided with extracts from the audit report**.**

Point 1	**Basis for audit report** We were unable to obtain sufficient audit evidence to support the amounts provided for certain income and expense items ...
Point 2	Furthermore, the repurchase of shares on 31 May 2018 is not in accordance with provisions of the Companies Act, 1973 (Act 61 of 1973), as the liquidity of the company has been compromised …
Point 3	**Opinion** Because of the significance of the matters described above, we do not express an opinion …

REQUIRED:

4.3.1 Refer to Point 3.

What type of audit report did the company receive?

4.3.2 Refer to Point 1.

Give TWO examples of audit evidence that the auditors would have required regarding this problem.

4.3.3 Refer to Point 2.

- Apart from the current ratio, identify and calculate ONE other financial indicator that the auditors would have used in deciding on this opinion.
- Explain what the directors could have done to prevent this comment by The auditors. Provide TWO points.

4.3 Audit report

What type of audit report did the company receive?

Disclaimer

Types of audit evidence

- asset registers
- source documents e.g. Cheque stabs, invoice
- journals ledgers
- debtors' statements
- creditors' statements
- physical inspections
- bank statements
- contracts (signed) EFT voucher (proof of payment**)**

Explain what the directors could have done to prevent this comment by the auditors. Provide TWO points.

Cash in the investments

Postpone repurchase of shares (to another time when liquidity improves)

Ensure that the auditors and directors comply with the latest Companies Act

Try to convince auditors that solvency ratio is good.

Issue more shares to the public or existing shareholders

Offer rights issue to shareholders rather (than pay more dividends)

Company offers higher dividends to shareholders rather than repurchasing of shares.

Reduce the dividends paid to improve liquidity.

Re-negotiate loan repayments / credit terms.

Promote more cash sales / off-load stock.

QUESTION 4 JUNE 2019 : AUDIT REPORT AND COMPANY FINANCIAL STATEMENTS (80 marks; 45 minutes)

4.1 Choose a term in COLUMN B that matches an explanation in COLUMN A. Write only the letters (A–E) next to the question numbers (4.1.1 to 4.1.4) in the ANSWER BOOK.

COLUMN A	COLUMN B
4.1.1 Reflects the financial position of the business on a specific date.	A Audit report
4.1.2 Shows whether the business made a profit or loss.	B Cash Flow Statement
4.1.3 Provides details about the movement of money with regard to operating, investing and financing activities.	C Balance Sheet
	D Income Statement

4.1.4 Provides an unbiased opinion on the reliability of the financial statements of a business.	E Directors' report

4.2 AUDIT REPORT

Extract from the audit opinion of Everest Ltd for the financial year ended 30 April 2018:

> **Audit opinion**
>
> In our opinion, the financial statements fairly present, in all material respects, the financial position of the company at 30 April 2018 and the results of their operations and cash flow for the year ended in accordance with International Financial Reporting Standards, and in the manner required by the Companies Act, 2008 (Act 71 of 2008).
>
> **Kego and Murray Associates**
> **Chartered accountants (SA)**
>
> **31 July 2018**

REQUIRED:

4.2.1 Choose the correct word from those given in brackets. Give ONE reason.

Everest Ltd received a/an (qualified/unqualified/disclaimer of opinion) audit report.

4.2.2 Give ONE reason why the Companies Act requires public companies to be audited by an independent auditor.

4.2.3 Newspaper reports have indicated that Kego and Murray Associates have been found guilty of misconduct in terms of audit work done at several large firms. Explain how this may influence shareholders of Everest Ltd. State TWO points.

SOLUTION

4.1

4.1.1	Balance sheet
4.1.2	Income statement
4.1.3	Cashflow statement
4.1.4	Audit report

4.2. Audit report

4.2.1

Choose the correct word from those given in brackets.
Unqualified

Give ONE reason. It is a good/clean audit report The words 'fairly present' indicates that there were no problems encountered by the auditors.

4..2.2

Give ONE reason why the Companies Act requires public companies to be audited by an independent auditor.
Any ONE valid reason • Unbiased view will be presented • Separation between management and ownership • Interest of the shareholders are safeguarded • Business is working with money of shareholders • To reduce / deter the possibility of fraud occurring

4.2.3

Newspaper reports have indicated that Kego and Murray Associates have been found guilty of misconduct in terms of audit work done at several large firms. Explain how this may influence shareholders of Everest Ltd. State TWO points.
Any TWO relevant points. The shareholders will not be able to rely on the audit report The shareholders will not reappoint the auditors at the next AGM (will be fired) The shareholders may demand a re-audit by another reputable firm The shareholders may insist on legal action if audit was fraudulently done Existing shareholders might want to offload / sell their shares Existing shareholders will be concerned over the value of their investment in the company.

MVVS LTD

QUESTION 4 Nov 2020 P1: CORPORATE GOVERNANCE (15 marks; 10 minutes)

Shareholders and employees associated with a company will be particularly interested in whether the company is well governed and managed by the directors.

At the AGM, the shareholders will elect two types of directors:

- Executive directors: They attend board meetings and work at the company on a full-time basis.
- Non-executive directors: They attend board meetings and do NOT work at the company.

You are provided with four aspects of corporate governance that will be of concern to the stakeholders.

REQUIRED:

4.1 Audit Report:

Explain why a qualified audit report is not a good reflection of a company. Provide TWO points. (4)

4.2 The Board of Directors:

Explain why it is important for a company to include non-executive as well as executive directors on the Board of Directors. (4)

4.3 The Remunerations Committee:

According to the Companies Act, 2008 (Act 11 of 2008), a company must have a Remunerations Committee.

Explain the role/responsibility of this committee and give a reason why this committee is necessary. (3)

4.4 Directors engage with clients on a regular basis in an effort to negotiate contracts and to increase sales and services.

Explain why there should be a company policy that directors must declare to the Board all gifts, donations or favours received by them from clients. Provide TWO points. (4)

SOLUTION

4.1 Explain why a qualified audit report is not a good reflection of a company. Provide TWO points.

- Certain information on financial statements are not clear / missing.
- There is insufficient audit evidence for significant items; Auditors cannot verify certain information.
- Lack of internal controls; possible negligence or colluding.
- Negative impact in the future; consequences on the image / share price due to decreased demand for shares (from potential shareholders)
- Existing shareholders might decide to sell their shares

4.2 Explain why it is important for a company to include non-executive as well as executive directors on the Board of Directors.

- Executive directors are involved with internal functioning (operations) of the company / hands-on / decisions may be based on a narrow view.
- Non-executive directors have a wider perspective of the business environment; and act in the best interest of the company.
- The non-executive directors would exercise a watch-dog role; keep executive directors in check.
- More regular inputs than an internal auditor or other directors.
- Their inputs would be unbiased and independent.
- They share accountability with the other directors / more people have the interests of the company in mind.
- Executive directors would be more vigilant and professional in their duties / not tempted to engage in unethical activities.

- The more directors there are, the more opinions will be generated, which could benefit the company.
- The non-executive directors can be paid less than the other directors (because they do not work permanently in the company).

4.3 According to the Companies Act, 2008 (Act 11 of 2008), a company must have a Remunerations Committee.

Review all salaries, bonuses and other earnings

To prevent directors from paying themselves too much

They must approve, and give advice on the proposals re fees, bonuses etc.

REASON:

- To ensure fairness / transparency in the payment of fees/salaries
- To prevent fraud / corruption / wastage
- Detect mismanagement or fraudulent activities
- They can compare the remuneration / earnings against financial information of other companies in the industry / fairness to workers

4.4 Directors engage with clients on a regular basis in an effort to negotiate contracts and to increase sales and services.

Explain why there should be a company policy for all gifts, donations or favours received by the directors from clients to be declared to the board by the directors concerned.

- Transparency in awarding contracts, tenders or appointing service providers;
- Could result in not appointing the best suited client for the job / not adhering to or flouting company policy.
- Policy would prevent colluding with service providers.
- Directors / service providers would know the consequences of not abiding by policy and therefore not be tempted to engage in fraudulent activities / corruption.
- This could be viewed as bribery for contracts.
- This could be viewed as nepotism (if family and friends involved).
- To protect the image of the business.
- Conflict of interest (which could be corrupt / fraudulent).

BIBILIOGRAPHY

Past examination papers and answers are the product of Department of Education Curriculum » National Senior Certificate (NSC) and FET Examinations » Past Exam Papers and Memos.