



GAUTENG PROVINCE

EDUCATION
REPUBLIC OF SOUTH AFRICA

SECONDARY SCHOOL IMPROVEMENT PROGRAMME (SSIP) 2024

Accounting

Grade 12

Term 2

Learner's Guide

Session 9-20

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SESSION 9: ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS

NOTES ON CONTENT

INTRODUCTION

The session will cover the financial statements that are prepared by the company to provide detailed report on their financial performance.

The financial statements will be analysed to communicate financial information to various users of the financial information. The analysis will assist the management in making sound financial decisions.

The following categories of Financial Indicators are covered in this module:

- Profitability Ratios
- Liquidity Ratios
- Solvency
- Return
- Financial gearing

This session will focus at:

- Calculation of financial indicators using the financial statements
- Analysis and interpretation of the following financial statements
 - Income statement
 - Balance Sheet

Certain categories of financial indicators will be integrated and must be used together in providing answers to important decisions :

- **PROFITABILITY, RETURN and MARKET** related financial indicators focus on sales, management of expenses and profits.
- **OPERATING EFFICIENCY and LIQUIDITY** would focus on the management of working capital (current assets and current liabilities)
- **OPERATING EFFICIENCY and PROFITABILITY** also focus on managing expenses and daily operating activities (current assets and current liabilities).
- **SOLVENCY and GEARING** will be concerned with the long-term issues of the business. The focus would therefore be on total assets and total liabilities.

It is therefore necessary to consider and quote related groups of financial indicators when answering the typical examination-type questions in interpretation.

Strategy in answering interpretative questions (recommended steps)

- Identify the appropriate financial indicators necessary to answer the question.



At times, the question will not give any indications of the financial indicators to be used.

Example- Comment on the liquidity of the business

You may need to calculate the ratios (if they are not given on the table of indicators).

- Quote the figures and show the trend. Do some comparison (increased/decreased)

Comparisons would include:

- Information of the same business (previous financial year)
- Other businesses in the same industry (competitors)
- Targets set by the business (such as mark-up percentage)
- An alternative action (such as an investment in a fixed deposit)

Comment

- Show some insight or understanding (focus on whether this is **good** or **bad** for the business). Provide short, concise statements.
- Be guided by the mark allocation as to how much information you need to provide.

UNDERSTANDING WHAT TO DO OR HOW TO RESPOND TO QUESTIONS IN ACCOUNTING:

Commonly used statements (Action verbs):

Prepare.....	Provide the missing....	What advice....
Post to.....	Quote and explain....	Suggest....
Complete.....	Comment on....	Choose the.....
Calculate....	Will the business...	Support your
Show how.....	Should the business.....	Give TWO....
Indicate how....	Is the director justified....	Why would.... /Would you...

Classification	Financial Indicators	Formulae	Answer	Integration
Profitability <i>Did the business operate well and make a profit?</i>	Gross profit on sales	$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$	%	Income Statement
	Gross profit on cost of sales	$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$	%	
	Operating profit on sales	$\frac{\text{Operating profit}}{\text{Sales}} \times \frac{100}{1}$	%	
	Operating expenses on sales	$\frac{\text{Operating expenses}}{\text{Sales}} \times \frac{100}{1}$	%	
	Net profit on sales	$\frac{\text{Net profit}}{\text{Sales}} \times \frac{100}{1}$	%	
Solvency	Solvency ratio	Total assets: Total liabilities	Ratio $x : 1$	B.Sheet
Liquidity <i>Can the business pay its short term debts?</i>	Current ratio	Current assets: Current liabilities	Ratio $x : 1$	B.Sheet
	Acid test ratio	Current assets - inventories: Current liabilities	Ratio $x : 1$	B.Sheet
	Stock turnover rate	$\frac{\text{Cost of sales}}{\text{Average Stock}}$	Times	IS/BS
	Stock holding period	$\frac{\text{Average Stock}}{\text{Cost of sales}} \times \frac{365}{1}$	Days / months	IS/BS
	Average debtors' collection period	$\frac{\text{Average Debtors}}{\text{Credit Sales}} \times \frac{365}{1}$	Days / months	IS/BS
	Average creditors payment period	$\frac{\text{Average Creditors}}{\text{Credit Purchases}} \times \frac{365}{1}$	Days / months	IS/BS
Return <i>What was the return on my investment ?</i>	Return on Shareholders' Equity (ROSHE)	$\frac{\text{Net profit after tax}}{\text{Shareholders' Equity}} \times 100$	%	IS/BS
	Return on Capital Employed (ROTCE) <i>Do I cover the financial cost of the loan ? (interest % of loan)</i>	$\frac{\text{Net profit before tax} + \text{interest on loan}}{\text{Average Capital Employed}} \times 100$	%	IS/BS
		Capital Employed is: 		
			Aver Shareholders Equity + Average Loans	
	Earnings Per Share <i>What is my possible return on my investment?</i>	$\frac{\text{Net profit after tax}}{\text{Number of issued shares issued}} \times \frac{100}{1}$	Cents	IS
Return <i>What was the return on my investment ?</i>	Dividends Per Share	$\frac{\text{Interim} + \text{Final dividends}}{\text{Number of issued shares issued}} \times \frac{100}{1}$	Cents	Note 8,RI
	Net Asset value per share <i>What is the real value of my shares</i>	$\frac{\text{Shareholders' Equity}}{\text{Number of issued shares issued}} \times \frac{100}{1}$	Cents	B/S, Note 7 and 8
	Dividend pay-out rate	$\frac{\text{Dividends for the year}}{\text{Net profit after tax}} \times \frac{100}{1}$	% <i>Dividends per share Earnings per share</i>	I/S, Note 7 and 8
Financial risk/Gearing	Debt -equity ratio (gearing) <i>Is the business financed by own money or borrowed money?</i>	Non-current liabilities : Shareholders' equity	Ratio $x : 1$	BS
B.Sheet/BS =Balance sheet		I/S =Income statement	RI=Retained Income	

SUMMARY OF ALL THE RATIOS NEEDED FOR ANALYSIS AND INTERPRETATION

The following is an explanation of all the financial indicators. Make sure that you have insight and understanding. Focus on the reason why you are using that specific financial indicator.



Figures and percentages are assumed

PROFITABILITY RATIOS: *Did the business operate well and make a profit?*

	Gross profit on turnover = % $\frac{\text{Gross profit}}{\text{Turnover}} \times \frac{100}{1} = 60\%$ Explanation - For every R1 sales, 60 cents become gross profit. Compare to previous results - Compare to the Mark-up %	4	Operating profit on turnover = % $\frac{\text{Operating profit}}{\text{Turnover}} \times \frac{100}{1} = 45\%$ Explanation - For every R1 sales, 45 cents is operating profit. Compare to previous results - If the percentage is too low comparing to previous year or competitors, it means expenses are high.
	Gross profit on cost of sales (mark-up) = % $\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1} = 92\%$ Explanation - Did you achieve your mark-up % e.g. 100%? - Goods sold at price lower than Mark-up. Possible reasons for difference: - Seasonal sales /Cash discounts - Incorrect pricing/ trade discount	5	Net profit after tax on turnover = % $\frac{\text{Net profit after tax}}{\text{Turnover}} \times \frac{100}{1} = 26\%$ Explanation - For every R1 of sales, 26 cents is net profit or earnings. It is better than what you can earn from a bank in interest (e.g. 12%) - If the percentage is too low comparing to previous year or competitors, it means expenses are high.
	Total expenses on turnover = % $\frac{\text{Total expenses}}{\text{Turnover}} \times \frac{100}{1} = 17\%$ Explanation - Every R1 sales, 17 cents is spent to pay expenses. - If the percentage is lower comparing to previous year, it means expenses are well controlled		

LIQUIDITY: Can the business pay its short-term debt?

Current ratio = x: 1 Current assets: Current liabilities 1,5 : 1 Explanation ■ The business has R1, 50 for every R1 debt. The business can pay the debt within the short term. ■ Compare to previous results or competitors NOTE: If the ratio is too high it means too much cash, stock and debtors are tied up.	4	Stock holding period (in days) Average stock X 365 days = 91 days Cost of sales 1 Explanation ■ Stock was available for 91 days on the shelves. This will guide you on when to place order of stock. ■ The longer the period, the more working capital is tied up and it means your money is tied up in stock and its less liquid compared to cash, that will affect the ability to pay your short-term debts. NOTE: excessive stock will result to losses theft, burglary etc
Acid-test ratio = ...: 1 Current assets minus stock: Current liabilities 0,7 : 1 Explanation ■ The business has 70 cents for every R1 of short-term debt. The business cannot afford to pay short term debts. Compare to previous results ■ The reason for the above results could be that the business excessively invested in trading stock.	5	Debtors' average collection Period = days <u>Average debtors</u> x <u>365</u> = 45 days (or 12) Credit sales 1 Explanation (credit period = 30 days) ■ Debtors do not honour their agreement. They took 15 days longer than the agreed 30 days. ■ This will affect the ability of the business to pay short term debts or creditors. NOTE: Always compare this indicator to creditors payment period.
Rate of stock turnover (times) Cost of sales = replaced 4 times per year Average stock Explanation ■ Stock is replaced 4 times per year. ■ Quicker rate is more favourable ■ It means your money is tied up in stock and you will not be able to pay your short-term debt. ■ Low rate of stock turnover will result to: ■ Stockpiling - ageing, poor quality, changing fashions This could have resulted from: ■ Wrong purchase policy. /Poor sales policy/ Economic circumstances.	6	Creditor average payment Period (days) <u>Average creditors</u> x <u>365</u> = 72 days Credit purchases 1 Explanation (credit period 60 days) • Took 72 days to pay instead of 60 days. (extra 13 days were taken) • Will be charged interest / negotiate 90 days (If the period is shorter than 60 days, negotiate discount) NB: This indicator must be checked against the Debtors collection, the reason could be that debtors are not paying on time, the screening process might have been poor.

RETURNS: What was the return on my investment?

Return on shareholders' Equity = % $\frac{\text{Net profit after tax}}{\text{Average shareholders' equity}} \times \frac{100}{1} = 35\%$ (Bank: 12% interest on investment) Explanation - Return on investment was 35%. It is more than what the bank can offer. Compare to previous results - Compare to alternative investments, such as return on a fixed deposit NOTE: Average equity is: $\frac{2020 + 2021}{2}$	4 Net asset value per share (NAV) expressed in cents per share $\frac{\text{Ordinary shareholders' equity}}{\text{Number of ordinary shares issued}} \times \frac{100}{1} = 300 \text{ cents}$ Explanation - The NAV should be compared to the market price of shares (listed at JSE) - Compare the value of your shares to other public companies - Compare NAV for current year to previous as well as the market price for current year to previous year - If NAV is above the market price it means the investors do not have confidence in the business, this might negatively affect the average price of shares.																								
Dividends per share (cents per share) $\frac{\text{Interim + Final dividends}}{\text{Number of issued shares issued}} \times \frac{100}{1}$ 50 cents per share Explanation - Compare dividends for the current year to the previous year. - Compare to dividends offered by other companies, if the information is provided - Compare the dividends to earnings per share	Example Transactions: - Declared and paid a dividend of 20 cents per share. (during the year) - Declared a dividend of 30 cents per share (end of year) <table><tr><td>Dr.</td><td colspan="2">Appropriation account [f3]</td><td>Cr.</td></tr><tr><td>Income tax</td><td>30</td><td>Profit and loss</td><td>100</td></tr><tr><td>Ord. Share dividends</td><td>50</td><td></td><td></td></tr><tr><td>(20 + 30)</td><td></td><td></td><td></td></tr><tr><td>Retained income</td><td>20</td><td></td><td></td></tr><tr><td></td><td>100</td><td></td><td>100</td></tr></table> (20 + 30) ÷ 100 shareholders = 50c per share	Dr.	Appropriation account [f3]		Cr.	Income tax	30	Profit and loss	100	Ord. Share dividends	50			(20 + 30)				Retained income	20				100		100
Dr.	Appropriation account [f3]		Cr.																						
Income tax	30	Profit and loss	100																						
Ord. Share dividends	50																								
(20 + 30)																									
Retained income	20																								
	100		100																						
Earnings per share $\frac{\text{Net income after tax}}{\text{no. shares issued}} \times \frac{100}{1} =$ 70 cents per share Explanation Compare earnings for the current year to the previous year. NOTE: Net income after tax is regarded as EARNINGS. From the Appropriation Account if you say :PROFIT (100) Less Income tax is equal to 70. The difference is your earnings.	Dividend pay-out rate $\frac{\text{Dividends for the year}}{\text{Net profit after tax}} \times \frac{100}{1} \text{ (Answer is \%)}$ - Compare the current rate to the previous year Examination Questions on Earnings and Dividends You will be expected to comment on the dividend policy: - Compare the earnings and dividends - If earnings is MORE than dividends paid-the company has retained profits for future growth.																								

LOANS? Take out more loans or will the bank agrees to a higher loan	SOLVENCY: credit worthiness of the business
Debt/Equity ratio (borrowed or own money?) Long term liabilities : Shareholders' equity 0.5: 1 Explanation - It explains the extent to which the business is financed by borrowed capital - The financial risk is low, financial institutions can grant loans to the business	Solvency Total assets: total liabilities = 1,8: 1 Explanation - The business has R1.80 for every R1 owing - This ratio tests the credit worthiness of the business and indicates whether the business can meet its commitments.
Return on capital employed = % $\frac{\text{Net profit before tax and interest}}{\text{Average capital employed}} \times \frac{100}{1} \text{ (answer \%)}$ (e.g. interest on loan: 15%) Explanation - Compare the ROTCE with previous results - Compare it with interest on loan (% rate) - If it's bigger than the rate of interest it means the business is lowly geared or favorably geared.	

EXAMPLE 1 - FINANCIAL INDICATORS

INFORMATION

The following information relates to the financial records of Bigfoot Ltd.

INCOME STATEMENT OF BIGFOOT LTD- FEBRUARY		
	2023	2022
Sales	1 828 000	1 650 000
Cost of sales	(1 040 000)	(860 000)
Gross profit	788 000	790 000
Other operating income	206 560	193 120
Rent income	204 000	190 000
Provision for bad debt adjustment	2 560	3 120
Gross operating profit	994 560	983 120
Operating expenses	(530 800)	(493 600)
Advertising	25 000	19 600
Insurance	13 700	11 000
Bad debts	5 800	7 000
Water and electricity	24 000	22 800
Salaries and wages	360 000	328 000
Stationery	2 000	1 600
Sundry expenses	84 300	89 600
Trading stock deficit	2 000	0
Depreciation	14 000	14 000
Operating profit	463 760	489 520
Interest income	7 300	5 000
Profit before interest expense	471 060	494 520
Interest expense	(34 000)	(30 000)
Net profit before tax	437 060	464 520
Income Tax	(131 118)	(139 356)
Net Profit after tax	305 942	325 164

BALANCE SHEET OF BIGFOOT LTD ON 28 FEBRUARY			
		2023	2022
ASSETS			
NON-CURRENT ASSETS		2 062 000	1 996 000
Tangible Assets		1 986 000	1 922 000
Financial Assets			
Fixed Deposit		76 000	74 000
CURRENT ASSETS		732 660	665 600
Inventory		420 800	398 600
Trade and other receivables		159 660	156 600
Cash and cash equivalents		152 200	110 400
TOTAL ASSETS		2 776 660	2 661 600
EQUITY AND LIABILITIES			
Shareholders Equity		2 247 060	2 008 000
Ordinary Share Capital		2 200 000	2 000 000
Retained Income		47 060	8 000
NON-CURRENT LIABILITIES		400 000	424 000
Mortgage loan		400 000	424 000
CURRENT LIABILITIES		129 600	229 600
Trade and other payables		129 600	229 600
TOTAL EQUITY AND LIABILITIES		2 776 660	2 661 600

ADDITIONAL INFORMATION

The following were totals for 2021:

	2021
Trading stock	360 000
Trade and other receivables	169 400
Trade and other payables	230 400

- All purchases and sales are on credit.
- The mark-up used by the business is 100% on cost price.
- The business sells bedroom furniture.
- Interest on alternative investment is 8%

SUGGESTED SOLUTION

Percentage gross profit on sales		Profitability
2023	2022	
$\frac{\text{Gross profit}}{\text{sales}} \times \frac{100}{1}$ $\frac{\text{R788 000}}{\text{R1 828 000}} \times \frac{100}{1} = 43,1\%$	$\frac{\text{Gross profit}}{\text{sales}} \times \frac{100}{1}$ $\frac{\text{R790 000}}{\text{R1 650 000}} \times \frac{100}{1} = 47,2\%$	
■ There is a decline from 47, 2% to 43,1%. ■ It can be due to sales prices incorrectly marked. ■ Too much trade discount or goods sold for less than mark-up (no adherence to policy).		

Percentage gross profit on cost of sales (mark-up %)		Profitability
2023	2022	
$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$ $\frac{\text{R788 000}}{\text{R1 040 000}} \times \frac{100}{1} = 75,8\%$	$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$ $\frac{\text{R790 000}}{\text{R860 000}} \times \frac{100}{1} = 91,9\%$	
■ The mark-up has decreased from 91, 9% to 75, and 8%. ■ The business does not meet their mark-up of 100% on cost price ■ Too much trade discount or goods sold for less than mark-up (no adherence to policy). ■ Could be resulting from stock losses or theft.		

Percentage operating profit on sales		Profitability
2023	2022	
$\frac{\text{Operating profit}}{\text{Turnover}} \times \frac{100}{1}$ $\frac{R463\,760}{R1\,828\,000} \times \frac{100}{1} = 25,4\%$	$\frac{\text{Operating profit}}{\text{Turnover}} \times \frac{100}{1}$ $\frac{R489\,520}{R1\,650\,000} \times \frac{100}{1} = 29,7\%$	
There is a decline from 29,7% to 25,4%. Sales have increased yet operating profit has decreased. A large amount of the income is used to pay for expenses, expenses are not well managed. The business should increase the control over expenses (Recommendation)		

Percentage operating expenses on sales		Profitability
2023	2022	
$\frac{\text{Operating exp}}{\text{Turnover}} \times \frac{100}{1}$ $\frac{R530\,800}{R1\,828\,000} \times \frac{100}{1} = 29\%$	$\frac{\text{Operating exp}}{\text{Turnover}} \times \frac{100}{1}$ $\frac{R493\,600}{R1\,650\,000} \times \frac{100}{1} = 29,9\%$	
It decreased from 29,9% to 29%. Costs have slightly increased, they should be controlled.		

Percentage net profit on sales		Profitability
2023	2022	
$\frac{\text{Net profit}}{\text{Turnover}} \times \frac{100}{1}$ $\frac{R437\,060}{R1\,828\,000} \times \frac{100}{1} = 23,9\%$	$\frac{\text{Net profit}}{\text{Turnover}} \times \frac{100}{1}$ $\frac{R464\,520}{R1\,650\,000} \times \frac{100}{1} = 28,2\%$	
The indicator has declined from 28,2% to 23,9%. Increase or poor control in expenses.		

Solvency ratio	
2023	2022
Total assets : Total liabilities R2 776 660 : R529 600 = 5,2 : 1	Total assets : Total liabilities R2 661 600 : R653 600 = 4,1 : 1
Ratio improved from 4, 1:1 to 5, 2:1. For every R1 liabilities there are R5, 20 assets to pay for it, the business is solvent.	

Current ratio		Liquidity
2023	2022	
Current assets: Current liabilities R732 660: R129 600 = 5,7: 1	Current assets : Current liabilities R665 600 : R229 600 = 2,9 : 1	
- Ratio increased from 2, 9:1 to 5,7:1, for every R1 owing the business has R5,70 to pay for it. - The high ratio is likely to indicate high stock levels and that means cash is tied up in stock.		

Acid-test ratio		Liquidity
2023	2022	
Current assets - inventories: Current liabilities (R732 600 – R420 800): R129 600 = R311 800: R129 600 = 2,4: 1	Current assets - inventories: Current liabilities (R665 600 – R398 600): R229 600 = R267 000: R229 600 = 1,2: 1	
- Ratio increased from 1,2:1 to 2,4:1. - This means that the business can pay its short-term debts without having to sell stock.		

Average debtors' collection period		Liquidity
2023	2022	
$\frac{\text{Average Debtors}}{\text{Credit Sales}} \times \frac{365}{1}$ $\frac{\frac{1}{2} (R156\,600 + R159\,660)}{R1\,828\,000} \times \frac{365}{1}$ $= 31,6 \text{ days}$	$\frac{\text{Average Debtors}}{\text{Credit Sales}} \times \frac{365}{1}$ $\frac{\frac{1}{2} (R156\,600 + R169\,400)}{R1\,650\,000} \times \frac{365}{1}$ $= 36,1 \text{ days}$	
- The period decreased from 36,1 days to 31,6 days which is an improvement. - Debtors are paying their accounts quicker. - Encourage debtors by offering discount for early payments and charge interest on debtors who take more than 30 days to settle their accounts.		

Average creditors' payment period		Liquidity
2023	2022	
$\frac{\text{Average Creditors}}{\text{Credit Purchases}} \times \frac{365}{1}$ $\frac{\frac{1}{2} (R229\,600 + R129\,600)}{R1\,040\,000} \times \frac{365}{1}$ $= 63 \text{ days}$	$\frac{\text{Average Creditors}}{\text{Credit Purchases}} \times \frac{365}{1}$ $\frac{\frac{1}{2} (R230\,400 + R229\,600)}{R860\,000} \times \frac{365}{1}$ $= 97,6 \text{ days}$	
- The period decreased from 97,6 days to 63 days. - Business is paying their creditors quicker. - The business receives payments from debtors before they pay the creditors which is good for the cash flow of the business. - Paying within the credit term result to creditworthiness and they will not be charged interest for overdue accounts.		

Rate of stock turnover		Liquidity
2023	2022	
$\frac{\text{Cost of sales}}{\text{Average inventories}}$ $\frac{\text{R1 040 000}}{\frac{1}{2} (\text{R398 600} + \text{R420 800})}$ $= 2,5 \text{ times per year}$	$\frac{\text{Cost of sales}}{\text{Average inventories}}$ $\frac{\text{R860 000}}{\frac{1}{2} (\text{R398 600} + \text{R600 000})}$ $= 2,3 \text{ times per year}$	
- There is an improvement of 2,3 to 2,5 times per year. - This is satisfactory as the business sells furniture, their stock is moving faster.		

Stock holding period		Liquidity
2023	2022	
$\frac{\text{Average inventories}}{\text{Cost of sales}} \times \frac{365}{1}$ $\frac{\frac{1}{2} (\text{R398 600} + \text{R420 000})}{\text{R 1 040 000}} \times \frac{365}{1}$ $= 143,6 \text{ days}$	$\frac{\text{Average inventories}}{\text{Cost of sales}} \times \frac{365}{1}$ $\frac{\frac{1}{2} (\text{R398 600} + \text{R360 000})}{\text{R860 000}} \times \frac{365}{1}$ $= 161 \text{ days}$	
- The period has improved from 161 to 143,6 days. 143 is a long period for a business to keep stock, they should review their purchasing policy and the market strategies.		

Debt / Equity ratio (gearing ratio)		Liquidity
2023	2022	
$\frac{\text{Non-current liabilities: Shareholders equity}}{\text{= R400 000: R2 274 060}}$ $= 0,18: 1$	$\frac{\text{Non-current liabilities: Shareholders equity}}{\text{= R424 000: R2 008 000}}$ $= 0,21: 1$	
- The ratio improved from 0,21:1 to 0,18:1. - The business is at low risk / lowly geared. - The business is creditworthy, the business can obtain an additional loan in future. - The financial risk is low		

EXAMPLE 2: FINANCIAL INDICATORS

REQUIRED

Use the information extracted from the financial records of Grayston Ltd to:

- Calculate the debt/equity ratio for both years
- Calculate the interest on loan and percentage interest on loan
- Calculate the total capital employed (TCE)
- Calculate the return on total capital employed (ROTCE)

INFORMATION

The following information was extracted from the financial records of Grayston Limited:

	2023	2022
Ordinary share capital	24 800 000	13 600 000
Retained income	2 680 000	1 280 000
Non-current liabilities – Loan: First Bank	4 750 000	6 400 000
Total capital employed	???	???
Interest on loan	11%	11%

	2023
Interest on loan	?
Net profit before tax	2 320 000

ADDITIONAL INFORMATION

- R2 400 000 of the loan amount was repaid during the year. Interest was capitalized.
- The company sold new shares during 2023 to raise funds for expansion of the business.

WORKED EXAMPLE

Gearing ratio

Calculation for debt/equity ratio - 2022	Calculation for debt/equity ratio - 2023
Non-current liabilities: Shareholders' equity = 6 400 000: (13 600 000 + 1 280 000) = 0,4: 1	Non-current liabilities: Shareholders' equity = 4 750 000: (24 800 000 + 2 680 000) = 0,2: 1

Calculate the interest on loan			
LOAN ACCOUNT			
Bank	2 400 000	Balance b/d	6 400 000
Balance c/d	4 750 000	Interest on loan	750 000
	7 150 000		7 150 000

Calculate ROTCE for 2023

measure returns

$$\begin{aligned}
 & \frac{\text{Net profit before tax + interest on loan}}{\text{Average capital employed}} \times \frac{100}{1} \\
 &= \frac{2\,320\,000 + 750\,000}{(32\,230\,000 + 21\,280\,000) / 2} \times \frac{100}{1} \\
 &= \frac{3\,070\,000}{(53\,510\,000) / 2} \times \frac{100}{1} \\
 &= 11,5\%
 \end{aligned}$$

OSC + RI =
Shareholder

	2022	2023
Ordinary share capital (OSC)	13 600 000	24 800 000
Retained income (RI)	1 280 000	2 680 000
Non-current liabilities – Loan: First Bank	6 400 000	4 750 000
Total capital employed (TCE)	21 280 000	32 230 000

TCE =
shareholders
equity + Long
term-loan

COMMENT

The ROTCE is 11.5%, slightly above 11% of interest rates. The business has failed to use the loan efficiently in generating profits.

Calculate the earnings per share

INFORMATION

The following information was extracted from the financial records of Grayston Ltd:

	2023	2022
Ordinary share capital	320 000	264 000
Retained income	80 000	36 000
Shareholders' equity	400 000	300 000
Number of shares	(140 000 shares)	

	2023
Profit before tax	130 000
Income tax	(60 000)
Net profit after tax OR earnings	

Expected answer: earnings per share

$$\frac{\text{net profit after tax}}{\text{number of shares in issue}} \times 100 = \text{earnings per share}$$

$$\frac{70\,000}{140\,000} \times 100 = 50 \text{ cents}$$

measure returns

$$130\,000 - 60\,000 = 70\,000$$

Calculate the total dividend per share

INFORMATION

The following information was extracted from the financial records of Grayston Ltd:

	2023	2022
Ordinary share capital	320 000	264 000
Retained income	80 000	36 000
Shareholders' equity	400 000	300 000
Number of shares	140 000 shares	

	2023
Profit before tax	130 000
Income tax	(60 000)
Net profit after tax	70 000

Dividends on ordinary shares(interim)	28 000
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Additional Information

- A final dividend of 25 cents was declared at the end of year.

$$\frac{\text{interim dividends}}{\text{number of shares in issue}} \times 100 = \text{dividends per share}$$

$$\frac{28\,000}{140\,000} \times 100 = 20 \text{ cents (interim dividends)}$$

Total dividends

Interim dividends PLUS final dividends

20 cents + 25 cents = 45 cents

measure returns

Dividend payout policy

- Grayston Ltd paid 45 cents for dividends and earnings per share amount to 50 cents.
- They retained 5 cents or 10% of earnings

Scenarios

Earnings per share	Dividends per share	Retained earnings/income	Comment
150 cents	150 cents	zero funds	100% of earnings was paid to shareholders. No retained funds, the business wants to please the shareholders.
300 cents	320 cents	Zero funds retained 20 cents paid from retained income	The business paid 100% of their earnings plus 6,7% from retained income. No plans to expand the business.
350 cents	250 cents	100 cents	The business retained 150 cents (28,6%). The retained income will be used to expand the business.

Dividend pay-out rate

$$\frac{\text{dividends}}{\text{earnings}} \times 100 = \text{dividend pay out rate}$$

$$\frac{45}{50} \times 100 = 90\%$$

measure returns

Net asset value per share (NAV)

The following details were extracted from the financial statements of Simunye Ltd for the year ended 30 June:

	2023	2022
Net income before taxation	640 000	560 000
Income tax	298 000	243 800
Dividends on ordinary shares	326 000	122 000
Retained income at end of year	320 000	250 000
Ordinary share capital	2720 000	2 200 000
Market value of shares	1 000 000	950 000
Net asset value per share	?	257 cents
Number of shares	370 cents	350 cents

Expected response: NAV

measure returns

$$\frac{\text{Shareholders Equity}}{\text{number of shares in issue}} \times 100 = \text{NAV}$$

$$\frac{3\,040\,000}{1\,000\,000} \times 100 = 304 \text{ cents}$$

Comment

- NAV has improved from 257 cents to 304 cents (by 47 cents)
- The market price of shares (listed at JSE) is 66 cents above NAV.
- NAV is below the market price it means the investors have confidence in the business, this will attract investors.

Basic knowledge needed to master financial indicators

A formula sheet is provided in an exam, but names of financial indicators are not provided.

- Knowledge of names of financial indicators
- Classification of financial indicators
- Commenting – identify indicators, analyse (indicate trends and quote figures)
- Compare financial indicators that are related – **Refer to the diagram below**
- Compare and analyse performance of two different companies

Related Financial indicators that should be compared

NAV	Market value of shares	Higher market price indicate that shareholders have confidence in companies shares
ROSHE	Rate of investments	ROSHE-determines if the business should invest the funds elsewhere.
ROTCE	Rate of interest on loan	ROTCE- ABOVE interest rate is positively geared or favourable BELOW interest rate – negatively geared (unfavourable to use loans)
Debt Equity	Financial risk	Debt-Equity measure degree of financial risk Lower ratios indicate creditworthiness Use of borrowed funds is favourable when interest rates are low
Earnings per share	Dividends per share	Earnings are distributed, and some may be retained for future expansion of business.

Use this structure regularly when you complete practice activities, it will assist you to locate formulas in an exam.

GRADE 12 ACCOUNTING FINANCIAL INDICATOR FORMULA SHEET	
$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$	$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$
$\frac{\text{Net profit before tax}}{\text{Sales}} \times \frac{100}{1}$	$\frac{\text{Net profit after tax}}{\text{Sales}} \times \frac{100}{1}$
$\frac{\text{Operating expenses}}{\text{Sales}} \times \frac{100}{1}$	$\frac{\text{Operating profit}}{\text{Sales}} \times \frac{100}{1}$
Total assets : Total liabilities	Current assets: Current liabilities
(Current assets – Inventories) : Current liabilities	Non-current liabilities: Shareholders' equity
(Trade & other receivables + Cash & cash equivalents): Current liabilities	
$\frac{\text{Average trading stock}}{\text{Cost of sales}} \times \frac{365}{1}$	$\frac{\text{Cost of sales}}{\text{Average trading stock}}$
$\frac{\text{Average debtors}}{\text{Credit sales}} \times \frac{365}{1}$	$\frac{\text{Average creditors}}{\text{Cost of sales}} \times \frac{365}{1}$
$\frac{\text{Net income after tax}}{\text{Average shareholders' equity}} \times \frac{100}{1}$	$\frac{\text{Net income after tax}}{\text{Number of issued shares}} \times \frac{100}{1}$ (*See note below)
$\frac{\text{Net income before tax} + \text{Interest on loans}}{\text{Average shareholders' equity} + \text{Average non-current liabilities}} \times \frac{100}{1}$	
$\frac{\text{Shareholders' equity}}{\text{Number of issued shares}} \times \frac{100}{1}$	$\frac{\text{Dividends for the year}}{\text{Number of issued shares}} \times \frac{100}{1}$
$\frac{\text{Interim dividends}}{\text{Number of issued shares}} \times \frac{100}{1}$	$\frac{\text{Final dividends}}{\text{Number of issued shares}} \times \frac{100}{1}$
$\frac{\text{Dividends per share}}{\text{Earnings per share}} \times \frac{100}{1}$	$\frac{\text{Dividends for the year}}{\text{Net income after tax}} \times \frac{100}{1}$
$\frac{\text{Total fixed costs}}{\text{Selling price per unit} - \text{Variable costs per unit}}$	
Note: * In this case, if there is a change in the number of issued shares during a financial year, the weighted average number of shares is used in practice.	

WORKED EXAMPLE 3**INFORMATION**

The following information appeared in the accounting records of Bright Ltd for the financial year ended 28 February 2023.

		2023	2022
Current ratio	Liquidity	3,6:1	2,8:1
Acid test ratio		0,5:1	0,7:1
Rate of stock turnover		3,7 times	5 times
Average debtors' collection period		28 days	35 days
Return on shareholders' equity	Return on Investment	16%	18%
Return on total capital employed		12%	14%
Earnings per share		45 cents	54 cents
Dividends per share		22 cents	44 cents
Gross profit on cost of sales	Profitability	70%	65%
Gross profit on sales		28%	32%
Net profit after tax on sales		12%	15%
Operating profit on sales		16%	21%
Debt-equity ratio	Risk and Gearing	0,6:1	0,3:1
Interest rate on long-term loans		13%	12%
Interest on fixed deposit		8%	8%
Net asset value per share	Return	335 cents	346 cents
Market price per share		347 cents	340 cents

REQUIRED:

1. Comment on the profitability of the business. Quote **TWO** financial indicators (with figures).
2. Directors feel that the business will experience difficulty in meeting its short-term debts in the next financial year. Explain why you either agree or disagree with them. Quote **THREE** financial indicators with figures to support your opinion.
3. Although shareholders are satisfied with their % returns, they are concerned about the change in dividend pay-out policy. Explain why they are satisfied with their % returns. Provide **TWO** possible reasons for the change in the dividend pay-out rate.

4. The directors took the decision to increase the loan during the year. Explain why this was a poor decision. Quote relevant financial indicators in your explanation.
5. The company paid R3,50 per share to repurchase 50 000 shares during April 2020. This was R0,75 above the average share price. Explain whether the shareholder received a fair price for his shares. Quote TWO financial indicators with figures.

WORKED EXAMPLE 1

COMMENTING ON FINANCIAL INDICATORS

1. Comment on the profitability of the business. Quote and explain TWO relevant financial indicators (with figures).

- An increase in the mark-up % (gross profit on cost of sales) has caused a decrease in the % GP on sales (32% to 28%)
- NP after tax also decreased from 15% to 12% (by 3% points); operating profit dropped from 21% to 16%.

2. Directors feel that the business will experience difficulty in meeting its short-term debts in the next financial year. Explain why you either agree or disagree with them. Quote THREE financial indicators with figures to support your opinion.

- Current ratio increased (2,8:1 to 3,6:1).
- Acid test ratio dropped (0,7: 1 to 0,5: 1);
- A clear indication on stock not moving (stock piling); also reflected by the decrease in the stock turnover rate from 5 times to 3,7 times.

3. Although shareholders are satisfied with their % returns, they are concerned about the change in dividend pay-out policy. Explain why they are satisfied with their returns. Provide TWO possible reasons for the change in the dividend pay-out rate.

- ROSHE: Although it decreased (from 18% to 16%) it is still better than any alternative investments such as a fixed deposit which fluctuates around 8%.
- Last year the company distributed 81, 5% of the EPS as DPS, they retained only 18.5%
- This year it was only 49%. An indication that the company has decided to retain a greater portion of the earnings.
- They wanted to use the resources for future expansions of the business. They plan to address cash flow issues. Equalization of dividends, over the long term.

4. The directors took the decision to increase the loan during the year. Explain why this was a poor decision. Quote relevant financial indicators in your explanation. (8)

- An increase in the financial risk. Debt/Equity increased from 0,3: 1 to 0,6 : 1.
- The ROTCE dropped from 14% to 12%. It is now less than the interest on loan (13%).
- Meaning that the company is negatively geared.

- 5. The company paid R3,50 per share to repurchase 50 000 shares during April 2020. This was R0,75 above the average share price. Explain whether the shareholder received a fair price for his shares. Quote TWO financial indicators with figures.**
- He received more than the NAV which is now 335 cents.
 - It is also higher than the NAV at the beginning of the year (346 cents).
 - It is also close to the market price at the end of the year (347 cents; 340 cents last year).
 - Looking at trends, although the NAV is declining, the MP is increasing, an indicator of investor confidence.

SESSION 10: ANALYSIS AND INTERPRETATIONS OF FINANCIAL STATEMENTS

ACTIVITY 1

INTERPRETATION OF COMPANY INFORMATION (35 marks; 25 minutes)

E Cape 2020 - Adapted

You are presented with financial information of two companies operating in the same industry and of similar size, for the year ended 29 February 2023.

REQUIRED:

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

- 1.1 Compare the liquidity position of both companies and comment on the company that is managing the short-term assets more effectively. (6)
- 1.2 Compare the dividend pay-out policy of each company. (4)
Provide TWO possible reasons why one company decided to change their policy. (4)
- 1.3 Lock Ltd decided to increase their loans during the current financial year, whilst Down Ltd decided to maintain their existing loans. (8)
Comment on the decisions of both companies. Make reference to the degree of risk and gearing
- 1.4 A shareholder of Down Ltd is concerned about the drop in the market price of the shares. Explain why he feel this way. Provide TWO points. (4)
- 1.5 M. Mtolo owns 576 000 shares in Down Ltd, which represents 48% of the total issued shares. He wants to purchase another 25 000 shares. (5)
Do a calculation to show how this would change his % shareholding in the company.
Provide TWO reasons why you think he is specifically interested in increasing his shareholding in Down Ltd. (4)

INFORMATION:

	LOCK LTD		DOWN LTD	
	2023	2022	2023	2022
Current ratio	1,9: 1	2,1: 1	3,6: 1	2,8: 1
Acid test ratio	1,3: 1	1,4: 1	1,5: 1	1,5: 1
Dividends per share	45 cents	65 cents	60 cents	62 cents
Earnings per share	86 cents	80 cents	70 cents	72 cents
% Return on average equity	13%	11%	11,6%	12%
% Return on average capital employed	15%	12%	11,7%	13%
Debt/equity ratio	0,6: 1	0,3: 1	0,4: 1	0,4: 1
Net asset value per share	642 cents	630 cents	610 cents	618 cents
Market price per share	645 cents	622 cents	582 cents	615 cents
Interest rate on loans	13%		13%	

35

ACTIVITY 1: INTERPRETATION OF COMPANY INFORMATION

1.1 Compare the liquidity position of both companies and comment on the company that is managing the short-term assets more effectively.

LOCK LTD	
DOWN LTD	
COMMENT	

6

1.2 Compare the dividend pay-out policy of each company.

LOCK LTD	
DOWN LTD	
Provide TWO possible reasons why one company decided to change their policy.	

4

4

- 1.3 Lock Ltd decided to increase their loans during the current financial year, whilst Down Ltd decided to maintain their existing loans. Comment on the decisions of both companies. Make reference to the degree of risk and gearing**

LOCK LTD	
DOWN LTD	

8

- 1.4 A shareholder of Down Ltd is concerned about the drop in the market price of the shares. Explain why they feel this way. Provide TWO points.**

--

4

- 1.5 M. Mtolo owns 576 000 shares in Down Ltd, which represents 48% of the total issued shares. He wants to purchase another 25 000 shares.**

Do a calculation to show how this would change his % shareholding in the company.

--

5

Provide TWO reasons why you think he is specifically interested in increasing his shareholding in Down Ltd.

--

4

35

MAJOR SHAREHOLDING**EXAMPLE 1****INFORMATION****RIZO LTD and TUGELA LTD**

Morris Mazibuko inherited a lump sum from the estate of his deceased grandfather. He bought shares two years ago from two companies namely RIZO LTD and TUGELA LTD. The financial year for both companies ended on 28 February 2023. RIZO LTD bought back some of its shares in January in 2023.

Use the information provided to respond to the questions.

REQUIRED

- A. Calculate the percentage of shares owned by Morris after buy back of shares. (3)
- B. Calculate the number of shares Morris will have to buy from Tugela LTD to own 35% of the company. (3)
- C. Morris wants to make an additional investment of R100 000 in one of the two companies. Advise him on the company to choose and provide **TWO** points that will motivate the choice of company. (Quote relevant figures) (4)

INFORMATION A

		RIZO LTD	TUGELA LTD
Total number of shares		?	800 000
Value of shares owned by Morris		R960 000	R720 000
% of shares owned by Morris		40%	30%
Issue price of shares	(31 December 2022)	R4.00	R3.00
Market value at JSE	(28 February 2023)	R4.20	R3.50
Dividends	(28 February 2023)	50 cents	45 cents

INFORMATION B

- RIZO LTD bought back 150 000 shares on 1 January 2022.
- The two companies did not issue shares during the accounting period.

WORKED EXAMPLE**RIZO LTD and TUGELA LTD**

Calculate the percentage of shares owned by Morris after buy back of shares at RIZO Ltd

Shares owned by Morris before buyback

$$R960\ 000 \div R4 = 240\ 000 \text{ shares}$$

Total number of shares issued by Rizo Ltd before buyback

$$240\ 000 \div 40\% = 600\ 000 \text{ total shares}$$

OR

$$240\ 000 \times 100/40 = 600\ 000$$



The percentage of shares owned by Morris after buy back of shares

Total shares **less** shares bought back

$$600\ 000 - 150\ 000 = 450\ 000$$

$$240\ 000 \div 450\ 000 \times 100 = 53\%$$

Morris will be a major shareholder after buy back.

Calculate the number of shares Morris will have to buy from Tugela LTD to own 35% of the company. (additional shares)

Number of shares owned by Morris at Tugela Ltd.

Total number of shares x percentage owned by Morris

$$800\ 000 \times 30\% = 240\ 000 \text{ shares}$$

$$240\ 000 \times \frac{35}{30} = 280\ 000$$

UK Method is used to calculate

Number of shares Morris will have to buy from Tugela LTD to own 35%

$$280\ 000 - 240\ 000 = 40\ 000 \text{ additional shares}$$

35%

30%

Morris wants to make an additional investment of R100 000 in one of the two companies. Advise him on the company to choose.

TUGELA LTD is preferred:

- Dividend of 45 cents is 15% return on investment, comparing to 12.5% received from RISO LTD.
- The value of Tugela shares has increased by 17% or 50 cents, and RISO LTD only increased by 5% or 20 cents.

MAJOR SHAREHOLDING

EXAMPLE 2

Mary is the CEO of the company. Her shareholding is as follows:

NUMBER OF SHARES	DATE PURCHASED	% SHAREHOLDING
420 000	10 January 2022	46,7%

INFORMATION:

Share capital

- 900 000 shares were in issue on 1 July 2022.
- 75 000 ordinary shares were repurchased from the estate of deceased shareholder at R10,70 per share on 1 October 2022.

QUESTIONS AND EXPECTED RESPONSES

A. Calculate Mary's % shareholding on 1 October 2022 after the repurchase of shares.

$$\frac{420\,000 \times 100}{900\,000 - 75\,000} = 50.9\%$$

825 000

B. Explain how Mary has benefitted from the decision to repurchase the shares.

Answer: Mary became the majority shareholder

C. The independent auditor discovered that Mary decided to repurchase the shares without informing the board of directors. Why should the independent auditor be concerned about this?

- Not good corporate governance / Not in accordance with King Code
- CEO cannot make these decisions without getting board approval
- Considered to be insider trading / Abuse of position for personal benefit
- Unethical conduct / Not transparent

ACTIVITY 2: ANALYSIS AND INTERPRETATION**FREESTATE 2020 adapted****(45 marks; 40 minutes)****2.1 BENCO LTD**

You are provided with information relating to Benco Ltd for the financial year ended 30 September 2022.

REQUIRED

- 2.1.1 From 2021 to 2022 the directors made a deliberate decision to change the policy on the distribution of profit in the form of dividends. Explain this change. Quote figures/calculations to support your answer. (4)
- 2.1.2 If the balance on the loan at the end of 2022 is R680 000, calculate the shareholders' equity at the end of 2022. (2)
- 2.1.3 Comment on whether the shareholders should be satisfied with the market price of their shares. Quote TWO relevant financial indicators (actual figures/ratios/percentages) and their trend. Give an additional comment to support your answer. (5)

INFORMATION**C. Financial indicators**

	2022	2021
Earnings per share (EPS)	60 cents	56 cents
Dividends per share (DPS)	33 cents	56 cents
Net asset value per share (NAV)	364,7 cents	315,6 cents
Debt/Equity ratio	0,5: 1	0,1: 1
Current ratio	1,6: 1	1,5: 1
Acid test ratio	0,6 :1	0,4: 1
Market price per share	385 cents	310 cents

2.2 METSI LTD

You are provided with the information of Metsi Limited. The company is registered with an authorized share capital of 2 000 000 shares. The financial year ended on 28 February 2023.

REQUIRED:

2.2.1 The CEO, Nikola Pelser, currently owns 40% of the issued shares. The board of directors decided to issue 50% of the unissued shares in July 2023.

- Calculate the minimum number of shares that Nikola must buy in July 2023 to gain control of the company. (4)
- Nikola wants to purchase the additional shares, at R12 per share without advertising the shares to the public. Give TWO reasons why you would not approve of this arrangement. (4)

2.2.2 New shares were issued at the beginning of the financial year at R10,00 each. Explain why the existing shareholders would or would not be happy with this issue price. Quote TWO financial indicators (with figures) to explain their opinion. (4)

INFORMATION:

The following financial indicators were taken from the accounting records of Metsi Limited for the years ended:

	28 Feb 2023	28 Feb 2022
Shares issued	1 200 000	450 000
Net asset value per share	1 600 cents	1 400 cents
Debt/equity ratio	0,1 : 1	1,3 : 1
Current ratio	1,4 : 1	0,9 : 1
Acid-test ratio	0,7 : 1	0,8 : 1
Rate of stock turnover	4 times p.a.	3 times p.a.
Debtors' collection period	28 days	35 days
Creditors' payment period	20 days	40 days
Earnings per share	610 cents	590 cents
Dividends per share	125 cents	135 cents
Market price of shares	1 700 cents	1 600 cents

ACTIVITY 2: ANALYSIS AND INTERPRETATION

2.1.1

From 2021 to 2022 the directors made a deliberate decision to change the policy on the distribution of profit in the form of dividends. Explain this change. Quote figures/calculations to support your answer.

4

2.1.2

If the balance on the loan at the end of 2022 is R680 000, calculate the shareholders' equity at the end of 2022.

2

2.1.3

Comment on whether the shareholders should be satisfied with the market price of their shares. Quote TWO relevant financial indicators (actual figures/ratios/percentages) and their trend. Give an additional comment to support your answer.

5

2.2.1

Calculate the minimum number of shares that Nikola must buy in July 2023 to gain control of the company.

4

Nikola wants to purchase the additional shares, at R12 per share without advertising the shares to the public. Give TWO reasons why you would not approve of this arrangement.

4

2.2.2

New shares were issued at the beginning of the financial year at R10,00 each. Explain why the existing shareholders would or would not be happy with this issue price. Quote TWO financial indicators (with figures) to explain their opinion.

4

23

ACTIVITY 3**INTERPRETATION OF FINANCIAL STATEMENTS (30 marks;24 minutes)*****GP 2020 Adapted*****3.1 AVIEE LTD**

Information was extracted from the financial records of Aviee Limited. The company is listed on the stock exchange.

REQUIRED:

3.1.1 Calculate the following financial indicators on 31 August 2022.

- Acid-test ratio (4)
- Debt-equity ratio (3)
- Return on average shareholders' equity (5)

3.1.2 Comment on the dividend policy for 2022. Provide a calculation to support your answer. (5)

3.1.3 The directors decided to change the dividend policy in 2022. Give TWO reasons for this change. (4)

3.1.4 Comment on the gearing and degree of risk for 2022. Quote TWO relevant indicators in your comment. (6)

3.1.5 The shareholders are dissatisfied with the repurchase price of shares. Using the relevant indicators and figures, explain why they are dissatisfied. (3)

30

INFORMATION:

Extract from the financial statements on 31 August 2021 and 2022:

	2022 R	2021 R
Fixed deposit: Sierra Bank	200 000	480 000
Loan: Max Bank	3 000 000	1 200 000
Current assets (including inventories)	2 273 400	2 492 800
Inventories	942 200	1 435 100
Current liabilities	1 024 000	1 511 000
Cash and cash equivalents	72 800	4 800
Bank overdraft	0	224 000
Shareholders' equity	13 686 600	11 653 000
Shareholders for dividends	264 000	352 000
Net profit before tax	1 908 000	
Income Tax	30%	

Financial indicators on 31 August:

	2022	2021
Current ratio	2,2: 1	1,6: 1
Acid-test ratio	?	0,7: 1
Debt-equity ratio	?	0,1: 1
Earnings per share	77 cents	87 cents
Dividends per share	40 cents	80 cents
Return on average shareholders' equity (ROSHE)	?	11,9%
Return on capital employed (ROTCE)	16,4%	15,3%
Net asset value	778 cents	728 cents
Interest rate on loans	13%	12%
Market value on JSE	780 cents	725 cents
Interest rate on fixed deposit	11%	11%
Number of shares	880 000	?
Price at which shares were repurchased	800 cents	

ACTIVITY 3: INTERPRETATION OF FINANCIAL STATEMENTS AND AUDIT REPORT

GP 2020

3.1 AVIEE LTD

3.1.1 Calculate the acid-test ratio.

4

Calculate the debt-equity ratio.

3

Calculate the return on average shareholders' equity.

5

3.1.2 Comment on the dividend policy for 2020. Provide a calculation to support your answer.

5

3.1.3

The directors decided to change the dividend policy in 2020. Give TWO reasons for this change.

4

3.1.4

Comment on the gearing and degree of risk for 2020. Quote TWO relevant indicators in your comment.

6

3.1.5

The shareholders are dissatisfied with the repurchase price of shares. Using the relevant indicators and figures, explain why they are dissatisfied.

3

TOTAL MARKS
30

ACTIVITY 4: INTERPRETATION OF FINANCIAL INFORMATION**(45 marks; 36 minutes)****MPUMALANGA 2022**

- 4.1 Complete the following sentences using the word (s) in the list below. Write only the word next to the question number (4.1.1 – 4.1.5) in the ANSWER BOOK.

liquid; profitable; solvent; return; risk/gearing

- 4.1.1 A company with total assets exceeding total liabilities is ...
- 4.1.2 A company that relies heavily on loans will have high ...
- 4.1.3 A company that controls its income and expenses properly will be ...
- 4.1.4 The percentage net income on equity indicates the ... earned by shareholders
- 4.1.5 A company that is able to settle its immediate debts is ...

(1 x 5) (5)**4.2 FINANCIAL INDICATORS OF TWO COMPANIES:**

Your friend, Jack, has bought shares in both companies. He asks you for your opinions on the financial results. The companies are the same size.

REQUIRED:

Explain your answer to the following questions. In each case compare and quote financial indicators of both companies (actual figures, ratios or percentages) to support your answer.

- 4.2.1 Jack is of the opinion that KAT Ltd is handling its working capital more effectively and is in a better liquidity situation than KIT Ltd. Explain and quote THREE financial indicators to support his opinion **(9)**
- 4.2.2 The operating efficiency of KIT Ltd are better than that of KAT Ltd. Quote and explain ONE financial indicator to support your opinion. **(2)**
- 4.2.3 Which company uses more loans? Explain whether this is a good idea or not. In each case, quote a financial indicator to support your answer. **(6)**
- 4.2.4 Compare and comment on the dividends pay-out policies of both companies. **(8)**

- 4.2.5 KIT Ltd has a better percentage return, earnings and dividends than KAT Ltd. Explain by quoting THREE financial indicators to support this opinion. (9)
- 4.2.6 The existing shareholders of the TWO companies hold different opinions of the current market value of their shares. (3)
- Explain why the existing shareholders of KIT Ltd are happy with this. Quote a financial indicator /figure to support your answer. (3)
 - Explain why the existing shareholders of KAT Ltd are very disappointed with this. Quote a financial indicator/figure to support your answer. (3)

INFORMATION:

	KIT LTD	KAT LTD
Market price per share on the JSE	750 cents	885 cents
Net asset value per share	609 cents	939 cents
Earnings per share	410 cents	176 cents
Dividends per share	240 cents	185 cents
% return on shareholders' equity	21,3%	11,2%
% return on total capital employed	32,6%	13,6%
% interest rate on loan	15,0%	15,0%
Debt/equity ratio	0,3 : 1	2,0 : 1
Current ratio	6,0 : 1	1,5 : 1
Acid-test ratio	2,8 : 1	0,9 : 1
Period for which stock is on hand	150 days	88 days
Average debtors' collection period	53 days	25 days
% Gross profit on cost of sales	62,2%	58,3%
% Operating expenses on sales	37,9%	44,5%
% Operating profit on sales	10,1%	7,3%

ACTIVITY 4

4.1.

4.1.1	
4.1.2	
4.1.3	
4.1.4	
4.1.5	

5

4.2.1

Jack is of the opinion that KAT Ltd is handling its working capital more effectively and is in a better liquidity situation than KIT Ltd. Explain and quote **THREE** financial indicators to support his opinion.

9

- 4.2.2** The operating efficiency of KIT Ltd are better than that of KAT Ltd. Quote and explain ONE financial indicator to support your opinion.

2

- 4.2.3** Which company uses more loans? Quote a financial indicator to support your answer.

Explain whether this is a good idea or not. In each case, quote a financial indicator to support your answer.

6

4.2.4 Compare and comment on the dividends pay-out policies of the TWO companies.

	Financial indicator or explanation with figures	Comparison and comment
KIT Bpk		
KAT Bpk		

8

4.2.5 KIT Ltd has a better percentage return, earnings and dividends than KAT Ltd. Explain by quoting THREE financial indicators to support this opinion.

9

4.2.6

Explain why the existing shareholders of KIT Ltd are happy with this. Quote a financial indicator/figure to support your answer.

3

Explain why the existing shareholders of KAT Ltd are very disappointed with this. Quote a financial indicator/figure to support your answer.

3

TOTAL MARKS

45

ACTIVITY 5: FINANCIAL INDICATORS OF TWO COMPANIES (30 marks)

2022 FREESTATE

5.1 FINANCIAL INDICATORS OF TWO COMPANIES

Your friend, Peter, is considering buying shares in a company that sells sportswear. He asks you for advice and presents you with the following financial indicators of two companies he is contemplating. The companies are of similar size, and they have issued the same number of shares.

NOTE:

When answering the questions, compare the information given and quote relevant financial indicators of both companies (percentages, ratios and/or figures).

REQUIRED:

- 5.1.1 Zee Ltd is more liquid than Ryan Ltd. Quote and explain TWO financial indicators (with figures) to prove your agreement. (6)
- 5.1.2 Which company uses more loans? Quote and explain a financial indicator to support your answer. Explain whether this is a good idea or not. (6)
- 5.1.3 Explain why you think the market price of Ryan Ltd's shares is much better than that of Zee Ltd. Quote and explain TWO financial indicators to support your answer. (4)
- 5.1.4 Which company is more likely to expand its business? Explain your answer by using relevant calculations. (5)
- 5.1.5 Ryan Ltd has a better percentage return, earnings and dividends than Zee Ltd. Explain THREE financial indicators to support this opinion. (9)

INFORMATION:

	Ryan Ltd	Zee Ltd
Market price per share on the JSE	755 cents	590 cents
Net asset value per share	605 cents	625 cents
Earnings per share (EPS)	813 cents	179 cents
Dividends per share (DPS)	537 cents	182 cents
% return on shareholders' equity	28,5%	11,5%
% return on capital employed (before tax)	35,6%	12,4%
% interest rate on loans	14%	14%
Debt/Equity ratio	0,2 : 1	1,9 : 1
Current ratio	5,8 : 1	1,7 : 1
Acid-test ratio	3,7 : 1	0,8 : 1
Debtors' average collection period	55 days	26 days

ACTIVITY 5

- 5.1.1 Zee Ltd is more liquid than Ryan Ltd. Quote and explain TWO financial indicators (with figures) to prove your agreement.**

--

6

- 5.1.2 Which company uses more loans? Quote and explain a financial indicator to support your answer. Explain whether this is a good idea or not.**

--

6

- 5.1.3 Explain why you think the market price of Ryan Ltd's shares is much better than that of Zee Ltd. Quote and explain TWO financial indicators to support your answer.**

--

4

5.1.4 Which company is more likely to expand its business? Explain your answer by using relevant calculations.

5

5.1.5 Ryan Ltd has a better percentage return, earnings and dividends than Zee Ltd. Explain THREE financial indicators to support this opinion.

9

30

ACTIVITY 6: INTERPRETATION OF FINANCIAL INFORMATION

ASC JUNE 2022

(45 marks; 35 minutes)

You are provided with information relating to two furniture companies, Vrede Ltd and Nigel Ltd, for the financial year ended 30 April 2022.

The directors of both companies have been trying to improve their results after tough trading times in 2020/2021, but they are using different strategies in the 2022 financial year:

- The directors of Vrede Ltd decided to persist with a conservative approach.
- The directors of Nigel Ltd decided to change to a more aggressive approach.

REQUIRED:

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

6.1 Profitability/Operating efficiency:

Refer to Information A.

Identify and explain which company has been more efficient in controlling its operating activities. Quote TWO financial indicators. (5)

6.2 Liquidity:

Refer to Information A.

- Identify and explain which company has better liquidity financial indicators. Quote TWO financial indicators. (3)
- Explain ONE concern you have about the liquidity of the other company. Quote ONE financial indicator. (2)

6.3 Dividends:

Refer to Information A.

Comment on the difference between the dividend pay-out policies implemented by the directors of the two companies and explain ONE possible reason for EACH of their decisions in their respective companies. Quote figures or indicators. (6)

6.4 Gearing, risk, financing and investing activities:

Refer to Information A, B and C.

- Explain the specific decisions taken by the directors of EACH company that have affected gearing and risk. Quote rand amounts. (4)
- Comment on the gearing and risk of Nigel Ltd. Quote TWO financial indicators. (4)
- At the Nigel Ltd AGM, an angry shareholder said that the directors' aggressive strategies would probably lead to the failure of the company in future. Explain TWO points why the shareholder might feel this way. (5)

6.5 Shareholders' assessment of market prices of shares:

Refer to Information A and B.

Shareholders of Vrede Ltd are not satisfied with the market price of their shares, whereas the shareholders of Nigel Ltd are satisfied. Explain by quoting figures or indicators and, for EACH company, identify a factor that would have affected the market price of the shares. (6)

6.6 Shareholding of Jay Sonto in Vrede Ltd and Nigel Ltd:

Refer to Information B and D.

Jay invested a total of R10,2 m in the companies in 2019. He is unsure whether changes in his shareholding and share prices have benefited him. Jay wants to sell 19 000 of his Nigel Ltd shares on the JSE.

- Provide calculations to show the change in Jay's % shareholding in Nigel Ltd over the financial year. Comment on his % shareholding in EACH company. (4)
- Calculate the total profit or loss he is currently making on his shares in EACH company. Advise if it is wise to sell 19 000 shares in Nigel Ltd, or not. (6)

INFORMATION:**A. FINANCIAL INDICATORS**

	VREDE LTD		NIGEL LTD	
	2022	2021	2022	2021
% operating expenses on sales	23,9%		23,0%	
% operating profit on sales	13,6%		19,9%	
% net profit on sales	7,0%		9,2%	
Current ratio	1,8 : 1		1,2 : 1	
Acid-test ratio	0,7 : 1		0,5 : 1	
Stock turnover rate	11 times	12 times	23 times	12 times
Debt-equity ratio	0,3 : 1	0,5 : 1	1,3 : 1	0,6 : 1
Net asset value per share	R32,95		R23,08	
Earnings per share	R2,54		R4,10	
Dividends per share	R1,90	R1,40	R4,40	R2,80
Dividend pay-out rate	74,8%		107,4%	
% return on shareholders' equity	7,8%	11,2%	16,8%	10,4%
% return on total capital employed	10,5%		16,2%	

B. SHARE PRICES, EQUITY, LOANS AND INTEREST

	VREDE LTD 2022	NIGEL LTD 2022
Average issue price	R31,00	R24,00
Market price on stock exchange (date)	R24,00	R32,00
Repurchase price per share	R0,00	R29,00
Interest rate on loans	12,0%	12,0%
Interest expense	R900 000	R2 100 000
Loans at year-end	R7 500 000	R17 500 000
Shareholders' equity at year-end	R29 654 000	R13 846 000

C. EXTRACT FROM CASH FLOW STATEMENT

	VREDE LTD 2022	NIGEL LTD 2022
Financing activities	R7 400 000	R(4 540 000)
300 000 new shares issued	9 900 000	0
260 000 shares repurchased	0	(7 540 000)
Change in loan	(2 500 000)	3 000 000
Investing activities	(3 300 000)	880 000
Change in fixed assets	(3 100 000)	730 000
Change in investments	(200 000)	150 000

D. SHAREHOLDING OF JAY SONTA IN EACH COMPANY

	VREDE LTD	NIGEL LTD
Shares owned by Jay Sonta since 2019:	200 000 shares	320 000 shares
% shareholding on: 1 May 2021	33,3%	37,2%
30 April 2022	22,2%	?
Price paid per share on: 1 May 2019	R27,00	R15,00
Total shares in issue on: 1 May 2021	600 000 shares	860 000 shares
30 April 2022	900 000 shares	600 000 shares

ACTIVITY 6

ASC JUNE 2022

6.1 Profitability/Operating efficiency:

Identify and explain which company has been more efficient in controlling its operating activities. Quote TWO financial indicators.

5

6.2 Liquidity:

Identify and explain which company has better liquidity financial indicators. Quote TWO financial indicators.

3

Explain ONE concern you have about the liquidity of the other company. Quote ONE financial indicator.

2

6.3 Dividends:

Comment on the difference between the dividend pay-out policies implemented by the directors of the two companies and explain ONE possible reason for EACH of their decisions in their respective companies. Quote figures or indicators.

	COMMENT ON POLICIES (with figures)	POSSIBLE REASON FOR DECISION
VREDE LTD		
NIGEL LTD		

6

6.4 Gearing, risk, financing and investing activities:

Explain the specific decisions taken by the directors of EACH company that have affected gearing and risk. Quote rand amounts.		
VREDE LTD		
NIGEL LTD		4
Comment on the gearing and risk of Nigel Ltd. Quote TWO financial indicators.		
		4
At the Nigel Ltd AGM, an angry shareholder said that the directors' aggressive strategies would probably lead to the failure of the company in future. Explain TWO points why the shareholder might feel this way.		
		5

6.5 Shareholders' assessment of market prices of shares:

Explain by quoting figures or indicators and, for each company, identify a factor that would have affected the market price of the shares.		
VREDE LTD		
NIGEL LTD		6

6.6 Shareholding of Jay Sonto in Vrede Ltd and Nigel Ltd:

Provide calculations to show the change in Jay's % shareholding in Nigel Ltd over the financial year.	
Comment on his % shareholding in EACH company.	
VREDE LTD	
NIGEL LTD	
Calculate the total profit or loss he is currently making on his shares in EACH company.	
VREDE LTD	NIGEL LTD
Advise if it is wise to sell 19 000 shares in Nigel Ltd, or not.	

4

6

Total marks
45

EASY MARKS

CALCULATIONS FOR FINANCIAL INDICATORS		
Debt-equity ratio		
Workings		Answer
$\frac{900\,000}{\checkmark} : \frac{8\,980\,300}{\checkmark}$		$0,1 : 1 \checkmark$ one part correct;
		3
Earnings per share (EPS)		
Workings		Answer
$\frac{968\,800}{1\,000\,000} \times 100^*$ $\frac{968\,800}{(800\,000 + 200\,000)} \times 100^*$		one part correct $96,9 \text{ cents}$ $\checkmark$
		4
Dividend pay-out rate		
Workings		Answer
$\frac{(28 + 12)}{40 \text{ cents}} \times 100^*$ $\frac{(280\,000 + 120\,000)}{96,9 \text{ cents}} \times 100$ OR $\frac{400\,000}{968\,800} \times 100$		$41,3\% \checkmark$ one part correct
		3
% return on average equity (ROSHE)		
Workings		Answer
$\frac{968\,800}{\frac{1}{2}(8\,980\,300 + 7\,411\,500)} \times 100^*$		$11,8\% \checkmark$
		4
4 – 5 method marks depending on indicators assessed.		

You earn a method mark if one figure is correct

Financial indicators are paired with Cash Flow

EXTRACTED FROM 2021 TRIAL EXAM (DBE)

Comment on the solvency of the company. Quote ONE financial indicator with figures.

Comment ✓ figure ✓

The degree of solvency has declined from 5,0 : 1 to 2,0 : 1 (by 3,0 : 1)

Although the solvency declined (trend not good), the business is still solvent.

2

Explain why the directors are satisfied with the change in the liquidity of the company. Quote TWO financial indicators with figures.

Financial indicator ✓ ✓ figures with explanation ✓ ✓

- **Acid test ratio** is now more efficient at 0,8 : 1 whereas it was too high at 2,6 : 1 in 2023 / more productive use of liquid assets (working capital)
- **Stock turnover rate** has improved from 3 times to 6 times indicating that stock is sold more quickly.

You must be able to identify liquidity indicators

4

You must be able to identify indicators, quote figures and comment

EXTRACTED FROM 2021 TRIAL EXAM (DBE)

Comment on the % return and earnings per share of the company.
Quote TWO financial indicators with figures.

Financial indicator (with trend) ✓ ✓ figures with explanation ✓ ✓

- **ROSHE** declined from 8,7% to 5,3% (by 3,4% percentage points / 39%) / compared to alternative investments
- **EPS** declined from 96 cents to 72 cents (by 24 cents; by 25%) / representing a drop in profitability (assuming no change to share capital)

4

SESSION 11: AUDITING

INTRODUCTION

This session covers the Audit reports of a public company. The annual report of each company should include the report of independent auditors who were assigned to audit the financial records of the business.

Annual Report

Is the yearly publication that public companies must provide to shareholders to describe the company's financial condition and operations over the previous financial year. This report provides important financial information to potential investors

The annual report include the following :

- independent audit report
- directors report
- published financial statements
(Income statement, Balance sheet and Cash flow statement)
- Dividends recommended during the financial year
- Major transactions that took place after the end of the financial year
- Major changes to the company's financial statements

The different types of audit reports covered in this module are as follows:

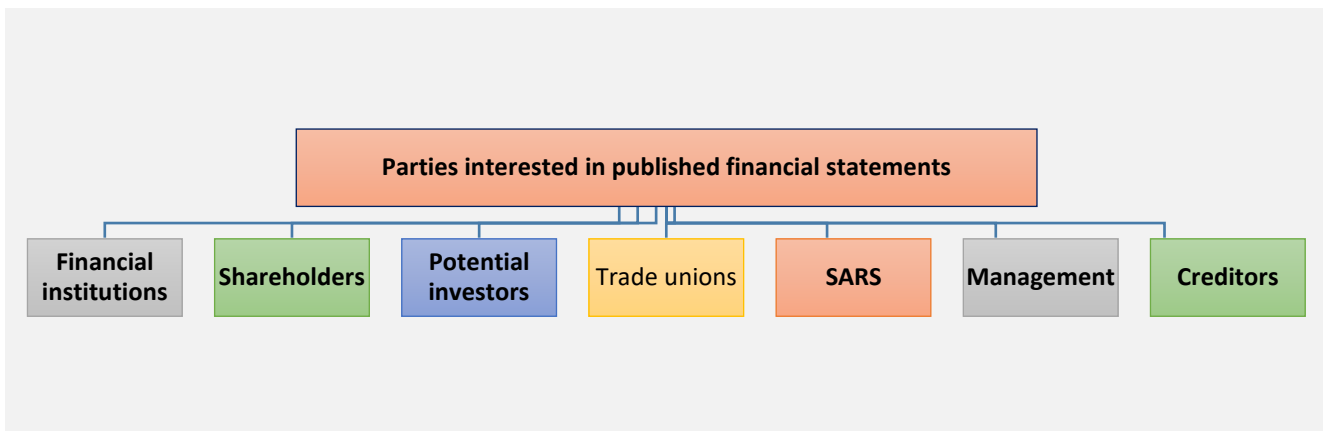
- Qualified
- Unqualified
- Disclaimer of opinion

Auditing- is defined as the on-site verification activity, such as inspection or examination of financial statements, documents, internal control processes to ensure compliance to requirements

Types of audit

- **External Audit** –involves examination of the truth and fairness of the financial statements of an entity by an external auditor who is independent of the organisation in accordance with reporting framework such as IFRS.
- **Internal audit** –is performed by employees of the organisation, they monitor the effectiveness of internal controls, policies and procedures and propose improvements.

Parties interested in the published financial statements



Terminology and key concepts in relation to auditing

Concept	Definition
Directors Report	Section of the annual report in which the directors report to the shareholders on the activities of the company.
Independent auditors	The report in which independent auditors express their opinion on financial statements audited. They report to the shareholders of the company.
Integrated reporting	Annual reporting that includes full disclosure of the companies' financial position and sustainability.
Published financial Statements	The financial statements of the public company prepared for shareholders and other people who have interest in the success of the company.
IFRS	International financial reporting standards provide general guidance for the preparation of financial statements.
GAAP	GAAP (Generally Accepted Accounting Principles) refers to common set of accounting principles, standards and procedures that companies and their Accountants should follow when they prepare the financial statements.
Auditor's opinion	Is a formal statement made by an auditor concerning the business (client's) financial statements. The two types of audit opinion are qualified opinion and unqualified opinion.

Difference between internal and external auditors

Internal Auditor

- Employed by the company/In the payroll of the company
- Report to directors of the company
- Internal auditors will examine issues related to company business practices and risks
- Examines all records intensely
- Ensure that the organization is complying with relevant laws and policies.
- Evaluate internal control processes and make recommendations on how to improve.

External Auditor

- Appointed by shareholders at the AGM
- Report to Shareholders
- External auditors examine the financial records
- External auditor express an opinion on the financial statements of the company
- Use a sample test basis to select documents for verification.
- Responsible for investigating financial statements for errors and fraud, performing audits on operations, and reporting on findings, and providing recommendations.

TYPES OF AUDIT REPORTS

- **Unqualified report** is a clean report and free from discrepancies and it gives a **true and fair view** of the financial statements
- **Qualified report** is issued when the independent auditor found **one or two discrepancies** that do not comply with the prescribed accounting standards (IFRS). However, the rest of the financial statements are **fairly presented**
- **Disclaimer of opinion**- this report is issued when the auditor **could not express an opinion** and refuses to present an opinion on the financial statement because of a lack of evidence or evidence withheld by the company or that the statements do not adhere to the GAAP and IFRS standards.
- **Adverse Opinion** -is issued when the auditor found that the financial statements of a company is **misstated, do not conform** with GAAP, stating that the **information is incorrect, unreliable and inaccurate** in order to assess the financial position of the company and do not present a fair view of the company's position and operations

Audit evidence

Is evidence obtained by auditors during financial audit and recorded in the audit working papers ,audit evidence is needed to confirm the accuracy of the financial statements of the business.

Examples of Audit evidence

- Policies and procedures of the company
- Records of asset registers, stock registers etc.
- Source (internal/external) documents –used to verify transactions.
- Journals and Ledgers
- Internal control processes and the efficiency of internal audit
- Reports of internal auditors to ensure that controls are efficient/Reports of audit committee which assess the internal and external audit processes.
- Confirmations may be received from outside parties
- Written and oral representations from management and staff

Samples of Audit reports

1. Unqualified Audit opinion

We have examined the financial statements set out on pages 8 to 29

In our opinion, the financial statements fairly present, in all material respects, the financial position of the company on 30 September 2018 and the results of their operations and cash flow for the year then ended in accordance **with International Financial Reporting Standards, and in the manner required by the Companies Act, 2008 in South Africa.**

Barlow and Bryan Accountants (SA)
Registered Accounts and auditors
Johannesburg

Chartered

External auditor not samples the information to be audited

Express an opinion for that specific financial year

No material misstatements

Stipulate the used legislature

Auditors to be registered with professional bodies such as SAICA

2. Qualified Audit opinion

We have examined the financial statements set out on pages 8 to 29

In our opinion, **except for the effects of the company's overvaluation of its fixed assets, the financial statements fairly present,** the financial position of the company on 30 September 2018 and the results of their operations and cash flow for the year then ended in accordance with International Financial Reporting Standards, and in the manner required by the Companies Act, 2008 in South Africa.

Barlow and Bryan
Chartered Accountants (SA)
Registered Accounts and auditors
Johannesburg

Material misstatements but there's no widespread

3. Disclaimer of opinion

We have examined the financial statements set out on pages 8 to 29

Because of the significance of the matters described in the basis for disclaimer of opinion paragraph, **we do not express an opinion on the financial statements as to whether they have been properly prepared**, in all material respects, in accordance International Financial Reporting Standards, and in the manner required by the Companies Act, 2008 in South Africa

Barlow and Bryan
Chartered Accountants (SA)
Registered Accounts and auditors
Johannesburg

Significant or gross misstatements,
NO opinion expressed



Take note of the following information on Audit Reports:

- Auditors are appointed by the shareholders
- The auditor's report is **addressed to the shareholders** of the business not the directors
- The directors are responsible for the preparation of the financial statements
- Negative audit reports can damage the reputation of the business and investors / potential investors can be driven away.

EXAMPLE 1: AUDIT REPORT

AUDITING AND CORPORATE GOVERNANCE

TUGELA BROTHERS

The audit report provided below is based on the financial information extracted from the books of Tugela Brothers for the year ended 2023 February.

INFORMATION A

To Shareholders

We have audited the financial statements set out on pages 12 to 32 ...

Opinion

In our opinion the financial statements present fairly, in all material respects, the financial position of the company as of 28 February 2023 ...
... in accordance with International Financial Reporting Standards (IFRS) and the requirements of the Companies Act (Act 71 of 2008) of South Africa.

Basis for Opinion

We are independent of the company ...
We have fulfilled our ethical responsibilities, which are consistent with international standards ...
... and the audit evidence obtained is sufficient and appropriate to provide a basis for our opinion.

- (a) Provide a brief explanation of the words / statements underlined on the extract above. (9)
- (b) Comment on the type of Audit Report illustrated above and support your answer (2)

INFORMATION B

A shareholder with close ties with the external audit company has decided to sell his shares back to the company at a price that is lower than the current market price. This shareholder owns 40% of the shares in the business.

- (c) Discuss the actions of this shareholder by providing **THREE** points. Your answer should include the relationship between the shareholder and the independent auditor as well as the market price and his percentage shareholding. (3)

SUGGESTED SOLUTION

AUDITING AND CORPORATE GOVERNANCE

(a) Provide a brief explanation of the words / statements underlined on the extract above.

- | | |
|--------|---|
| (i) | Pages 12 to 32 <ul style="list-style-type: none"> These are the pages (Financial Statements) extracted from the Annual report, the auditors are only responsible for the information obtained from these pages, and they cover the scope (extent) of their audit. ✓ |
| (ii) | In our opinion <ul style="list-style-type: none"> Based on findings (could be random sample) ✓ |
| (iii) | Present fairly, in all material respects <ul style="list-style-type: none"> The fair presentation of financial statements is judged according to the uniform standards or generally accepted accounting principles. ✓ |
| (iv) | IFRS <ul style="list-style-type: none"> Business operates on the international markets; policies are consistent and comparable ✓ The company is influenced by the global economy/exchange rates |
| (v) | Companies Act (Act 71 of 2008) <ul style="list-style-type: none"> Policies are consistent and comparable ✓ Abides by the laws of the country in terms of disclosure, taxes and ethics. Financial statements are prepared according to applicable accounting framework and meet the requirements of the Companies Act. |
| (vi) | Independent <ul style="list-style-type: none"> Unbiased / no vested interest in the company ✓ |
| (vii) | Ethical responsibilities
Not influenced by bribery / corruption ✓ |
| (viii) | Audit evidence <ul style="list-style-type: none"> Audit evidence: Records, external source documents etc. inspected by auditors in coming to the conclusion as expressed as an opinion. ✓ |
| (ix) | Sufficient and appropriate <ul style="list-style-type: none"> The evidence was relevant and they have seen enough to come to their decision ✓ |

(b) Comment on the type of Audit Report illustrated above and support your answer

Unqualified report ✓

Financial statements that have been audited are fairly and correctly presented on their records and it complies with the accounting standards. ✓

(c). Discuss the actions of this shareholder by providing **THREE** points. Your answer should include the relationship between the shareholder and the independent auditor as well as the market price and his percentage shareholding.

Three valid points ✓ ✓ ✓

- Close ties with external auditor – could be receiving privileged information about the company / possible collapse in the future (insider trading)
- External auditor is expected to be unbiased and impartial
- He owns a large percentage of shares / someone else could end up being a majority shareholder / share capital will be deflated (reduced) – may result in unrealistic financial indicators in the future (smaller share capital) /
- Market price reflects the image of the company and the demand for shares – it does not make sense to accept a lower price if he could sell his shares on the JSE.
- This shareholder is trying to cut his losses and get out before a disaster
- He has 40% of shares so his losses would be greater.

ACTIVITY 1 – AUDIT REPORT

2019 NOV NSC EXAM -Adapted

AUDIT REPORT FOR YEAR-END 28 FEBRUARY 2023

The financial statements of Visiv Ltd (see QUESTION below) were audited. You are provided with extracts from the audit report.

Extracts from the audit report:

	Basis for audit report
Point 1	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 2022 is not in accordance with provisions of the Companies Act, 1973 (Act 71 of 2008), as the liquidity of the company has been compromised ...
	Opinion
Point 3	Because of the significance of the matters described above, we do not express an opinion ...

REQUIRED:

- 1.1 **Refer to Point 3.**
What type of audit report did the company receive? (1)
- 1.2 **Refer to Point 1.**
Give TWO examples of audit evidence that the auditors would have required regarding this problem. (2)
- 1.3. **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.
(Refer to information below) (4)
 - Explain what the directors could have done to prevent this comment by the auditors. Provide TWO points. (2)

INFORMATION

Extract from Balance Sheet	
Trading stock	1 102 000
Net trade debtors	1 090 000

After processing all adjustments:

- The current liabilities totalled R2 900 000
- The current ratio is 0.8: 1.

WORKSHEET 1

1. AUDIT REPORT

1.1 What type of audit report did the company receive?

--

1

1.2 Give TWO examples of audit evidence that the auditors would have required regarding this problem.

Example 1	
Example 2	

2

1.3 Apart from the current ratio, identify and calculate ONE other financial indicator that the auditors would have used in deciding on this opinion.

Identify ONE other financial indicator:

Calculate the financial indicator:

Explain what the directors could have done to prevent this comment by the auditors. Provide TWO points.

Point 1

Point 2

4

2

ACTIVITY 2

NSC NOV 2018

2. AUDIT REPORT

13 Marks

Extracts from the audit report of Tembiso Ltd are provided.

INFORMATION:**To Shareholders**

We have audited the financial statements set out on pages 8 to 52 ...

Opinion

Point 1 In our opinion the financial statements present fairly, in all material respects, the financial position of the company as at 28 February 2018 ...

Point 2 ... in accordance with International Financial Reporting Standards (IFRS) and the requirements of the Companies Act (Act 71 of 2008) of South Africa.

Basis for Opinion

Point 3 We are independent of the company ...

Point 4 We have fulfilled our ethical responsibilities, which are consistent with international standards ...

Point 5 ... and the audit evidence obtained is sufficient and appropriate to provide a basis for our opinion.

REQUIRED:

2.1 **Refer to points 1 to 3.**

Why did the auditors mention these points? Give ONE explanation for EACH point.

(5)

2.2 **Refer to points 4 and 5.**

Explain TWO examples of:

- Ethical responsibilities
- Audit evidence

(8)

WORKSHEET 2**2 AUDIT REPORT****2.1****Point 1****Opinion**

1

Point 2**IFRS and Companies Act**

2

Point 3**Independent**

2

2.2**Point 4****TWO examples of ethical responsibilities:****Example 1:****Example 2:**

4

Point 5**TWO examples of audit evidence:****Example 1:****Example 2:**

4

13 MARKS

ACTIVITY 3

NSC FEB 2018

AUDIT REPORT: DF ENTERPRISES LTD

REQUIRED:

- 3.1 Choose the correct word(s) from those given in brackets. Write only the word(s) next to the question number (3.1(a)–3.1(b)) in the ANSWER BOOK.
- (a) The audit report is completed by the (internal/external) auditor. (1)
- (b) The (directors/shareholders/auditors) are responsible for the preparation of the financial statements. (1)
- 3.2 Refer to the audit report below.
- (a) The audit report below indicates a/an (qualified/unqualified) opinion. (1)
- (b) Explain why the shareholders should be concerned about this audit report. State TWO points. (4)

INFORMATION:

EXTRACT FROM THE AUDIT REPORT OF DF ENTERPRISES LTD**Basis for Qualification of Opinion**

Source documents for expenditure amounting to R550 000 could not be traced.

Audit Opinion

In our opinion, except for the effects of the unsubstantiated expenditure described in the **Basis for Qualification of Opinion** paragraph, the financial statements fairly represent the financial position of the company on 30 June 2023 and the results of their operations and cash flows for the year ended, in accordance with the International Financial Reporting Standards, and in the manner required by the Companies Act (Act 61 of 1973) of South Africa.

WORKSHEET 3

3 AUDIT REPORT: DF ENTERPRISES LTD

3.1	(a)		
	(b)		

2

3.2	(a) The audit report below indicates a/an (qualified/unqualified) opinion.	
	(b) Explain why the shareholders should be concerned about this audit report. State TWO points.	

1

4

7 MARKS

ACTIVITY 4**NSC NOV 2017****4.1 AUDIT REPORT****6 Marks**

An extract of the independent audit report of Karin Ltd for the financial year ended on 28 February 2023 is provided.

REQUIRED:

As a shareholder, what concerns would you have regarding this audit report? Explain THREE points.

(6)**INFORMATION:****EXTRACT FROM THE AUDIT REPORT OF KARIN LTD**

We have audited the annual financial statements of Karin Ltd for the year ended 28 February 2023. These financial statements are the responsibility of the company's directors.

Basis for Disclaimer of Opinion

During our audit we established that bonuses paid to directors, amounting to R9,8 million, had not been authorised by the Remunerations Committee.

Audit Opinion

Because of the significance of the matters described above, we have not been able to obtain sufficient audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements of Karin Ltd for the year ended 28 February 2023.

Bongani and Botha, Chartered Accountants (SA)

6

WORKSHEET 4**4 AUDIT REPORT**

As a shareholder, what concerns would you have regarding this audit report? Explain THREE points.

Point 1:

Point 2:

Point 3:

6

6 MARKS

SESSION 12: CORPORATE GOVERNANCE

What is Corporate Governance ?

- **Corporate governance** is the system by which companies are directed and controlled, Boards of directors are responsible for the **governance** of their companies.
- Is the corner stone of any good business. It encompasses the processes, practices and policies that a company relies on to make formal decisions and to manage the company.
- It is about how the business should be managed, controlled, taking the interest of shareholders and other stake holders into account who may be affected by operations of the business.

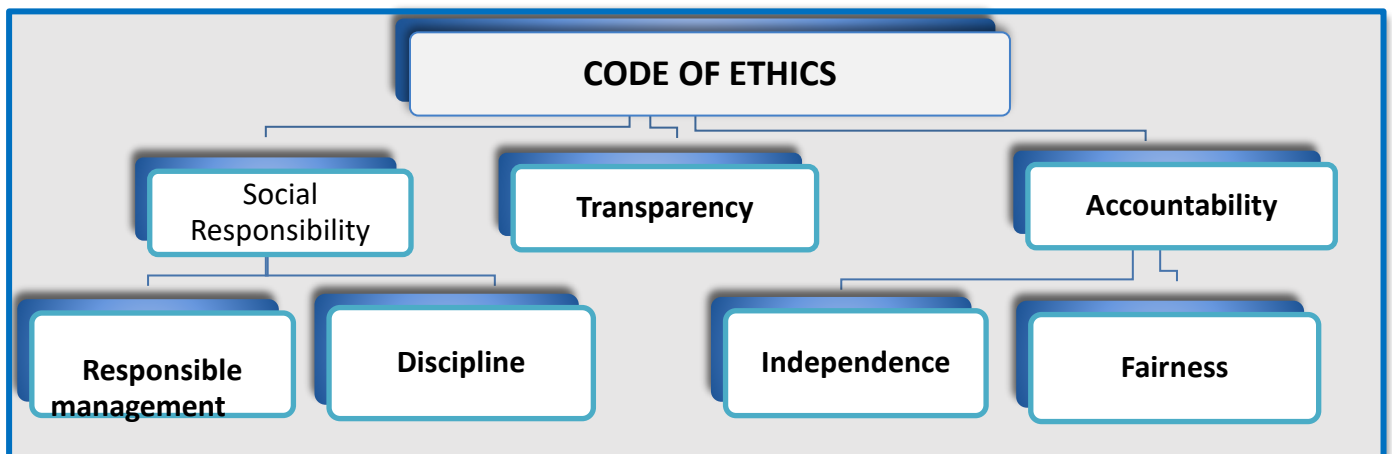
What is the role of shareholders in governance ?

- The shareholders' role in **governance** is to **appoint the directors and the auditors** and to satisfy themselves that an appropriate **governance** structure is in place.

How does good Corporate Governance benefit the company?

- Helps the company to regulate risk and reduce the opportunity for corruption.

There are seven primary **characteristics of good governance**, refer to the diagram below:

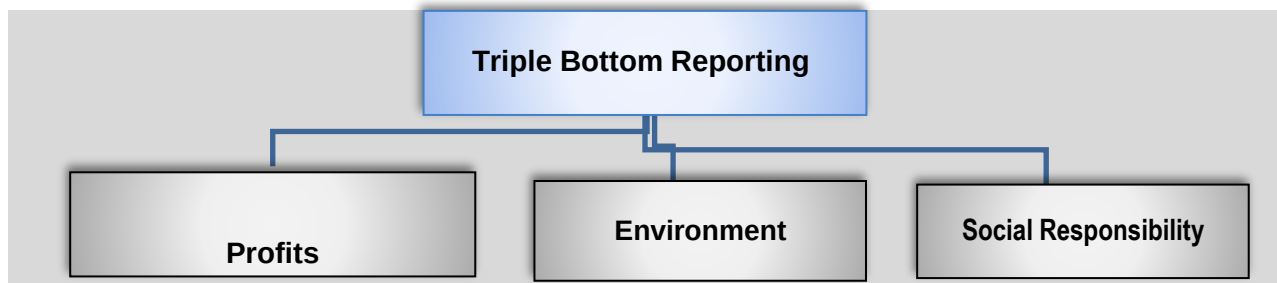


Acronym of for code of ethics is **STARDIF**

King Code and Triple Bottom Reporting

King Code is a set of **principles and recommended practices** that are aimed at achieving good corporate governance (management).

King Code recommends that **non-financial information** should be communicated to shareholders and stakeholders, reporting should not only be based on profits that are made by the entity. Refer to the diagram below:



The purpose of King is to:

- Create an ethical culture in organisations
- Improve their performance and increase the value they create
- Ensure there are adequate and effective controls in place
- Build trust between all stakeholders
- Ensure the organisation has a good reputation
- Ensure legitimacy.

TRIPLE BOTTOM LINE REPORTING

Social Responsibility (People): the positive and negative impact an organisation has on its most important stakeholders. These include employees, families, customers, suppliers, communities, and any other person influencing or being affected by the organisation.

Environment (Planet): the positive and negative impact an organisation has on its natural environment. This includes reducing its carbon footprint (carbon dioxide), usage of natural resources, toxic materials and so on, but also the active removal of waste, reforestation, and restoration of nature.

PROFIT: the positive and negative impact an organisation has on the local, national and international economy. This includes creating employment, paying taxes, wealth creation and any other economic impact an organisation has. The goal is not profit only profit but prosperity to all.

Directors of Companies

Corporates are managed by a **board of directors** and the directors are divided into the following categories :

Executive directors

- The executive director is involved in the routine management of the business and is a full-time employee of the company.
- Executive directors usually have a salary package which consists a mix of fixed salary, commissions and incentives based on company performance, share option schemes and other perks and benefits.
- Executive directors are privileged because they have intimate knowledge of how the company is run.

Non-Executive Directors

- They do not take part in the management and operation of the company but plays a crucial role in the formulation of policies and plans, and decision making of the company.
- Non-executive directors are paid their service fee based on the complexity of their role and the term of their appointment.
- 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 watchdog role, keeping executive directors in check
- More regular inputs than an internal auditor or other directors
- Their inputs would be unbiased and independent.

Remuneration Policy

- The purpose of remuneration policy is to provide direction on fair, responsible and transparent remuneration.
- The policy aims to provide clear and transparent guidelines to develop market-related, modern remuneration practices and promote positive outcomes and an ethical culture and responsible corporate citizenship.

Remuneration Committee

According to the Companies Act, 2008 (Act 11 of 2008), a company must have a Remunerations Committee

Roles and responsibilities of remuneration committee

- Review salaries, bonuses and other earnings
- To prevent directors from paying themselves very high salaries
- They must approve and give advice on the proposed fees, bonuses etc.

What are the benefits of the committee to the business and stakeholders?

- It will ensure transparency and fairness in the payment of fees and salaries.
- Detect mismanagement and fraudulent activities
- Remuneration and earnings will be compared against other companies within the same industry
- Prevent fraud, corruption and wastage.

ACTIVITY 1

NSC NOVEMBER 2020 EXAM

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 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:

1.1 Audit report:

Explain why a qualified audit report is not a good reflection of a company. (4)
Provide **TWO** points

1.2 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 Director

1.3 The Remunerations Committee

According to the Companies Act, 2008 (Act 11 of 2008), a company must have a Remunerations Committee (3)
Explain the role or responsibility of this committee and give a reason why this committee is necessary

1.4 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)

MEMBERS OF THE COMMITTEES AND ROLE OF EACH COMMITTEE

Committees	Members of committee	Role of committee
(a) Audit Committee	At least three non-executive directors of the company must be members of the committee	- Make submissions to the board regarding the accounting policies, financial controls, accounting records and reporting. - Nominate the independent auditor. - Ensure that the appointment of an auditor complies with Companies Act and other relevant legislation.
(b) Remuneration committee	- Majority of members should be non-executive directors. - The chairperson of the committee should be an independent, non-executive director.	- Review salaries, bonuses and other earnings - To prevent directors from paying themselves very high salaries - They must approve and give advice on the proposed fees, bonuses etc.
(c) Social and Ethics Committee	A minimum of three members, who are directors or prescribed officers of the company, one of them should be a non-executive director.	- Have to monitor the company's social and economic development. - Monitor good corporate citizenship, including contribution to development of communities in which services/products are provided or marketed. - Monitor the impact of the public activities and its products or services to the environment, health, and public safety. - Monitor consumer relationships, the company's policies and record relating to advertising, public relations and compliance with consumer protection laws.
(d) Risk Committee	- A minimum of three members, who are executive directors, non-executive directors and even non-directors. - This committee must be chaired by a non-executive director.	- The committee is responsible for the risk policy and plan, they must monitor and review policies and plans. - Responsible for performing risk assessment on regular basis - Determine the company's risk appetite and risk tolerance - Monitor the whole risk management process, the internal and external assurance providers will provide feedback on the effectiveness of this process.

EXAMPLE

NSC NOVEMBER 2020 EXAM**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 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:**1.1 Audit report:**

Explain why a qualified audit report is not a good reflection of a company. (4)
Provide **TWO** points

1.2 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 Director

1.3 The Remunerations Committee

According to the Companies Act, 2008 (Act 11 of 2008), a company must have a Remunerations Committee (3)
Explain the role or responsibility of this committee and give a reason why this committee is necessary

1.4 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

1.1 Explain why a qualified audit report is not a good reflection of a company. Provide TWO points

- Certain information on the financial statements is missing or not clear
- There is insufficient audit evidence for significant items / auditors cannot verify certain information
- Lack of internal controls , possible negligence or colluding
- Existing shareholders might decide to sell their shares

1.2 Explain why it is important for a company to include non-executive as well as executive directors on the Board of Director

- Executive directors are involved with internal functioning (operations) of the company, they are hands on.
- 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 watchdog role, keeping executive directors in check
- More regular inputs than an internal auditor or other directors
- Their inputs would be unbiased and independent

1.3 According to the Companies Act, 2008 (Act 11 of 2008), a company must have a Remunerations Committee Explain the role or responsibility of this committee and give a reason why this committee is necessary

Explanation

To prevent directors from paying themselves very high salaries

They must approve and give advice on the proposals such as fees and bonuses

Reason

- To ensure transparency and fairness in the payment of salaries and fees
- To prevent fraud, corruption and wastage
- Detect mismanagement or fraudulent activities
- They can compare remunerations against financial information of other companies in the industry.

1.4 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

- Transparency in awarding contracts, tenders or appointing service providers
- Policy would prevent colluding with service providers
- This could be viewed as bribery for contracts
- This could be viewed as nepotism
- To protect the image of the business
- Conflict of interests which could be corrupt and fraudulent

ACTIVITY 1**CORPORATE GOVERNANCE
ADAPTED -DBE PRELIM 2021****(15 marks; 15 minutes)****REQUIRED:**

- 1.1** Give ONE word/term for each of the following descriptions by choosing a word/term from the list below. Write only the word/term next to the question numbers (1.1.1 to 1.1.3) in the ANSWER BOOK.

external auditors; internal auditors; shareholders; directors

- 1.1.1** Their role is to manage and control all aspects of the company's activities
1.1.2 Their role is to express an unbiased opinion on the reliability of the information in the financial statements.
1.1.3 Their role is to assess the internal control measures in a company on an on-going basis. (3 x 1) **(3)**

1.2 ELECTRONIC LTD

The information relates to Electronic Ltd. In recent months, Electronic Ltd has been receiving negative publicity in the national newspapers. A shareholder, Quinton Miller, is concerned about possible corruption in this company.

REQUIRED

- 1.2.1** Explain, in your own words, why you agree or disagree with the extract below that appeared in a local newspaper. State TWO different points.

Sustained (On-going) corruption, fraud and mismanagement will not take place at a listed company unless there is illegal or criminal collusion (dishonest collaboration) on the part of the board of directors and the auditors.
--

[Paraphrased from @TheJaundicedEye, Independent, Saturday 7 March 2023]

- 1.2.2** Refer to the information on the next page.

Explain TWO points to prove possible corruption for EACH of the following problems. Quote figures or calculations.

Problem 1: Payment of directors' fees

Problem 2: Control and productivity of other employees

INFORMATION:

Information identified from the books of the company

NOTE: Rand amounts are expressed in millions

		% Change	28 February 2023	28 February 2022
Directors' fees:				
Chief executive officer (CEO)	1	72%	R11,2 m	R6,5 m
Chief financial officer (CFO)	1	72%	R9,9 m	R5,8 m
Other full-time directors	12	8,3%	R39,0 m	R36,0 m
Other employees				
Number of employees		19%	570 employees	480 employees
Salaries and wages		22%	R91,0 m	R74,4 m
General information:				
Gross profit		11%	R289,0 m	R260,0 m
Operating profit		(20%)	R61,0 m	R76,2 m
Operating profit per employee		(50%)	R0,1 m	R0,2 m
Net profit		(21%)	R41 m	R52 m

ACTIVITY 1**1.1**

1.1.1		
1.1.2		
1.1.3		
		3

1.2 ELECTRONIC LTD**1.2.1**

Explain, in your own words, why you agree or disagree with the extract that appeared in a local newspaper. State TWO different points.

4**1.2.2**

Explain TWO points to prove possible corruption for EACH of the following problems. Quote figures or calculations

Problem 1: Payment of directors' fees

Problem 2: Control and productivity of other employees

4

ACTIVITY 2 : CORPORATE GOVERNANCE**(15 marks)****2022 Free State Prelim****AUDIT REPORTS**

You are provided with extracts from the independent audit reports of Metsi Ltd and Just Water Ltd.

Extract from audit report of Metsi Ltd:

In our opinion, the financial statements fairly present, in all material respects, the financial position of this company on 28 February 2022 and the results of their operations and cash flow for the year ended under International Financial Reporting Standards, and in the manner required by the Companies Act of South Africa.

Extract from audit report of Just Water Ltd:

We found that the internal control procedures were not adhered to – and that documentation did not exist for a significant portion of the transactions tested.

Because of the significance of the matter described in the previous paragraph, we could not obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Therefore, we do not express an opinion on the financial statements for the year ended 28 February 2022.

REQUIRED:

- 2.1 Comment on the audit reports of both companies. If you want to buy shares in a company, explain how the report will affect your decision concerning the shares you would purchase in the company. In which company would you invest? (5)
- 2.2 The board of directors has different committees with different functions. Choose the function in COLUMN B that matches the committee in COLUMN A. Write only the letter (A–D) next to the question numbers (4.2.1 to 4.2.4) in the ANSWER BOOK.

2.2.1 Audit committee	A Review salaries, bonuses, and other earnings.
2.2.2 Remuneration committee	B Responsible for performing risk assessment regularly.
2.2.3 Social and ethics committee	C Ensure that the appointment of an auditor complies with the Companies Act and the legislation.
2.2.4 Risk committee	D Monitor the impact of the public activities and their products or service to the environment, health, and public safety.

(4)

- | | | |
|-----|--|-----|
| 2.3 | The purpose of a business rescue plan is to provide a company with temporary supervision and protection against its creditors, to give them a 'breathing space' to reorganise and restructure its financial affairs. Name TWO parties who might be affected by a business rescue plan. | (2) |
| 2.4 | Who is the audit report addressed to? Give a reason for your answer. | (2) |
| 2.5 | Give TWO examples of audit evidence that the auditors would have required to complete the audit. | (2) |

ACTIVITY 2

2022 FREE STATE PRELIM

2.1

Comment on the audit reports of both companies. If you want to buy shares in a company, explain how the report will affect your decision concerning the shares you would purchase in the company.

In which company should you rather invest?

5

2.2

2.2.1		2.2.3	
2.2.2		2.2.4	

4

2.3

The purpose of a business rescue plan is to provide a company with temporary supervision and protection against its creditors, to give them a 'breathing space' to reorganise and restructure its financial affairs. Name TWO parties who might be affected by a business rescue plan.

2

2.4

Who is the audit report addressed to? Give a reason for your answer.

2

2.5

Give TWO examples of audit evidence that the auditors would have required to complete the audit.

2

15

ACTIVITY 3: CORPORATE GOVERNANCE

NEW AGE LTD

A major shareholder of New Age Ltd is not happy with the Remunerations Committee of the company, he feels that the directors did not deserve the salary increase for the financial year ended on 30 June 2022. Assist the shareholder to prepare a report that he will present at the next AGM (Annual General Meeting).

REQUIRED

The report should address the following areas:

- 3.1 Calculate the percentage increase in directors' fees. (2)
- 3.2 Calculate the total dividends for June 2022. (2)
- 3.3 Provide **TWO** points to justify the concern of a shareholder (why he is not happy). Quote figures or financial indicators (4)
- 3.4 In relation to the financials provided, what would you propose at the AGM. Provide **ONE** point. (2)

Extract from the financial records of New Age Ltd:

	30 June 2022	30 June 2021
Directors fees	R3 960 000	R3 300 000
Salaries for employees	R7 000 000	R7 000 000
Net profit after tax	R2 400 000	R3 420 500
Retained income	R4 200 500	R2 200 500
Dividends per share	50 cents	90 cents
Total dividends	?	R720 000
Number of shares in issue	800 000	800 000

ADDITIONAL INFORMATION

- The company has employed three directors, they are paid equal annual fee.

10

ACTIVITY 3: CORPORATE GOVERNANCE

3.1	Calculate the percentage increase in directors' fees.	
		2
3.2	Calculate total dividends per share.	
		2
3.3	Provide TWO points to justify the concern of the shareholder (why he is not happy). Quote figures or financial indicators	
		4
3.4	In relation to the financials provided, what should be proposed at the AGM? Provide ONE point.	
		2

TOTAL MARKS**10**

SESSION 13: INVENTORY VALUATION

INTRODUCTION TO INVENTORY

The session introduces inventory valuation methods and type of goods that can be suitably valued using the specific inventory valuation methods. The grade 10 content covered the perpetual inventory system and in grade 11 the periodic inventory system and perpetual inventory were covered.

In grade 12 the content focus on three inventory valuation methods and two stock (inventory) systems.

DEFINITION OF INVENTORY

Inventory refers to goods that are in various stages of production or ready for sale. The different categories of goods are as follows:

- **Raw Material** –unprocessed material or goods used to produce goods, intermediate (semi-finished goods) and finished goods.
- **Work- in-progress** –goods that are in the process of production, they are partially finished goods that are awaiting completion.
- **Finished goods** are **manufactured** products in stock that are available for consumption or sales. These goods do not require any further processing.

Different types of inventories		
Raw Material		
Work- in-progress		
Finished goods		

INVENTORY

- **Inventory** is generally the **LARGEST CURRENT ASSET**, and it is expected to sell within a period of one year.
- Businesses should do inventory count to determine the value of inventory missing, stolen or damaged.
- The inventory count will also assist in determining the items of stock that are selling slowly, or items that have been overstocked.
- The overstocking of items places businesses at a risk of being stuck with merchandise that is obsolete.
- Obsolete inventory should be marked down to sell. The marking down of goods will reduce the profit margin.
- There are two systems used to count the stock, they are **Perpetual** and **Periodic** Inventory System.

Perpetual Inventory System

The movement of stock is recorded on an **ongoing** or **continuous basis**. The exact quantities and types of stock items on hand are shown by the system at any point in time. This inventory management system uses the specialized and automated software.

Periodic Inventory System

There is **no continuous recording** of the movement of trading stock. The value of the trading stock on hand is worked out/counted periodically. This system is mostly preferred by small businesses.

COMPARISON OF PERPETUAL AND PERIODIC INVENTORY SYSTEMS

PERPETUAL	PERIODIC
■ Cost of sales is calculated at POINT OF SALE ■ Stock value can be determined/identified at any time (from records) ■ Stock bought is regarded as an ASSET ■ Stock purchases and sales are recorded in the Trading Stock Account ■ Stock deficits can easily be determined ■ Better control of stock movement, stock is recorded on continuous basis ■ The system requires expensive equipment such as scanning equipment, computers and bar codes	■ Cost of sales calculated at END OF FINANCIAL PERIOD ■ Stock value determined/identified by physical stock count ■ Stock bought is regarded as an EXPENSE ■ Stock purchases and sales are recorded in the Purchases Account ■ It is very difficult to determine stock deficits ■ It is cost effective, it does not use expensive equipment ■ This system is suitable for businesses where it is not possible to determine the cost price of each item, an example is a supermarket.

COMPARISON OF THE PERPETUAL INVENTORY SYSTEM WITH THE PERIODIC INVENTORY SYSTEM													
No.	Transaction	PERPETUAL STOCK SYSTEM						PERIODIC STOCK SYSTEM					
		A/c Debit	A/c Credit	Journal	A	O	L	A/c Debit	A/c Credit	Journal	A	O	L
1.	Bought merchandise for cash	Trading stock	Bank	CPJ	±	0	0	Purchases	Bank	CPJ	–	–	0
2.	Bought merchandise on credit	Trading stock	Creditors control	CJ	+	0	+	Purchases	Creditors control	CJ	0	–	+
3.	Return merchandise to suppliers	Creditors control	Trading stock	CAJ	–	0	–	Creditors control	Creditors Allowances or Purchases	CAJ	0	+	–
4.	Carriage on purchases [Cash]	Trading stock	Bank	CPJ	±	0	0	Carriage on purchases	Bank	CPJ	–	–	0
5.	Carriage on purchases [Credit]	Trading stock	Creditors control	CJ	+	0	+	Carriage on purchases	Creditors control	CJ	0	–	+
6.	Merchandise taken for own use	Drawings	Trading Stock	GJ	–	–	0	Drawings	Purchases	GJ	0	±	0
7.	Merchandise donated	Donation	Trading Stock	GJ	–	–	0	Donation	Purchases	GJ	0	±	0
8.	Merchandise sold for cash	Bank	Sales	CRJ	+	+	0	Bank	Sales	CRJ	+	+	0
		Cost of sales	Trading stock	CRJ	–	–	0						
9.	Merchandise sold on credit	Debtors Control	Sales	DJ	+	+	0	Debtors Control	Sales	DJ	+	+	0
		Cost of sales	Trading stock	DJ	–	–	0						
10.	Merchandise returned by debtors	Debtors Allowances	Debtors Control	DAJ	–	–	0	Debtors Allowances	Debtors Control	DAJ	–	–	0
		Trading stock	Cost of sales	DAJ	+	+	0						
11.	Closing Stock							Trading Stock	Closing stock	GJ	+	+	0

CALCULATION OF COST OF SALES

- **Perpetual Inventory system** – cost of sales calculated at **POINT OF SALE**
- **Periodic inventory** – cost of sales is calculated at the end of financial period as indicated below:

Calculation for the cost of sales – Perpetual Inventory	
Assume your sales = R500 000	
Mark up is 60%	
Cost of sales is : $500\,000 \times \frac{100}{160} = 312\,500$	

Calculation for the cost of sales		
Opening stock	XXXX	
Add Purchases	XXXX	<i>Always remember to deduct purchases returned</i>
Add Carriage on purchases	XXXX	<i>Carriage on sales will affect the profit and loss account or operating expenses in the income statement</i>
Add import duties	XXXX	
Less closing stock	(XXXX)	
Cost of sales	XXXX	

Advantages and disadvantages of each stock system:

Perpetual Inventory	
Advantages	Disadvantages
■ The business can verify physical stock at any time ■ The business can prepare interim accounts ■ Discrepancies, errors, shrinkage in stock are discovered and action can be taken. ■ Regular updates in stock help in avoiding deterioration (decline in quality) in stock and obsolescence (outdated). ■ Stock can be replenished or replaced timeously.	■ The system is complicated, it requires more accounting entries. ■ It is very expensive to run this system

Periodic Inventory	
Advantages	Disadvantages
- It is cost effective as there is inexpensive equipment like bar codes and scanning equipment - It is not necessary to calculate cost of sales on a continuous basis - This system is suitable for businesses where it is difficult to determine the cost price of individual items	- Control over stock is not very effective - Theft is not quickly detected – a stock-take is necessary to determine leakages or theft - Trading stock deficit account is not completed, the business will forfeit the reduction of taxable income.

INVENTORY VALUATION

- The systems and methods applied by the entity(business) in order to validate or confirm the value of stock on hand at the end of a particular period.
- Inventory valuation allows you to evaluate your cost of goods sold and ultimately the gross profit.
- The physical stock-count is one of the processes used to determine the value of stock on hand.

THREE INVENTORY VALUATION METHODS:

- First-In-First-Out (FIFO)
- Weighted Average
- Specific Identification

FIFO

- The stock that was bought first is sold first, and the stock on hand will be the stock that you recently bought.
- This method is preferably used to value goods with short/ limited shelf life.
- Proper packing and display are essential - “old” stock should be in the front and “new” stock at the back.
- The Prudence concept is in use, the value of the stock at the year- end is realistic because the stock is valued at the most recent prices.



EXAMPLE

LG TV'S in Benoni sells TV's and TV accessories. The purchases and sales for the month of April are shown below. The business uses the FIFO method of stock valuation.

REQUIRED

- Calculate the number of TV's on hand on 30 April 2023
- Calculate the value of closing stock on 30 April 2023

Transactions during April 2023

Information	Number of units	Cost per unit R	Total value R
Opening stock	6	1 000	6 000
Purchases during the month	27		37 500
5 April credit purchases	12	1 250	15 000
17 April credit purchases	15	1 500	22 500
24 April returns to suppliers	2	1 250	2 500
Sales during the month	18	2 700	48 600
Opening stock (30 April 2023)	?		?

SUGGESTED ANSWER

HOW TO CALCULATE THE VALUE OF CLOSING STOCK USING FIFO??

Use the **BOTTOM-UP APPROACH**

	Available for sale	Sold	On hand
Opening stock	6	-6	
Purchases 5 April	12	-10	
Purchases 17 April	15	-2	13
Returned goods	(2)		
	31	-18	13



Always
adjust the units
returned

31 goods available **LESS** 18 goods sold **EQUALS** to
13 goods on hand (31 - 18) A

13 x R1 500 = R19 500 B

Check the 17 of April 17 items were bought,
therefore our closing stock was bought at R1 500
per item. (start from bottom)

Note: stock bought first is sold first

EXAMPLE 2

PACKER'S SUITCASE SHOP

Charles Packer sells travel suitcases. The year-end is 30 June 2023.

REQUIRED:

- 2.1 Indicate the following calculations on 30 June 2023 using the first-in-first-out (FIFO) method.
 - Value of closing stock
 - Cost of Sales
 - Gross Profit
- 2.2 Charles suspects that suitcases have been stolen. Provide a calculation to support his concern.
- 2.3 Charles is concerned about the volume of stock on hand.
 - Calculate for how long his closing stock is expected to last.
 - State ONE problem with keeping too much stock on hand and ONE problem with keeping insufficient stock on hand.

INFORMATION:

- **Stock balances:**

	UNITS	UNIT PRICE	TOTAL
Opening stock	420	R2 175	R913 500
Closing stock	496		?

- **Purchases, returns and carriage:**

	UNITS	UNIT PRICE	TOTAL
Purchases	3 155		R8 460 850
September 2022	850	R2 250	R1 912 500
December	980	R2 670	R2 616 600
March 2023	875	R2 930	R2 563 750
June* (see returns)	450	R3 040	R1 368 000
Returns* (from June purchases)	25	R3 040	R76 000

- **Sales:** 3 050 travel suitcases were sold at R4 200 each.

SUGGESTED ANSWER

Value of closing stock				
Purchases	71		<i>Step three (496 - 425)</i>	<i>Use Bottom-up calculations</i>
Purchases LESS returns	<u>450 – 25 or 425</u>		<i>Step two</i>	
Closing stock	<u>496</u>		<i>Step one</i>	
Purchases	71 x R2 930	=	208 030	
Purchases LESS returns	425 x R3 040	=	1 292 000	
Closing stock			R1 500 030	

Cost of sales

Opening stock + Net purchases - Closing stock
 R913 500 + (**R8 460 850** - R76 000) - 1 500 030 *Check closing stock above*
R8 384 850
 = R7 798 320

Gross profit

Sales – Cost of sales
 (3 050 x R4 200) - R7 798 320 *Check cost of sales above*
R12 810 000
 = R5 011 680

Number of items stolen

Opening stock	420	OR net purchases 3 130
Plus purchases	3 155	
Less returns	(25)	
Less closing stock	(496)	
Goods available for sale	3 054	
Less Sales	3 050	
Number of items stolen	4 units	

OR T ACCOUNT

Number of items lost			
Opening stock	420	Sales	3 050
Net purchases	3 130	Closing stock	496
		stolen items	4
	3 550		3 550

Calculate for how long his closing stock is expected to last.

Option 1	Option 2	Option 3
<u>Closing stock x 365 days</u> Cost of sales $\frac{R1\ 500\ 030 \times 365}{R7\ 798\ 320}$ 70.2 days <i>Cost of sales –check calculation above</i>	<u>units on hand</u> cost of sales (units) $\frac{496 \times 12 \text{ months}}{3\ 050}$ 1.95 months	<u>units on hand</u> cost of sales (units) $\frac{496 \times 365}{3\ 050}$ 59.4 days

State ONE problem with keeping too much stock on hand and ONE problem with keeping insufficient stock on hand.

Problem of keeping too much stock on hand	Problem of keeping insufficient stock on hand
- Goods can become obsolete and will be useless to customers - The staff may notice the less movement in stock and decide to steal	The business will not be able to meet the demands of customers and they may decide to buy somewhere.

WEIGHTED AVERAGE METHOD

- Weighted average method is used when lots of stock is bought in small quantities.
- The average price gives a good composite picture of the cost of the goods.
- At the end of the year when the closing stock value is determined, the average price will be used to calculate the value of the closing stock
- The average cost of a product is calculated by **dividing the cost of the units by the total number of the units.**



EXAMPLE 3 - WEIGHTED AVERAGE

3 HOT-WHEELS (PTY) LTD

You are provided with information relating to Hot-Wheels (Pty) Ltd for the three months ending 30 September 2022. The business trades in motorbikes and helmets.

Mike, the owner, wants to assess his stock records before any price increases during the year.

REQUIRED:

Helmets:

- 3.1 Calculate the value of the closing stock on 30 September 2022 using the weighted-average method. (9)
- 3.2 Mike suspects that helmets are being stolen from the shop despite security cameras being installed. (5)
- Provide a calculation to verify his suspicion. (5)
 - What can Mike do to improve the internal control of stock? State THREE points. (3)

INFORMATION:

A. Helmets:

Information for three months ended 30 September 2022:

Stock balances according to physical count:

	UNITS	COST PRICE PER UNIT (R)	TOTAL (R)
1 July 2022	30	R500	R15 000
30 September 2022	12		?

Purchases:

DATE	UNITS PURCHASED	COST PRICE PER UNIT (R)	TOTAL (R)
20 July 2022	25	R510	R12 750
20 August 2022	30	R525	R15 750
20 September 2022	20	R540	R10 800
TOTAL	75		R39 300

Returns: Five defective helmets from the purchases in August 2022 were returned to suppliers for a full refund.

Sales: 85 helmets were sold at R600 each.

SUGGESTED ANSWER

Value of closing stock	
$\frac{15\,000 + 39\,300 - 2\,625}{(30 + 75 - 5)}$ = 516.75 average price per unit 516.75 x 12 units = R6 201 (Closing stock) FORMULA USED: $\frac{\text{Opening stock} + \text{Purchases} - \text{Returns}}{\text{Opening stock} + \text{Purchases} - \text{Returns}}$ (RANDS) (UNITS)	$525 \times 5 = 2\,625$ <i>The average will be multiplied by 12 units</i>

Calculation to verify that stock is stolen	
$(30 + 75 - 5 - 12 - 85 = 3 \text{ units stolen})$	<i>Returns, closing stock and sales are deducted</i>

What can Mike do to improve the internal control of stock? State THREE points.
■ Do regular physical stock counts ■ Place tracking devices on the products / security price tags ■ Provide secure display cabinets for the stock ■ Improve security at the gates / inspect items and check to sales slip ■ Division of duties (if staff is suspected) ■ Buy in smaller quantities / more regularly

EXAMPLE 4

The following information was extracted from the records of Roux Traders for the financial year ended 28 February 2023. The business uses the **weighted-average method and the periodic inventory system** to value the stock of school bags.

REQUIRED:

Calculate the value of the closing stock

INFORMATION:**A. STOCK BALANCES**

Date	Units	Total
1 March 2022 (Opening stock)	150	R11 280
28 February 2023 (Closing stock)	635	?

B. PURCHASES

Date	Units	Unit price	Amount (before carriage)	Carriage (per unit)	Total amount
Purchases	2 700				R239 400
May 2022	800	R82	R65 600	R3,00	R68 000
August 2022	900	R83	R74 700	R3,00	R77 400
January 2023	1 000	R90	R90 000	R4,00	R94 000

C. Additional information:

- 40 school bags bought in May 2020 were donated to needy learners at a local school.
- 2 180 bags were sold for R130 each during the year. Fifteen (15) of these bags were returned by debtors.

SUGGESTED ANSWER**Value of closing stock**

$$\frac{11\,280 + 239\,400 - 3\,400}{(150 + 2\,700 - 40)}$$

$$\frac{247\,280}{2\,810} = R\,88$$

$$R\,88 \times 635 = R\,55\,880$$

NOTE:**Donation - 40 X 85 = 3 400**

Donations are deducted, the actual cost of each item 82+3 (for carriage)

Items returned by customers will not be deducted, items returned are included in our stock

The stock returned to suppliers –there won't be subtraction of carriage, normally delivery costs are charged by a different service provider.

Rands
(Units)

Opening stock + purchases – returns +carriage +custom duty
opening stock +purchases -returns

EXAM QUESTIONS

ACTIVITY 1: INVENTORY VALUATION (FREE STATE PRELIM 2019 -Adapted)

1.1 JOSE LADIES HANDBAGS

You are provided with information relating to Jose Ladies Bags. The store is situated in Welkom and is owned by Josephine Heyns. The business trades in handbags. Handbags are valued using the first-in-first-out method and periodic inventory system.

REQUIRED:

- 1.1.1 Calculate the following:
- Value of the closing stock on 31 December 2022. (5)
 - Gross profit for the year ended 31 December 2022. (8)
- 1.1.2 Josephine suspects that some handbags have been stolen despite the cameras installed in the store.
- Calculate the number of handbags that are missing. (6)
 - Explain to Josephine why she only discovered the loss at the end of the year. (2)
 - Suggest ONE additional measure that she can implement to address the problem of missing items. (2)

INFORMATION

A. Stock of handbags:

DATE	UNITS	Cost price per unit	TOTAL (including transport)
1 January 2022	180	R1 200	R237 600
31 December 2022	220	?	?

B. Purchases during the year:

DATE	UNITS	Cost price per unit	TOTAL (Including transport)
February 2022	250	R1 230	R338 250
June 2022	370	R1 250	R508 750
September 2022	200	R1 275	R280 500
	820		R1 127 500

Note: Carriage on purchases is charged at 10% of the cost price.

C. Returns:

20 units from September 2022 purchases were returned to suppliers. They only covered the cost of the units returned, excluding transport costs.

D. Sales:

740 units were sold at R1 750 each, R1 295 000.

WORKSHEET**1.1.1****Calculate the value of the closing stock on 31 December 2022.**

5

Calculate the Gross profit for the year ended 31 December 2022.

8

1.1.2**Calculate the number of handbags that are missing.****Explain to Josephine why she only discovered the loss at the end of the year.****Suggest ONE additional measure that she can implement to address the problem of missing items.**

2

ACTIVITY 2: INVENTORY VALUATION

2.1 INVENTORY VALUATION (FREE STATE 2020 PRELIM)

Battery Specialist, owned by Thabo Lefo, sells two types of AA 6-pack unit batteries, Longlast and Petcell. The business uses the **periodic inventory system** to record their stock.

- FIFO method is used for Longlast
- Weighted average method is used for Petcell

REQUIRED:

2.1.1 Calculate the following for **Longlast AA 6-pack units**:

- The value of the closing stock on 31 October 2022. (6)

- 2.1.2
- Calculate the average stock-holding period. Note that the cost of sales amounted to R483 750 for the year ended 31 October 2022.
 - Comment on your findings above. (6)

2.1.3 The owner is concerned about the sales of Petcell AA 6-pack units and is considering to discontinue this product line.

Calculate the following for **Petcell AA 6-pack units** for the year ended 31 October 2022:

- The value of the closing stock. (5)
- The cost of sales of the Petcell AA 6-pack units. (3)
- The stock turnover rate for the year. (5)

2.1.4 Give TWO reasons why the owner must discontinue the sales of Petcell AA 6-pack units. (4)

INFORMATION:

A. Stock valuation methods:

- **FIFO method** for Longlast AA 6-pack units
- **Weighted average method** for Petcell AA 6-pack units

B. Stock records showed the following balances:

Longlast AA 6-pack units				Petcell AA 6-pack units		
Date	Number of units	Price per unit	Total value	Number of units	Price per unit	Total value
1 Nov 2021	2 000	R20	R40 000	800	R35	R28 000
31 Oct 2022	?	?	?	1 850	?	?

C. The following purchases and returns were reflected during the year:

Longlast AA 6-pack units				Petcell AA 6-pack units		
	Number of units	Price per unit	Total value	Number of units	Price per unit	Total value
TOTALS:	35 000		756 000	3 000		120 200
Nov 2021	(1 000)	R20	(20 000)	500	R35	R17 500
Jan 2022	17 000	R20	R340 000	-	-	
March 2022	7 000	R22,50	R157 500	1 000	R39, 70	R39 700
June 2022	9 000	R23	R207 000	-	-	-
June 2022	(2 000)	R23	(R46 000)	1 500	R42	R63 000
Sept 2022	5 000	R23,50	R117 500	-	-	-

D. Sales for the year were reflected as follows:

Longlast AA 6-pack units			Petcell AA 6-pack units		
Number of Units	Selling price	Total value	Number of units	Selling Price	Total value
23 500	R35	R822 500	1 950	R75	R146 250

E. Due to good internal control measures, there were no missing items.

WORKSHEET**INVENTORY VALUATION:**

Calculate the value of the closing stock of Longlast AA 6-pack units on 31 October 2022.

6

Calculate the average stock-holding period, given the cost of sales amounted to R483 750 for the year ended 31 October 2022.

Comment on your findings above:

6

The owner is concerned about the sales of Petcell AA 6-pack units, and considers to discontinue this product line:

Calculate the value of the closing stock of Petcell AA 6-pack units.

5

Calculate the cost of sales of the Petcell AA 6-pack units.

3

Calculate the stock turnover rate for the year.

5

Give TWO reasons why the owner must discontinue the sales of Petcell AA 6-pack units.

4

ACTIVITY 3

3. INVENTORY VALUATION (GAUTENG PRELIM 2020 Adapted)

You are provided with information relating to Cases for Places for the 2020 financial year. The business sells handbags and suitcases. You are provided with figures relating to the Iccug handbags. They use the periodic inventory system and the weighted average method to value stock.

REQUIRED:

- 3.1.1 Calculate the value of the closing stock on 28 February 2023. (10)
- 3.1.2 Calculate the following for the year ended 28 February 2023:
- Cost of sales (3)
 - Gross profit (3)
 - Average stock-holding period (in days) (5)
- 3.1.3 Should the owner be satisfied with the stock-holding period calculated above? Explain. Quote figures. (3)

NOTE: The stock-holding period for 2022 was 65 days.

INFORMATION:

A. Stock balances:

DATE	UNITS	TOTAL (including carriage)
1 March 2022	90	R25 640
29 February 2023	194	?

B. Purchases:

DATE	UNITS	COST PRICE PER UNIT (excluding carriage)	TOTAL
15 March 2022	350	R280	R 98 000
20 July 2022	624	R310	R193 440
9 September 2022	1 095	R290	R317 550
10 February 2023	515	R300	R154 500
TOTAL	2 584		R763 490

C. Carriage on purchases:

Spot-on Deliveries transports the handbags to the business at a fixed cost of R20 per handbag. This rate remained unchanged.

D. Returns:

60 of the handbags purchased on 9 September 2022 were returned. The supplier credited the business with the cost price per item. No refund was received for carriage on purchases of these returns.

E. Sales: 2 420 units at R450 each**3.2 FIT & SLIM**

Fit & Slim is an outlet of Sports Galore Wholesalers. Stock is valued using the FIFO method. The following figures have been given to the owner, but he is not happy as the actual figures as per stocktaking and the figures of the Trading Stock records in the books do not agree.

REQUIRED:

Identify ONE different problem in respect of the manner in which each product is managed. Quote figures to support your answer. In each case offer practical advice.

(9)

	Gym towels	Golf caps	T-shirts
Opening stock in unit	120	80	150
Purchases in units	5 600	960	1 200
Sales in units for the year	4 800	840	930
Closing stock in units	810	200	420
Selling price per unit	R45	R125	R350
Period of stock on hand	50 days	70 days	215 days
Cash deposited for the year	R216 000	R100 000	R325 500

WORKSHEET

3.1.1 CASES FOR PLACES

Calculate the value of closing stock on 28 February 2023.

10

3.1.2

Calculate the cost of sales.

3

Calculate the gross profit.

3

Calculate the average stock-holding period (in days).

5

- 3.1.3 Should the owner be satisfied with the stock-holding period calculated above? Explain. Quote figures. NOTE: The stock-holding period for 2022 was 65 days.

3

- 3.2 Identify ONE different problem in respect of the manner in which each product is managed. Quote figures to support your answer. In each case offer practical advice.

	Problem with figures	Possible solution
Gym towels		
Golf caps		
T-shirts		

9

SESSION 14: INVENTORY VALUATION-STOCK IDENTIFICATION

SPECIFIC IDENTIFICATION

In the previous session we discussed the two inventory systems namely perpetual and periodic inventory system. FIFO and Weighted average stock valuation methods were also covered and this module will focus on the Specific Identification method.

The session will also focus on the problem-solving content an internal controls and activities that are consolidated activities on stock valuation methods



Note that examiners will assess you on two of the stock valuation methods, the third method if included might test the knowledge of concepts, therefore it is very important to work out the examples and the attached past papers to practice.

SPECIFIC IDENTIFICATION

- This is the simplest form of stock validation, where every item is assigned a specific cost price.
- Each item sold is specifically identified as it appeared on the purchases invoice
- This system is relevant when large commodities are sold and every unit has its own cost price, e.g. vehicles, machinery, etc.
- Specific identification is manually intensive method in managing the stock.
- Every item in stock will be recorded at the specific original cost price.



Calculation of closing stock using Specific Identification method:

	UNITS					
Laptops - Model	Opening stock +	Purchases -	Returns -	Sales	=	Closing Stock x Cost per unit
	Stock Plus Purchases Less Returns Less Sales					
Mecer	200	250	40	390		20 X R5 000 = R100 000
Toshiba	-	400	-	350		50 X R5 500 = R275 000
						Units on hand x Price per item

EXAMPLE 1**INFORMATION**

- Bought 5 BMW cars for R100 000 each on credit from Durban Cars. These cars are imported from Germany and a customs duty fee of R12 000 is charged per car. Paid the customs duty through electronic funds transfer (EFT).
- Sold 1 BMW car to a customer on credit.

REQUIRED

Calculate the value of closing stock.

EXPECTED ANSWER

Value of closing stock
$(100\,000 \times 5) + (12\,000 \times 5)$ $= 500\,000 + 60\,000$ $= 560\,000$ (cost price) $560\,000 - (100\,000 + 12\,000)$ $= 560\,000 - 112\,000 = \mathbf{448\,000 \text{ closing stock}}$

EXAMPLE 2 : SPECIFIC IDENTIFICATION**(2019 NSC NOV ADAPTED)****GEORGE GRANDE**

George Grande is the majority shareholder and CEO of Grande Ltd. The year-end is 30 September 2022.

During April 2022, 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.

REQUIRED:

Calculate the value of the closing stock of TV sets on 30 September 2022 using the specific identification method.

A. 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

SUGGESTED ANSWER

Calculate the value of the closing stock of TV sets on 30 September 2022 using the specific identification method.		
Workings		Answer
LYN:	$(800 + 500 - 430) \times 6\,000 = 5\,220\,000$ A 1300 OR $(1\,300 \times 6\,000) - (430 \times 6\,000)$ $7\,800\,000 - 2\,580\,000 = 5\,220\,000$	R11 772 000 (A+B)
KYA:	$(950 + 500 - 540) \times 7\,200 = 6\,552\,000$ B 1 450 OR $(1\,450 \times 7\,200) - (540 \times 7\,200)$ $10\,440\,000 - 3\,888\,000 = 6\,552\,000$	

INTERNAL CONTROL – INVENTORIES

- Count stock regularly/randomly and check against stock records
- Order smaller quantities, but more frequently
- Improve physical security e.g., controls at entrance/security cameras
- Insure the stock against theft, fire and damages resulting from natural disaster
- Division of duties-receiving of stock, payments and stock keeping should be done by separate individuals to minimise the risk of fraudulent activities.
- Check if records of stock received match with payments for the stock

PROBLEM SOLVING QUESTIONS

From page 46 of this session, you are introduced to problem solving questions, workout the calculations illustrated in example 3, and follow the guidelines provided to assist you identify problems. When analysing problems, you need to support them with figures and you should be able to provide solutions that can be implemented.



The table presented on page 50 of this session is important for exams, the table provides formulas and approach that can be followed when responding to calculations on inventory, **95% PLUS** of examinable calculations on inventories are addressed in the information provided.

EXAMPLE 3 AND EXPECTED ANSWER

PROBLEM SOLVING – INVENTORY 2019 FREE STATE

Ben G Mobile Traders has two branches in two different towns selling laptops. Ben, the owner, is **concerned about the performance of each branch and has decided to investigate**. Information for the two branches for March 2023 is presented below:

REQUIRED:

Identify ONE problem in relation to each branch. Quote relevant figures to support your answer. In each case, offer Ben advice on how to solve the problem. (8)

INFORMATION:

A. General information for both branches (per month)			
Normal time	Monday to Fridays	8:30–16:30	160 hours
Overtime	Mondays to Fridays	16:30–18:30	40 hours
	Saturdays	9:30–12:30	12 hours
	Total		52 hours

Overtime salary/wage is **1½ times** the normal rate.

Added column – to assist with problem analysis		MC QUARTZ BRANCH	QWERT BRANCH
	Stock on hand (1 March 2023)	80 units	80 units
	Selling price per unit	R5 800	R5 800
Qwert-few units sold	Units sold	58	47
Qwert- more units returns	Units returned by customers	3	8
Missing cash, check calculation below	Credit sales	R191 400	R104 400
	Cash received and deposited from cash sales	R120 000	R121 800
Qwert-normal hours are few @75% [120/160 x100]	Hours worked (normal time)	156 hours	120 hours
Qwert –more hours of overtime @96% [50/52 x100]	Overtime hours	10 hours	50 hours
	Rent expense per month	R8 000	R8 000

Sales-Quartz	Sales-Qwert
$(5800 \times 58) - (5800 \times 3) = 319\ 000$ <i>Expected income</i> 336 400 17 400 $191\ 400 + 120\ 000 = 311\ 400$ (Credit sales +cash received) R7 600 is missing (319 000- 311 400)	$(5800 \times 47) - (5800 \times 8) = 226\ 200$ <i>Expected income</i> 272 600 46 400 $104\ 400 + 121\ 800 = 226\ 200$ (Credit sales +cash received) No missing cash

	PROBLEM ✓✓ ✓✓	ADVICE ✓✓ ✓✓
MC QUARTZ BRANCH	Only R120 000 deposited instead of R127 600 – R7 600 cash is missing. 60% of total sales is on credit.	Division of duties Regular check on sales and deposit. Increase cash sales/ reduce the credit sales.
QWERT BRANCH	8 units were returned. Worked only 75% of the normal time/ worked 96% of the overtime	Set sales targets. Calculate commission on net sales. Minimise overtime hours.

$R191\ 400 / 319\ 000 \times 100 = 60\%$

Structure of problem-solving questions - Inventories			
Problems that relate to internal control and decision making			
Type of problem	Explain and quote figures, percentages etc.		Possible Response/Answer: Solution to a problem or advice
Closing stock	♣ Fewer items		♣ Order sufficient to avoid loss to business or customers
	♣ Excessive /high number of items		♣ Keep reasonable levels of stock –to avoid theft of stock
Sales compared to cash deposit	♣ Sales figure exceeding the cash deposit		♣ Check cash regularly before making daily deposits ♣ Division of duties
Profit mark-up	♣ High Mark-up	Compared to other branches	♣ If too high reduce it to a percentage NOT LOWER than what other businesses' charge
	♣ Low Mark-up		♣ Increase mark-up (reasonable %), Should not exceed % charged by competitors
Selling price per unit	♣ Too low/high comparing to other competitors		♣ Increase/reduce selling price between R 200 and R300 or between 25% and 40%
Number/Percentage of sales	♣ Lower percentage of sales will result to stock piling. [compare purchases and sales]		♣ Regular counts of stock will identify items that are less demanded. [purchase lesser] ♣ Commission should be introduced to motivate sales personnel to sell more items ♣ Introduce a differently branded item
Missing stock	♣ Number of units stolen		♣ Regular counts of stock ♣ Increase physical security e.g. install cameras, portable expensive items be kept in locked cabinets. [refer to internal controls on inventory]

Structure of problem-solving questions - Inventories		
Problems that relate to internal control and decision making		
Type of problem	Explain and quote figures, percentages etc.	Possible Response/Answer: Solution to a problem or advice
Stock turnover rate	♠ Low stock turnover –the product could be unpopular to customers	♠ Increase stock turnover rate by improving marketing/advertising strategies
Stock holding Period	♠ Higher stock Holding period	♠ Improve marketing strategies for business to reduce stock holding period
Number of orders vs Sales	♠ Ordered goods exceeding sales	♠ Follow-up on orders to reach all the targeted sales. ♠ Customers who place orders should pay deposit upfront ♠ Order as per customer specifications
Returns by customers	♠ Higher returns by customers	♠ The business should order good quality products to reduce returns. ♠ Avoid cheaper goods of inferior quality ♠ Possible change to new supplier ♠ Order as per customer specifications ♠ Check quality before accepting stock delivered
Advertising expense	♠ High Advertising Expense but not satisfactory sales figures	♠ The business should use lower cost but effective methods to advertise the products.
Rent expense	♠ High mount of Rent expense compared to other stores or branches	♠ Look for cheaper business premises
Cash Sales Vs Credit sales	♠ Higher Credit sales, result to cash flow problems	♠ Encourage cash sales by offering cash discount

NOTE: The type of problems reflected above may indicate poor internal control and inappropriate decisions taken by management.

INVENTORIES: Calculations expected in exams

• Number of items stolen	Opening stock + Purchases – Returns –Sales –Donations – Drawings -Closing stock		
• Number of items on hand	Opening Stock + Purchases +Carriage on Purchases + Import duties – Returns – Closing Stock –Donations – Drawings		
• Value of stock on hand	Specific Identification/FIFO/Weighted Average Method – Check the slide below:		
• Cost of sales	USE Periodic/Perpetual inventory system [Periodic –check the slide three]		
• Gross profit	Sales – Cost of Sales = Gross profit OR [(C.stock +Sales) - (O.Stock+Purchases+Carriage+Custom Duty)]	OR T Account	
• Mark-up achieved	$\frac{\text{Gross Profit}}{\text{Cost of sales}} \times 100$		
• Calculate the unit price	<u>Opening stock + purchases – returns +carriage +custom duty</u> units of opening stock +purchases -returns	• formula is used to calculate the <u>value of closing stock</u> when using weighted average method	
• Calculate how long (in days) it is expected to sell the closing stock OR Stock Holding period	$\frac{\text{Average inventory}}{\text{Cost of sales}} \times 365 \text{ days}$ OR		
	$\frac{\text{Units of stock on hand}}{\text{Units sold}} \times 365 \text{ days}$ OR		
	$\frac{\text{Closing stock} \times 365 \text{ days}}{\text{OP stock} + \text{Purchases} - \text{Returns} - \text{Closing Stock}}$		Cost of sales

CONSOLIDATION ACTIVITIES

ACTIVITY 1: INVENTORY VALUATION AND INTERNAL CONTROL

NSC FEB/MARCH 2018 -Adapted

(35 marks)

1.1 Choose the correct word(s) from those given in brackets. Write only the word(s) next to the question number (1.1.1–1.1.3) in the ANSWER BOOK.

1.1.1 Merchandise purchased is recorded as an (asset/expense) to the business in the perpetual inventory system. (1)

1.1.2 The (specific identification/weighted-average) stock valuation method is best suited for unique high-value products. (1)

1.1.3 Cost of sales is usually calculated at the end of the financial year in the (periodic/perpetual) inventory system. (1)

1.2 MONGI TRADERS

You are provided with information relating to Mongi Traders. The business sells one type of plastic table. Their financial year ends on 31 December. The business uses the FIFO method to value their stock. They use the periodic inventory system.

REQUIRED:

1.2.1 Calculate the value of the closing stock according to the FIFO method on 31 December 2022. (6)

1.2.2 Calculate the following for the year ended 31 December 2022:

- Cost of sales
- Gross profit (8)

1.2.3 The owner considers changing the stock valuation method to the weighted-average method.

- Calculate the value of the closing stock on 31 December 2022 by using the weighted-average method. (6)
- What will be the effect on the gross profit if the owner changes to this valuation method? Provide figures. (3)

INFORMATION:**A. Inventories:**

DATE	NUMBER OF UNITS	PER UNIT	TOTAL VALUE
1 January 2022	540	R350	R189 000
31 December 2022	440	?	?

B. Purchases and returns in 2022:

Purchases:						
DATE	NO. OF UNITS	PER UNIT	TOTAL PURCHASES	CARRIAGE PER UNIT	TOTAL CARRIAGE	TOTAL PURCHASE COST
31 Mar.	550	R370	R203 500		R13 750	R217 250
30 Jun.	900	R380	R342 000		R22 850	R364 850
30 Sep.	500	R350	R175 000	R25	R12 500	R187 500
30 Nov.	300	R400	R120 000	R30	R9 000	R129 000
Totals	2 250		R840 500		R58 100	R898 600
Returns:						
DATE	NO. OF UNITS	PER UNIT	TOTAL RETURNS	CARRIAGE PER UNIT	TOTAL CARRIAGE	
5 Jul.	50	R380	R19 000	0	0	
These returns are from the purchases of June 2017. There is no refund for carriage.						

C. Sales:

2 300 units at R600 each = R1 380 000

1.3 INTERNAL CONTROL

You are provided with information relating to Leno Furnishers. They sell tables, chairs and beds for cash only. The owner is concerned that the figures provided reflect poor internal control and decision-making.

Identify ONE problem for each product. Quote figures. In EACH case, give advice on how to solve the problem.

(9)

INFORMATION:

Information from the records for the financial year:

	TABLES	CHAIRS	BEDS
Opening stock (units)	50	209	300
Units purchased	670	2 390	380
Units sold	600	2 400	480
Units as per physical count at year-end	90	199	200
Selling price per unit	R1 500	R800	R3 000
Total sales (amounts deposited)	R900 000	R1 800 000	R1 440 000

WORKSHEET

1.1

1.1.1	
1.1.2	
1.1.3	

3

1.2.1

Calculate the value of the closing stock according to the FIFO method on 31 December 2022.

6

1.2.2

Calculate the cost of sales.

Calculate the gross profit.

8

1.2.3

Calculate the value of the closing stock on 31 December 2022 by using the weighted-average method.

What will be the effect on the gross profit if the owner changes to this valuation method? Provide figures.

6

3

1.3

You are provided with information relating to Leno Furnishers. They sell tables, chairs and beds for cash only. The owner is concerned that the figures provided reflect poor internal control and decision-making.

Identify ONE problem for each product. Quote figures. In EACH case, give advice on how to solve the problem.

Product	Problem (with figures)	Advice
Tables		
Chairs		
Beds		

9

TOTAL MARKS
35

ACTIVITY 2: INVENTORY VALUATION AND PROBLEM SOLVING - LIMPOPO 2020 (40 marks; 32 minutes)

2.1 CONCEPTS:

Choose the stock system/valuation method from the list provided, that is best described by each of the statements below. Write only the stock system/valuation method next to each number (2.1.1 – 2.1.3) in the ANSWER BOOK.

perpetual inventory system; weighted-average method;
specific identification method; periodic inventory system; first in first out (FIFO)

- 2.1.1 This method assumes that stock is sold in order of date purchased.
- 2.1.2 This system ensures that cost of sales is calculated at the point of sale.
- 2.1.3 This stock system is more suited for low value goods that are purchased in bulk.
(3 x 1) (3)

2.2 SMART CARS TRADERS

Smart Cars Traders buy and sell BMW cars. The business uses the specific identification method for stock valuation. The financial year ends 30 June 2023.

REQUIRED:

- 2.2.1 Calculate the selling price per BMW 3 series sold during the 2023 financial year. (2)
- 2.2.2 Calculate the value of the closing stock on 30 June 2023 using the specific identification method. (6)

INFORMATION:

- A. Three different models of BMW cars were sold during the 2023 financial year.

MODELS	UNITS	UNIT PRICE	TOTAL	UNITS SOLD	TOTAL SALES
PURCHASES:					
BMW 3 series	10	R310 000	R3 100 000	10	R4 340 000
BMW 4 series	15	R480 000	R7 200 000	8	R5 376 000
BMW 5 series	12	R620 000	R7 440 000	5	R4 340 000
RETURNS:					
BMW 5 series	2	R620 000	(R1 240 000)		
Net purchases			R16 500 000		

2.3 DENNIS STORES

Dennis Stores sells one type of motorsport sunglasses. The financial year ends on 28 February 2023. The business uses the weighted-average method for stock valuation and the periodic inventory system.

REQUIRED:

2.3.1 Calculate the value of the closing stock on 28 February 2023 using the weighted-average method. (8)

2.3.2 Calculate following for the year ended 28 February 2023:

- Cost of sales
- Gross profit (6)

2.3.3 Calculate the average stock holding period (in days) on 28 February 2023. (5)

INFORMATION:

A. Stock:

DATE	PAIRS OF SUNGLASSES	TOTAL VALUE (INCLUDING CARRIAGE)
1 March 2022	510	R313 220
28 February 2023	320	?

B. Purchases:

DATE	PAIRS OF SUN-GLASSES	COST PRICE PER PAIR	TOTAL PURCHASES	CARRIAGE PER PAIR	TOTAL COST (INCLUDING CARRIAGE)
25/05/2022	460	R650	R299 000	R18	R307 280
02/08/2022	700	R680	R476 000	R18	R488 600
20/10/2022	500	R710	R355 000	R30	R370 000
01/02/2023	300	R725	R217 500	R30	R226 500
TOTAL	1 960		R1 347 500		R1 392 380

C. Returns:

Twenty pairs of sunglasses from the purchases on 1 February 2023 were returned to the supplier due to poor quality. The business account was credited with R15 100 (including carriage on purchases).

D. Sales:

2 115 pairs of sunglasses were sold at R1 400 each during the year.

2.4 PROBLEM-SOLVING

You are provided with information relating to three sneakers shops with different owners in Sabie. Each shop has a floor space of 100m².

REQUIRED:

- 2.4.1 Identify ONE problem in Shop 1 and ONE problem in Shop 2. Quote figures. IN each case, give ONE point of advice. (6)
- 2.4.2 Explain TWO good decisions that Frank has made in respect of Shop 3. Quote figures. (4)

Information per shop for December 2022:

	SHOP 1	SHOP 2	SHOP 3
Managers	Portia	Prudy	Frank
Sales	R340 000	R290 000	R900 000
Returns from customers	R4 320	R58 000	R18 000
Mark-up percentages	85%	50%	60%
Stock-holding period	150 days	30 days	30 days
Advertising	R9 000	R5 800	R36 000
Rent expense	R15 000	R20 000	R30 000
Days worked per week	6	5	7

WORKSHEET 2

2.1

2.1.1	
2.1.2	
2.1.3	

3

2.2 SMART CARS TRADERS

2.2.1

Calculate the selling price per BMW 3 series sold during the 2023 financial year.

2

2.2.2

Calculate the value of the closing stock on 30 June 2023 using the specific identification method.

6

2.3 DENNIS STORES

2.3.1

Calculate the value of the closing stock on 28 February 2023 using the weighted-average method.

8

2.3.2 Calculate the following for the year ended 28 February 2023:

Cost of sales:

Gross profit:

6

2.3.3 Calculate the average stock holding period (in days) on 28 February 2023.

5

2.4 PROBLEM SOLVING

2.4.1 Identify ONE problem in Shop 1 and ONE problem in Shop 2. Quote figures. In EACH case, state ONE point of advice.

BRANCH	PROBLEM AND FIGURE	ADVICE
Shop 1		
Shop 2		

6

2.4.2 Explain TWO good decisions that Frank has made in respect of Shop 3. Quote figures.

4

TOTAL MARKS
40

ACTIVITY 3: INVENTORY VALUATION**(45 marks; 25 minutes)****NSC 2019 NOV -Adapted**

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 2022.

REQUIRED:**CABINETS**

- 3.1 Calculate the value of closing stock for cabinets on 30 September 2022 using the first-in first-out method. (6)
- 3.2 In 2022, 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 2022. (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 2022, 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 2022 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. 2021	370	R800	R296 000	600	R108 000
30 Sep. 2022	280		?	265	R59 625
Purchases: 2022					
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:

	2022	2021
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

WORKSHEET 3

CABINETS

3.1

Calculate the value of closing stock using FIFO.	
Workings	Answer

6

3.2.1

Calculate the % mark-up achieved in 2022.	
Workings	Answer

4

3.2.2

Provide TWO points (with figures) to prove that this decision achieved its aims.	
Point 1	
Point 2	

4

3.2.3

The CEO feels that this decision also negatively affected the company.	
Provide TWO points (with figures) to support his opinion.	
Point 1	
Point 2	
Give the directors advice to solve this problem. Explain TWO points.	
Point 1	
Point 2	

4

2

LAMPS

3.3	Calculate the stockholding period for lamps (use closing stock).		<table border="1"> <tr><td> </td></tr> <tr><td>3</td></tr> </table>		3
	3				
Workings	Answer				

3.4	Calculate the number of missing lamps.		<table border="1"> <tr><td> </td></tr> <tr><td>5</td></tr> </table>		5
	5				
	Workings	Answer			
Give TWO suggestions to solve this problem.		<table border="1"> <tr><td> </td></tr> <tr><td>4</td></tr> </table>		4	
4					
Suggestion 1					
Suggestion 2					

TELEVISION SETS

3.5	Calculate the value of the closing stock of TV sets on 30 September 2022 using the specific identification method.		<table border="1"> <tr><td> </td></tr> <tr><td>7</td></tr> </table>		7
	7				
Workings	Answer				

3.6	Explain THREE different concerns that George would have about this problem.		<table border="1"> <tr><td> </td></tr> <tr><td>6</td></tr> </table>		6
	6				
	Concern 1				
	Concern 2				
Concern 3					

TOTAL MARKS
45/.....

SESSION 15: MANAGEMENT OF TANGIBLE ASSETS

TANGIBLE ASSETS

- Tangible or Fixed assets acquired by the business are not intended for resale but to be used for daily operations of the business to generate profit.
- The examples of fixed assets are listed below:
 - Land and buildings
 - Vehicles
 - Equipment
- The value of Tangible assets such as vehicles and equipment depreciate because of wear and tear resulting from daily use.
- The value of land and buildings appreciates if the property is well maintained.

CONCEPTS UNIQUE TO TANGIBLE ASSETS	
Depreciation	A reduction in the value of an asset over time due in particular to wear and tear.
Accumulated Depreciation	Is the total amount 'of depreciation deducted from the fixed asset since its acquisition.
Carrying value / book value	Original cost price less the depreciation that has accumulated over the period in which the asset has been in the business.
Age of Assets	Businesses should monitor their assets to identify assets that need to be replaced. Assets that are old due to wear and tear should be replaced with efficient assets.
Replacement Rate	It refers to how often the business determines a fixed asset will be replaced.
Replacement Value of Assets	When a fixed asset has to be replaced, the business needs to look if it is worth replacing the old asset and what it will cost them to buy the new asset.
Lifespan of assets	Estimated length of time the asset can reasonably be used to generate income and be of benefit to the business.

ACQUISITION OF ASSETS

Factors to be considered when new equipment is acquired (bought)

- The existing equipment has become old / out of date.
- Running costs of current assets may be too high.
- The business wants to keep up to date with new technology.

ASSET REGISTER

Is the list of assets that belong to the entity. The purpose of fixed asset register is to keep track of the book value of assets and determine the depreciation to be calculated and recorded for management and taxation purpose.

The business should keep every transaction relating to an asset in the fixed asset register. Each asset owned by the business should have a detailed entry page in the register.

DETAILS OF ASSETS RECORDED IN THE ASSET REGISTER

• Date of purchase	• Rate of depreciation
• Cost Price	• Book value
• Details of the seller	• Life expectancy
• Type and model	• Method of depreciation
• Serial number	• Depreciation
• Receipt/Invoice	• Accumulated depreciation

A FIXED ASSET REGISTER FORMAT

D M TRADERS NO.1			
Asset register			
General ledger account:	Vehicle account (B 6)		
Item:	Nissan delivery van 2 litre	Date purchased:	1 March 2021
From whom purchased:	Nissan Monument	Cost price:	R180 000
Percentage Depreciation:	20 % p.a. at cost price/straight line method		
Details of depreciation			
Dates	Annual depreciation Calculations	Accumulated depreciation	Book value or known as "Carrying value"



NOTE: only one asset will be recorded in this register

DEPRECIATION METHODS

FIXED METHOD

- Takes place over the **useful life** of the asset at a fixed rate. (e.g. over 5 years at 20% p.a.)

DIMINISHING BALANCE

- Writing off of depreciation on the **carrying value** at a fixed percentage (e.g. 15% p.a.)
- Writing off takes place over a longer period.

Standard formula used to calculate depreciation

ART	Amount	x	Rate (%)	X	Time	=	Depreciation
-----	--------	---	----------	---	------	---	--------------

Disposal of Tangible Assets

Fixed assets are **not purchased for the purpose of resale** in the normal course of running a business, however if the owner no longer requires the asset he may decide to dispose or sell it.

In an event an asset is sold the ,the business will have to **derecognise or remove** the assets from the financial assets of the business.

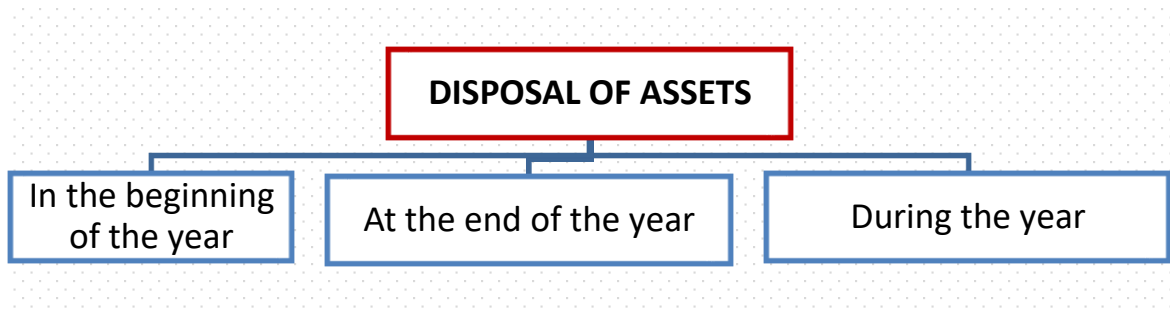
What are the reasons for disposing Tangible Assets?

- The existing asset is too old or has outlived its useful life
- Vehicles may have been involved in accidents
- Damaged assets that cannot be used by a business anymore
- Asset may be obsolete
- The existing asset is too old or has outlived its useful life

Different methods of disposing assets

Methods of disposing Tangible Assets	Account affected
■ Asset can be sold for cash ■ Asset can be sold on credit ■ They can be donated ■ Taken for personal use by the owner ■ They can be traded-in ■ Scrapped ■ Assets can be written off because of damages	■ Bank account ■ Debtors Control ■ Donation ■ Drawings ■ Creditors Control ■ Write off, no payment ■ Insurance claim approved/Accrued income

When are the Tangible Assets disposed?



Assets are disposed at a:

- Carrying Value (No profit or loss incurred)
- Profit (Above the carrying value)
- Loss (Below the carrying value)

NOTE : Carrying Value is the difference between the Cost Price and the Accumulated Depreciation

FORMAT OF AN ASSET DISPOSAL ACCOUNT AND ASSET ACCOUNT

DR				Asset Disposal				CR	
Mar	1	Equipment / Vehicle	xxxx	Mar	31	Accumulated depreciation on equipment		xxx	
						Bank /Debtors Control/Creditors Control / Donation/Drawings		xxx	
						Loss on sale of asset		xx	
			xxxx					xxxx	

Profit on sale of asset is recorded on the debit side

DR				Asset Account				CR	
Mar	1	Balance b/d @cost	xxxx	Mar	31	Asset disposal @cost		xxx	
		Bank /Creditors Control @cost				Balance c/d @cost		xxx	
			xxxx					xxxx	
		Balance b/d @cost	xxxx					xxxx	

NOTE: When assets are bought, the transaction will be recorded on the debit side and when the sales will be recorded on the credit side.

FORMAT –NOTE ON TANGIBLE ASSETS

Note 3 - Fixed/Tangible assets

	Land & Buildings	Vehicles/ Equipment
Carrying value at the beginning of the financial year	xxxx	xxxx
Cost	xxxx	xxxx
Accumulated depreciation	Nil	(xxx)
Movements		
Additions at cost	xxxx	xxxx
Disposals at carrying value	(xxx)	(xxx)
Depreciation	Nil	(xxx)
Carrying value at the end of the financial year	xxxx	xxxx
Cost	xxxx	xxxx
Accumulated depreciation	Nil	(xxx)

Tangible assets are recorded at a carrying value and reduce the balance of assets

These balances will exclude the asset that has been disposed off

EXAMPLE 1 - ASSETS BOUGHT AND SOLD DURING THE YEAR

INFORMATION

The financial year of BBB Traders ends on 28 February 2021.

The following balances appeared on 1 March 2020:

- Vehicles R312 000
- Accumulated depreciation on vehicles R104 000

TRANSACTIONS

- On 31 August 2020 BBB Traders sold an old vehicle to Zee Traders for R47 200 on credit. This vehicle originally cost R76 000. The total amount of depreciation at the beginning of the year amounted to R34 200.
- On 1 December 2020 a new delivery vehicle was bought for cash R200 000, the funds were transferred electronically to the motor dealer.

NOTE: Depreciation is calculated at 20% per annum on the diminishing balance method.

REQUIRED

1. Prepare the following accounts in the General Ledger:

- Equipment Account
- Accumulated depreciation
- Asset Disposal
- Note on Tangible Assets

SUGGESTED ANSWER

Calculation for carrying value for new and remaining assets:

	Total Assets	Sold Asset	Remaining Assets
Cost	312 000 -	76 000 =	236 000
Acc Depreciation	(104 000) -	(34 200)* =	(69 800)
Carrying Value	208 000 -	41 800 =	166 200

Calculate Depreciation for each category of assets:

Sold	Old	New
$41\,800 \times 20\% \times 6/12 = 4\,180^*$	$166\,200 \times 20\% = 33\,240$	$200\,000 \times 3/12 \times 20\% = 10\,000$
Total Depreciation: $4\,180 + 33\,240 + 10\,000 = 47\,420$		

GENERAL LEDGER OF BBB TRADERS

VEHICLES									
2020 Mar	1	Balance	b/d	236 000	2021 Feb	28	Asset disposal	GJ	76 000
2020 Dec	1	Bank		200 000			Balance	c/d	360 000
				436 000					436 000
2021 Mar	1	Balance	b/d	360 000					

Note: Each amount is recorded at cost in the Asset Account.

$34\ 200^* + 4\ 180^* = 38\ 380$
Depreciation of asset sold

$33\ 240 + 10\ 000$
Remaining and new asset

Depreciation of an asset sold

Accumulated depreciation on vehicles									
2021 Feb	28	Asset disposal	GJ	**38 380	2020 Mar	1	Balance	b/d	104 000
					Aug	31	Depreciation	GJ	4 180
		Balance	c/d	113 040	2021 Feb	28	Depreciation	GJ	43 240
				151 420					151 420
					2021 Mar	1	Balance	b/d	113 040

NOTE: When you sell an asset you need to remove the cost price of the asset and the accumulated depreciation from the books of the business.

Asset disposal									
2020 Aug	31	Vehicle	GJ	76 000	2020 Aug	31	Accumulated depreciation on vehicle	GJ	*38 380
		Profit on sale of an asset	GJ	9 580			Debtors control	CRJ	47 200
				85 580					85 580

GENERAL LEDGER OF BBB TRADERS

VEHICLES									
2020 Mar	1	Balance	b/d	236 000	2021 Feb	28	Asset disposal	GJ	76 000
2020 Dec	1	Bank		200 000			Balance	c/d	360 000
				436 000					436 000
2021 Mar	1	Balance	b/d	360 000					

Note: Each amount is recorded at cost in the Asset Account.

$$34\,200^* + 4\,180^* = 38\,380$$

Depreciation of asset sold

$$33\,240 + 10\,000$$

Remaining and new asset

Depreciation of an asset sold

Accumulated depreciation on vehicles									
2021 Feb	28	Asset disposal	GJ	**38 380	2020 Mar	1	Balance	b/d	104 000
					Aug	31	Depreciation	GJ	4 180
		Balance	b/d	113 040	2021 Feb	28	Depreciation	GJ	43 240
				151 420					151 420
					2021 Mar	1	Balance	b/d	113 040

NOTE: When you sell an asset you need to remove the cost price of the asset and the accumulated depreciation from the books of the business.

Asset disposal									
2020 Aug	31	Vehicle	GJ	76 000	2020 Aug	31	Accumulated depreciation on vehicle	GJ	*38 380
		Profit on sale of an asset	GJ	9 580			Debtors control	CRJ	47 200
				85 580					85 580

NOTE 3 ON TANGIBLE ASSETS		Calculations
	Vehicles	
Carrying value at the beginning of the financial year	208 000	
Cost	312 000	
Accumulated depreciation	(104 000)	
Movements		
Additions at cost	200 000	
Disposals at carrying value	(37 620)	$76\ 000 - 34\ 200 - 4\ 180 = 37\ 620$
Depreciation	(47 420)	$4\ 180 + 33\ 240 + 10\ 000 = 47\ 420$
Carrying value at the end of the financial year	322 960	
Cost	436 000	$312\ 000 - 76\ 000 + 200\ 000 = 436\ 000$
Accumulated depreciation	(113 040)	$104\ 000 + 47\ 420 - 34\ 200 - 4\ 180 = 113\ 040$

FULLY DEPRECIATED ASSETS (ASSETS WITH CARRYING VALUE OF R1)

EXAMPLE 2

REQUIRED

- Calculate the depreciation for the current year
- Indicate how the information provided below will appear in the Financial Statements

INFORMATION

Cost	R100 000
Accumulated depreciation at the beginning of the year	95 000

NOTE –depreciation on vehicles is calculated at 10% using the cost price method.

SUGGESTED SOLUTION - DEPRECIATION

$100\ 000 \times 10\% = 9\ 000$ This amount cannot be regarded as depreciation it is above the Carrying value of R5 000 (R100 000 – 95 000)

The correct calculation for depreciation is Book Value LESS R1 (R5 000 –R1) = R4 999

NOTE –Assets cannot be depreciated at an amount above their cost price

CHECK- the balances provided above, there's a small difference between the cost price and the accumulated depreciation. R100 000 – R95 000 = R5 000

Amount to be recorded in the income statement or statement of comprehensive income

Income Statement at the end of current year		Income Statement at the end of following yr.	
Operating expenses		Operating expenses	
Depreciation	R4 999	Depreciation	None

Amount that will be recorded in the Note on Tangible Assets:

Note on Tangible Assets –Current year		Note on Tangible Assets - Following year	
Cost	100 000	Cost	100 000
Accumulated Depreciation	(95 000)	Accumulated Depreciation	(99 999)
Carrying Value	5 000	Carrying Value	1
Movements		Movements	
Depreciation	4 999	Depreciation	0
Carrying Value	1	Carrying Value	1
Cost	100 000	Cost	100 000
Accumulated Depreciation	(99 999)	Accumulated Depreciation	(99 999)

NOTE: According to Historical Concept, the actual cost price of an asset will always be reflected in the note irrespective of the decline in the value.

Balance Sheet –Current year		Balance Sheet - Following year	
Assets		Assets	
Non- Current Assets		Non- Current Assets	
Tangible Assets	R1	Tangible Assets	R1
Financial Assets		Financial Assets	



The asset will be reflected at R1 in the Balance sheet until the business decides to sell or dispose the asset (in the next activities you will be introduced to asset disposal)

NOTE in most activities the business will have more than one vehicle, therefore it is unlikely for a large business to have a carrying value of R1, this figure will be combined with the carrying value of other vehicles.

ACTIVITY 1**ADAPTED****NSC NOV 2018****TANGIBLE ASSETS****21 Marks****1. MINDEW LIMITED**

The financial year-end is 31 May 2021.

REQUIRED:

- 1.1 Calculate the missing figures indicated by (i) to (v) in the table below. (17)
- 1.2 Explain how the internal auditor should check that movable fixed assets were not stolen. (2)
- 1.3 Land and buildings were bought five years ago for R6 m. Property prices have increased by 20% since then. The directors want to increase the value of this asset and reflect a profit of R1 200 000 in the financial statements.
As an independent auditor, what advice would you give? Provide ONE point. (2)

INFORMATION FOR YEAR-END 31 MAY 2021:

A.	FIXED ASSETS	LAND AND BUILDINGS	COMPUTER S	EQUIPMEN T	VEHICLE S
	Carrying value: Begin	6 000 000	13 000	1 027 500	1 300 000
	Cost	6 000 000	108 000	1 250 000	2 100 000
	Accumulated depreciation	-	(95 000)	(222 500)	(800 000)
	Movements				
	Additions	(i)	0	172 500	0
	Disposals	0	0	0	(iv)
	Depreciation	0	(ii)	(iii)	(256 000)
	Carrying value: End				
	Cost				
	Accumulated depreciation				(v)

B. Land and buildings:

Grant Construction was paid R882 000 for building new offices (R610 000) and repairing windows (R272 000).

C Computers:

A. The three computers were all bought on the same day at R36 000 each.

B. Depreciation is 33⅓% on cost.

These computers are expected to last another two years.

D Equipment:

A. Additional equipment was purchased on 1 February 2021.

B Depreciation is 10% p.a. on cost.

ANSWER SHEET: TANGIBLE ASSETS

1. MINDEW LIMITED

1.1		WORKINGS	ANSWER	
	(i)			
	(ii)			
	(iii)			
	(iv)			
	(v)			
				17

1.2	Explain how the internal auditor should check that movable fixed assets were not stolen.	
		2

1.3	As an independent auditor, what advice would you give? Provide ONE point.	
		2

ACTIVITY 2**ADAPTED NSC NOV 2017****FIXED ASSETS
MARKS****22**

The following information relates to Odette Ltd. The financial year ended on 28 February 2022.

REQUIRED:**2.1 Refer to Information B.**

Calculate the missing amounts denoted by **(a)** to **(e)**.

(22)**INFORMATION:****A. Amounts extracted from the records on 28 February 2022:**

Balance Sheet accounts section	R
Ordinary share capital	?
Retained income (28 February 2022)	520 000
Fixed assets (carrying value)	?

B. Fixed assets:

	LAND AND BUILDINGS	VEHICLES	EQUIPMENT	TOTAL
Cost		350 000	460 000	
Accumulated depreciation		(315 000)		
Carrying value (01/03/2021)	(a)	35 000		
Movements:				
Additions	325 000	422 550	0	
Disposals	0	0	(d)	
Depreciation		(b)	(13 766)	
Carrying value (28/02/2022)	2 550 000	(c)	50 994	(e)
Cost		772 550	340 000	
Accumulated depreciation				

ACTIVITY 2**TANGIBLE ASSETS****22 Marks****2.1**

(a)	Calculate the carrying value of Land and Buildings on 1 March 2021.	2
(b)	Calculate the total depreciation on Vehicles on 28 February 2022.	6
(c)	Calculate the carrying value of Vehicles on 28 February 2022.	4
(d)	Calculate the carrying value of Equipment sold on 31 December 2021.	6
(e)	Calculate the total carrying value of Fixed Assets on 28 February 2022.	4

ACTIVITY 3
ADAPTED NSC FEB 2018

FIXED ASSETS

15 Marks

MAFOKO LTD

The given information relates to Mafoko Ltd for the financial year ended 28 February 2022.

REQUIRED:

3.1 Refer to Information A and Information B.

Calculate the missing amounts denoted by (a) to (c) on the Fixed Asset Note. (15)

INFORMATION:

A. Information from the financial statements on 28 February:

	2022 R	2021 R
Depreciation	?	?
Interest expense	123 000	126 500
Net profit before income tax	422 500	157 500
Net profit after income tax	295 750	113 400
Fixed assets (carrying value)	4 934 450	3 993 390

B. Fixed Asset Note:

Fixed assets comprise only Buildings and Equipment.

	BUILDINGS	EQUIPMENT
Carrying value (01/03/2021)	2 866 990	1 126 400
Cost (01/03/2021)		2 200 000
Accumulated depreciation (01/03/2021)		(1 073 600)
Movements:		
Additions	(a)	300 000
Disposals		(c)
Depreciation		(b)
Carrying value (28/02/2022)		1 058 520
Cost (28/02/2017)		
Accumulated depreciation (28/02/2022)		

- Additional equipment was purchased on 1 June 2021.
- Extensions to the building were completed on 31 August 2021.
- Old equipment was sold at carrying value on 28 February 2022.
- Equipment is depreciated at 20% p.a. using the diminishing-balance method.

ACTIVITY 3: ANSWERSHEET

WORKINGS	AMOUNT
Additions to buildings	
Total depreciation on equipment	
Disposal of equipment at carrying value	

15

SESSION 16: MANAGEMENT OF TANGIBLE ASSETS

INTERNAL CONTROL ON TANGIBLE ASSETS

- Purchases of assets should be authorised by management
- An internal auditor must ensure that proper records and documentation relating to fixed assets are in place.
- Receipts /invoices should be proof of purchase for insurance and external audit purpose
- Fixed assets purchased must be labelled / bar coded or a serial number given for identification and asset verification.
- Regular stock taking of assets and comparing against the asset register
- Signing in and out of assets to track where they are and who used them
- The movement of assets must be recorded in a logbook, e.g. vehicles
- All fixed assets must be insured against fire, theft, etc.
- All fixed assets should be recorded in a Fixed Asset Register (check the example of a register below):

D M TRADERS
NO.1

Asset register

General ledger account:

Vehicle account (B 6)

Item:

Nissan delivery van 2 litre

Date purchased:

1 March 2021

From whom purchased:

Nissan Monument

Cost price:

R180 000

Percentage Depreciation:

20 % p.a. at cost price/straight line method

Details of depreciation

Dates	Annual depreciation Calculations	Accumulated depreciation	Book value or known as “Carrying value”

An asset register is an internal control tool used to track the value of assets the physical assets.

Auditors will verify physical assets against the asset register

The ownership of the asset can be verified by external auditors through the information attached in the register such as name of dealer or creditor, registration number if its vehicle.

The auditor can verify if the calculations for depreciation, book value of assets are accurate.

EXAMPLE ONE**EXTRACTED FROM NSC NOV 2018****TANGIBLE ASSETS****21 Marks****1. MINDEW LIMITED**

The financial year-end is 31 May 2018.

REQUIRED:

- 1.1 Calculate the missing figures indicated by (i) to (v) in the table below. (17)
- 1.2 Explain how the internal auditor should check that movable fixed assets were not stolen. (2)
- 1.3 Land and buildings were bought five years ago for R6 m. Property prices have increased by 20% since then. The directors want to increase the value of this asset and reflect a profit of R1 200 000 in the financial statements.
- As an independent auditor, what advice would you give? Provide ONE point. (2)

INFORMATION FOR YEAR-END 31 MAY 2018:

A.

FIXED ASSETS	LAND AND BUILDINGS	COMPUTERS	EQUIPMENT	VEHICLES
Carrying value: Begin	6 000 000	13 000	1 027 500	1 300 000
Cost	6 000 000	108 000	1 250 000	2 100 000
Accumulated depreciation	-	(95 000)	(222 500)	(800 000)
Movements				
Additions	(i)	0	172 500	0
Disposals	0	0	0	(iv)
Depreciation	0	(ii)	(iii)	(256 000)
Carrying value: End				
Cost				
Accumulated depreciation				(v)

B. Land and buildings:

Grant Construction was paid R882 000 for building new offices (R610 000) and repairing windows (R272 000).

C. Computers:

- The three computers were all bought on the same day at R36 000 each.
- Depreciation is $33\frac{1}{3}\%$ on cost.
- These computers are expected to last another two years.

D. Equipment:

- Additional equipment was purchased on 1 February 2018.
- Depreciation is 10% p.a. on cost.

E. Vehicles:

- Depreciation is 20% p.a. on carrying value.
- A vehicle was sold for cash at carrying value on 31 December 2017. The Fixed Assets Register reflected the following:

Cost	R176 000
Accumulated depreciation (1 June 2017)	R128 000

SUGGESTED SOLUTION

NO.	WORKINGS	ANSWER	EXPLANATION
	Buildings		
(i)	882 000 - 272 000	610 000	► Repairs are regarded as expenses, will be recorded under operating expenses. Note: Installation costs will increase the cost price of the asset.
	Computers		
(ii)	Depreciation on equipment	R13 000 – (R1 x 3) R12 997 Note: it is important to verify the calculations before you conclude that the carrying value is R1.	When the asset (s) is about to be fully depreciated the following should be noted : ► Cost price and accumulated depreciation figures are close, almost equal. ► The amount for carrying value is very small compared to cost and accumulated depreciation.
	When you verify the calculation, your answer will be	$33\frac{1}{3} \div 100 \times 108\,000$ OR $0,333333 \times 108\,000$ = R36 000 This is above the carrying value of R13 000 Check below $33\frac{1}{3}\%$ is simplified.	
			

Simplified depreciation rate:

$$33\frac{1}{3}$$

$$33\frac{1}{3} \div 100$$

$$\frac{100}{3} \times \frac{1}{100}$$

$$\frac{100}{300} \text{ OR } \frac{1}{3}$$

$$\frac{1}{3} \times 108\,000$$

36 000 (Depreciation is above carrying value of R13 000)

NO.	WORKINGS	ANSWER	EXPLANATION
	Equipment		
(iii)	New: $R172\,500 \times 10\% \times 4/12$ $= R5\,750$ Old: $R1\,250\,000 \times 10\%$ $= R125\,000$	R130 750	<i>Always categorise your calculations for depreciation as follows:</i> ➤ Sold Asset ➤ Old Asset (SON) ➤ New Asset
	Vehicles		
(iv)	Disposal at carrying value $176\,000 - 128\,000$ $= 48\,000$ $148\,000 \times 20\% \times 7/12$ $= 5\,600$ Cost - (Acc dep + Dep) $176\,000 - (128\,000 + 5\,600)$ Equals to carrying value ➡	42 400 A	➤ In your note for tangible assets the asset sold is recorded at the carrying value.
	Depreciation for remaining assets :Vehicles o Cost Price – cost of asset sold o Acc Depreciation –Acc depreciation of asset sold (take opening balances) $2\,100\,000 - 176\,000 = 1\,924\,000$ (Cost price of remaining assets) $800\,000 - 128\,000 = 672\,000$ (Acc depreciation of remaining assets) $(1\,924\,000 - 672\,000) \times 20\% = 250\,400$ B (Current depreciation –old assets) 1 252 000		
	Total depreciation on vehicles is: 5 600 (A) + 250 400 (B) = 256 000		
(v)	Acc depreciation on vehicles at end of year: o Acc dep at beginning PLUS Depreciation LESS Acc dep on asset sold $800\,000 + 256\,000 - (128\,000 + 5\,600) = 922\,400$ 133 600		

ACTIVITY 1: TANGIBLE ASSETS

GAUTENG PRELIM 2019

HALEY LTD

The given information relates to Hadley Ltd. The financial year ended on 28 February 2019.

Calculate the missing figures indicated by (a) to (e) in the Fixed Asset Note below. (17)

INFORMATION:

A Extract from the Income Statement for the year ended 28 February 2019

	R
Depreciation	?

B Fixed Asset Note

	Land and Building	Vehicles	Equipment
Carrying value on 28 Feb 2018	6 800 000	840 000	(c)
Cost	6 800 000	(b)	850 000
Accumulated depreciation	0	(960 000)	(180 000)
Movements			
Additions at cost		900 000	400 000
Disposals	(a)	0	(d)
Depreciation		(171 000)	(e)
Carrying value on 28 Feb 2019	5 800 000		
Cost	5 800 000	2 700 000	
Accumulated depreciation			

Land and Building

- Part of the Land and Building was sold at carrying value during the financial year.

Vehicles

- A new delivery van was bought on 1 November 2018.
- No vehicles were sold during the financial year.

Equipment

- A printer bought for R150 000 on 1 March 2016, was sold at carrying value on 31 August 2018.
- A new printer was purchased on 31 August 2018.
- Depreciation on equipment is written-off at 10% p.a. on the cost price.

Activity 1: GAUTENG PRELIM 2019

Calculate the missing figures indicated by (a) – (e) in the Fixed Asset Note.		
	CALCULATIONS	AMOUNT
(a)		
(b)		
(c)		
(d)		
(e)		

ACTIVITY 2 : TANGIBLE ASSETS**KZN PRELIM 2019**

- 2.1 Calculate the missing amount denoted (a) to (d) in the Tangible/Fixed asset note: **(use information A)** (16)

A. Fixed / Tangible assets

	Buildings	Vehicles	Equipment
Carrying value at the beginning	1 100 000		(D)
Cost price	1 100 000	937 500	
Accumulated depreciation		(537 500)	(81 000)
Movements			
Additions	(A)	350 000	120 000
Disposal at carrying value		(C)	(0)
Depreciation		(B)	(25 350)
Carrying value at the end	1 900 000		
Cost price	1 900 000		300 000
Accumulated depreciation			

Additional information in respect of fixed assets:

- An extension to the office block was undertaken during the financial year.
- Equipment of R120 000 was purchased on 1 December 2018.
- The business had three vehicles at the beginning of the year. The following details appeared in the fixed asset register on 1 July 2018:

	VEHICLE 1	VEHICLE 2	VEHICLE 3
Cost price	500 000	437 500	350 000
Accumulated depreciation	(450 000)	(87 500)	-
Date of purchased	1 January 2014	1 July 2017	1 July 2018

NOTE:

- Vehicle 1 is old and is reaching the end of its useful life.
- Vehicle 2 was sold at its carrying value on 1 April 2019
- Depreciation: vehicles at 20% on cost
: equipment at 15% on diminished method

QUESTION 2 KZN PRELIM 2019
Notes to the Financial Statements

2.1

	Calculations	Answer
A		
B		
C		
D		

QUESTION 3: FIXED ASSETS**NW PRELIM 2019****3.1 FIXED ASSETS**

You are provided with information for the financial year ended 28 February 2019 taken from the books of Bontle Ltd a public company listed on the Johannesburg Securities Exchange (JSE).

REQUIRED:

- 3.1.1 Calculate the cost price of the delivery vehicle that was traded in on 31 August 2018 (4)
- 3.1.2 **Refer to information A** (14)
Calculate the missing figures as indicated by (i)–(iv) on the fixed asset note

INFORMATION:**A. Incomplete Fixed Asset Note on 28 February 2019:**

	Land and buildings	Vehicles	Equipment
CARRYING VALUE AT THE BEGINNING OF THE YEAR	5 715 000		
Cost price	5 715 000	1 120 000	200 000
Accumulated depreciation	(0)	(460 000)	(171 000)
MOVEMENTS			
Additions	(ii)	450 000	65 000
Disposals	(i)	(iii)	
Depreciation		(153 000)	(iv)
CARRYING VALUE AT THE END OF THE YEAR	6 015 000		
Cost price	6 015 000	1 270 000	265 000
Accumulated depreciation	(0)		

B. Fixed/Tangible assets**Land and buildings**

A security office, cost price R400 000, was completely destroyed in a fire. Instead of repairing the old security office, the insurance claim and additional funds were used to build a new security office in a different place on the property.

Vehicles

A delivery vehicle bought on 1 March 2017 was traded in on 31 August 2018 for a new vehicle costing R450 000.

Depreciation on vehicles is written off at 20% p.a. on the diminishing balance method.

Equipment

Bontle Ltd bought a printing machine on 1 June 2016. On 1 December 2018 the company bought a new printing machine to the value of R65 000. No equipment was sold during the year.

Depreciation on equipment is written off at 18% p.a. on the cost-price method.

QUESTION 3

3.1 FIXED ASSETS

3.1.1 Calculate the cost price of the delivery vehicle that was traded in on 31 August 2018.

Calculation	Answer

4

3.1.2 Calculate the missing figures as indicated by (i)–(iv) on the fixed asset note.

No.	Calculations	Answer
(i)		
(ii)		
(iii)		
(iv)		

14

Problem Solving –Tangible Assets

Refer to the example attached below:

Note: The first column “problem identified” is added to the question to assist you to identify the problems.

MANAGEMENT OF FIXED ASSETS

You are the internal auditor for Kobus Hardware. Kobus is **concerned that he is spending too much on delivering goods to customers**. He has provided you with figures for a typical month, February 2021.

REQUIRED:

Identify ONE problem regarding **each vehicle/driver**. Quote figures to support your answers. Give Kobus ONE point of advice for EACH problem Identified. (9)

INFORMATION:

- A. Kobus has three delivery vehicles and employs three drivers to transport goods to his customers free of charge. The drivers are expected to work five days per week. There are four weeks in February.
- B. Some customers live close by while others live further away. None of the customers live more than 20 km from the shop **(I.e. maximum 40 km round trip)**.
- C. Information from the accounting records for February 2021:

Problem Identified		VEHICLE 1	VEHICLE 2	VEHICLE 3
	Name of driver	LEROY	FRED	BHEKI
	Date of purchase	1 Mar. 2019	2 Feb. 2017	1 May 2012
	Carrying value	R270 000	R102 000	R1
Leroy worked few days and was paid more	Number of days driver worked	12	20	20
	Salary of driver per month	R8 000	R5 000	R5 000
	Number of deliveries made	48	80	120
	Average number of trips per day	4	4	6
Fred has high number of kilometers above 40 km but deliveries are few	Kilometers travelled	1 300	4 600	3 000
	Average number of kilometers per trip	27	58	25
Bheki's car consume more petrol	Petrol (litres) used	59	209	214
	Kilometres per litre	22	22	14
	Petrol costs (R11,31per litre)	R668	R2 365	R2 424
	Petrol costs per km	R0,51	R0,51	R0,81

Always quote problems and figures

MANAGEMENT OF FIXED ASSETS

Identify ONE problem regarding each vehicle/driver. Quote figures to support your answers. Give Kobus ONE point of advice for EACH problem identified.

	Problem with figures Problem ✓ ✓ ✓ Figures ✓ ✓ ✓	Advice ✓ ✓ ✓
VEHICLE 1 (LEROY)	Leroy was <i>absent for 8 days.</i>/ He is the <i>highest paid driver, R8 000</i> where other drivers earn R5 000.	<i>Investigate the reason</i> for his absence./Only <i>pay for the number of days at work.</i>
VEHICLE 2 (FRED)	- Fred is travelling too many kilometres (4 600 km for 80 trips = 58 km per trip) which is higher than the maximum of 40 km per customer. - He is travelling more km than Bheki (4 200 compared to 2 800 km) but doing fewer trips (70 compared to 110).	Possible disciplinary action against Fred for unauthorised use of vehicle./Improve internal control over the use of the vehicles.
VEHICLE 3 (BHEKI)	Bheki is doing the most number of trips (120) but his vehicle is the oldest and the most expensive to run (R0,81 per km).	Consider replacing this vehicle as it is expensive to maintain.

SUMMARY OF PROBLEMS ASSOCIATED WITH VEHICLES –TANGIBLE ASSETS		
Type of problem	Explain and quote figures, percentages etc.	Possible Response/Answer: Solution to a problem or advice
Number of days driver worked and the salary paid	Few days worked ,but received more money or highest paid driver	- Investigate reasons for absence - Only pay for the number of days at work.
Kilometres travelled and number of deliveries	- More kilometres travelled but fewer deliveries - Unauthorised use of vehicle	- Improve internal control over the use of the vehicles. - Disciplinary action against the driver
Petrol Consumption	High petrol consumption because the vehicle is old	Consider replacing this vehicle as it is expensive to maintain.
Maintenance cost	High maintenance cost because the vehicle is old	
Carrying value	The vehicle with the lowest carrying value including R1 residual value is normally expensive to maintain,Sale or Disposal is normally recommended.	
Other problems - Date of purchase - Average number of trips per day - Insurance		

ACTIVITY 4: MANAGEMENT OF TANGIBLE ASSETS **Adapted from ASC 2015**

4.1 TANGIBLE ASSETS

The following information relates to the fixed/tangible assets of Jabulani Hypermarket for the year ended 28 February 2021.

REQUIRED:

- 4.1.1 Refer to Information **A**, **B** and **C**. Calculate the amounts indicated by (i)–(iii). Show the workings in the space provided in the ANSWER BOOK. (7)
- 4.1.2 Refer to Information **D**. Prepare the Asset Disposal Account for the computer sold on 30 November 2020. (13)
- 4.1.3 Refer to Information **E**. You are the internal auditor of Jabulani Hypermarket. The owner has asked you to investigate the control of trolleys and baskets used in the business.
- (a) Explain how the Fixed Assets Register will assist you in your duties as internal auditor. Provide ONE point. (2)
 - (b) The stock of trolleys and baskets is classified as a fixed asset. Give ONE suitable reason for this. (2)
 - (c) The owner has received numerous complaints from his customers about the trolleys and baskets. On a busy day the business often has up to 420 customers in the shop at the same time.
- Identify and explain THREE major problems (with figures) relating to the control of the trolleys and baskets. In EACH case, provide a valid, practical solution to improve the control over these assets. (9)

INFORMATION:

- A.** Information from the financial statements for the year ended 28 February 2021:

FIXED/TANGIBLE ASSETS	LAND AND BUILDINGS	VEHICLES	EQUIPMENT
Carrying value on 1 March 2020	2 500 000	264 600	(i)
Cost	2 500 000	552 000	900 000
Accumulated depreciation	0	(287 400)	(224 000)
Movement			
Additions	(ii)	0	470 000
Disposals at carrying value	0	0	
Depreciation	0	(iii)	
Carrying value on 28 February 2021	3 200 000		
Cost	3 200 000		
Accumulated depreciation	0		

- B.** The business has two vehicles. The following details appeared in the Fixed Assets Register:

	Vehicle 1	Vehicle 2
Cost	240 000	312 000
Accumulated depreciation on 1 March 2020	(225 000)	(62 400)
Carrying value on 1 March 2020	15 000	249 600

NOTE: Vehicle 1 is old and is reaching the end of its useful life.

- C.** The business provides for depreciation on its fixed assets as follows:
- On vehicles at 25% p.a. on cost
 - On equipment at 20% p.a. on the diminishing-balance method. Equipment comprises shopping baskets, trolleys, computers, fridges and other general shop equipment.
- D.** A computer was sold for cash to Mash Crusaders on 30 November 2020. A loss of R250 was incurred as the computer was slightly damaged. According to the Fixed Assets Register, the computer was originally purchased for R9 200. Accumulated depreciation on this item was R6 400 on 1 March 2020.
- E.** The following information refers to the trolleys and baskets of the business:

	TROLLEYS	BASKETS
Number of units on hand on 1 March 2020	148	120
Additional units purchased during the financial year at R2 000 each for the trolleys and R250 each for the baskets	112	35
Number of damaged units written off during the financial year	14	60
Number of units on hand as per physical count on 28 February 2021	210	95
Repair and maintenance cost for units during the financial year	R1 800	R16 000

ANSWER SHEET 4

4.1.1	NO.	CALCULATIONS	AMOUNT
	(i)		
	(ii)		
	(iii)		

7

4.1.2 ASSET DISPOSAL

13

NOTE: Most recent papers will not assess you on asset disposal account, but you will calculate the **carrying value of an asset sold** and that will be recorded in your note for Tangible Assets.

4.1.3 (a) Explain how the Fixed Assets Register will assist you in your duties as internal auditor. Provide ONE point.

2

(b) The stock of trolleys and baskets is classified as a fixed asset. Give ONE suitable reason for this.

2

(c) Identify and explain THREE major problems (with figures) relating to the control of the trolleys and baskets. In EACH case, provide a valid, practical solution to improve the control over these assets.		
	PROBLEM WITH FIGURES	PRACTICAL SOLUTION TO IMPROVE INTERNAL CONTROL
Problem 1		
Problem 2		
Problem 3		

9

TOTAL MARKS
33

SESSION 17: COST ACCOUNTING

MANUFACTURING CONCEPTS AND NOTES

CONCEPT	EXPLANATION
Manufacturing business	■ A manufacturing enterprise is an enterprise that manufactures products (completed products) from raw materials. ■ It transforms raw materials into finished or completed products.
Costing	It is the calculation of the costs involved in producing a product.
Unit	The word used to describe a single product produced in the factory.
Direct material costs	The raw material needed to produce the product – also called Direct raw material cost.
Direct labour costs	This is the payment to workers who are directly involved in manufacturing of the product.
Indirect labour costs	This is the amount paid to workers in the factory who are not directly involved with the production process e.g. the cleaning staff)
Factory overheads	■ These are the expenses incurred to run the factory, but none of them are directly involved with the production process. e.g. factory rent ■ Indirect labour and indirect materials are classified as factory overheads.
Primary production cost	Direct material cost plus direct labour cost
Total production cost or manufacturing costs	It is the total cost to produce the products. Prime cost plus factory overhead cost (Direct material cost + Direct labour cost + Factory overhead cost)
Cost per unit or unit cost	This is the cost of producing one product/unit (Total production cost ÷ total units produced)
Fixed costs	These costs do not change irrespective of the number of items produced, the cost for rent is the same whether the quantity produced by the factory is increased or reduced.
Variable costs	These costs increase when the factory produce more products and decrease when the factory produce less products (e.g. electricity)
Total costs	Fixed costs + Variable costs
Unit costs	This is the cost to produce one unit.
Marginal income (contribution)	The difference between the selling price per unit and the variable cost per unit. (SP/unit – VC/unit) It is used to work out the break-even point.
Selling and distribution cost	These are costs incurred in the selling of the finished goods, e.g. advertising and sales commission. These are variable costs.

CONCEPT	EXPLANATION
Administration cost	These are costs incurred to run the business but are not tied to the manufacturing or sales costs. These costs will include office rent, salaries of office employees, depreciation of office equipment etc.
Break-even point	- It is the number of units that need to be sold to cover all costs, but no profit is made. It is when total receipts are equal to total costs. - It is the point where there is no profit or loss incurred. NOTE :The break-even point can be calculated in units as well as rand value

FOUR DIFFERENT TYPES OF STOCK IN A MANUFACTURING BUSINESS			
Finished goods stock Products that are completely finished and are ready for sale. These goods are same as trading stock of the retail business.		Indirect materials/ consumable stores stock The indirect material stock that has not been used but is available for use, e.g. cleaning materials.	
Raw material stock The unprocessed material used to produce finished goods.		Work-in-progress stock Products that have not yet been completely turned into finished goods and are still in the manufacturing process.	

The following methods are used to allocate costs and expenses :

Rent amounting to R200 000 was paid during the year. This amount must be divided in the ratio 3:1:1 between the factory, the office and the sales department.			
Factory	Office	Sales department	200 000
3	1	1	5
$\frac{3}{5} \times 200\,000$	$\frac{1}{5} \times 200\,000$	$\frac{1}{5} \times 200\,000$	200 000
=120 000	= 40 000	= 40 000	
Sundry expenses amounted to R25 000. Factory accounts for 80%, Office 5% and Sales department 15%			
Factory	Offices	Sales department	
80%	5%	15%	100%
$\frac{80}{100} \times 25\,000$	$\frac{5}{100} \times 25\,000$	$\frac{15}{100} \times 25\,000$	R25 000
=R20 000	= R1 250	= 3 750	
Rent is allocated on proportion to floor area. R72 000 Floor space: Factory 1 000 square meters, Office 500 square meters, Sales department 500 square meters.			
Factory	Offices	Sales department	Total
1 000	500	500	2 000
$\frac{1\,000}{2\,000} \times 72\,000$	$\frac{500}{2\,000} \times 72\,000$	$\frac{500}{2\,000} \times 72\,000$	
= 36 000	= 18 000	= 18 000	

SUMMARY OF LEDGER ACCOUNTS

RAW MATERIALS STOCK (direct materials in the store room)

Balance (not used last year)	b/d		Direct mat cost (materials sent to factory)		4
Creditors control (raw materials bought)			Balance (amount left in storeroom year-end)	c/d	
Bank (raw materials bought)					

DIRECT LABOUR COST (labour costs)

Factory wages			Work-in Process (direct labour)		3

INDIRECT MATERIALS

Consumable stores stock (reversal)	9		Factory overhead cost (Indirect materials used)		2
Creditors control (bought)			Consumable stores stock (left over year-end)		8
Bank (bought)					

DIRECT MATERIAL COST

Raw material stock	4		Work-In -Process stock		10

CONSUMABLE STORES STOCK

Indirect materials stock (left over year-end)	8		Indirect materials (reversal of adjustment)		9

FACTORY OVERHEAD COST (total indirect costs)

Salaries, wages (indirect labour)	1		Work-in Process		5
Electricity, etc					
Depreciation (on machinery)					
Indirect materials	2				

WORK-IN-PROCESS

Balance (unfinished tables end of last year)	b/d		Finished goods stock (goods ready for sales)		6
Direct material cost		10	Balance (unfinished goods)	c/d	
Direct labour cost		3			
Factory overhead cost		5			

All direct and indirect expenses incurred in order to produce goods

FINISHED GOODS

Balance (goods not sold last year)	b/d		Cost of sales (goods sold this year)		7
Work-in-Process (ready to be sold)		6	Balance (goods not sold this year)	c/d	

COST OF SALES

Finished goods (finished goods sold this year)		7	Trading account		8

TRADING ACCOUNT

Cost of sales		8	Sales		
Profit and loss account (gross profit)					
		xx			xx

MANUFACTURING ACCOUNTS –EXAMLPE 1

The following information was extracted from the accounting records of Chantel Manufacturers, manufacturers of ladies handbags.

REQUIRED:

Draw up the following accounts in the General Ledger, properly closed/balance on 31 July 2020:

1. Raw Material stock
2. Work-In-Progress
3. Finished Goods Stock
4. Factory overheads
5. Indirect Material

INFORMATION:

Balances on 1 August 2019	
Raw Material	67 224
Consumables on hand (indirect material)	1 590
Work-In-Progress	11 335
Finished Goods	39 784

Summary of transactions and other information for the year ending 31 July 2020	
Raw material purchased in cash	R 389 200
Raw material purchased on credit	79 332
Raw material issued for production	496 200
Wages paid: Direct labour	338 780
Indirect labour	105 600
Consumables purchased for production	70 890
Factory rent paid	48 000
Factory insurance paid	16 000
Factory maintenance paid	32 500
Depreciation on factory equipment	28 600
Cost of sales of finished goods	1 143 220
Sale of finished goods	1 829 152
Cost price of finished goods	1 136 079
Consumables on hand (indirect material) 31 July 2020	1 056

EXPECTED ANSWER

Dr	Raw Material stock							B6	Cr
2019 Aug	1	Balance	b/d	67 224	2020 Jul	31	Raw Material issued	GJ	*496 200
2020 Jul	31	Bank	CPJ	389 200			Balance	c/d	39 556
		Creditors control	CJ	79 332					
				535 756					535 756
2020 Aug	1	Balance	b/d	39 556					

Dr	Work-in-Progress Stock							B7	Cr
2019 Aug	1	Balance	b/d	11 335	2020 Jul	31	Finished goods inventory	GJ	\$1 136 079
2020 Jul	31	Direct material costs	GJ	*496 200			Balance	c/d	12 360
		Direct labour costs	GJ	338 780					
		Factory overheads	GJ	# 302 124					
				1 148 439					1 148 439
2020 Aug	1	Balance		12 360					

Dr				Finished Goods Stock				B8		Cr
2019 Aug	1	Balance	b/d	39 784	2020 Jul	31	Cost of Sales	GJ	1 143 220	
2020 Jul	31	Work-in-progress	GJ	\$1 136 079			Balance	c/d	32 643	
				1 175 863					1 175 863	
2020 Aug	1	Balance		32 643						

Dr					Factory Overheads			C2		Cr
2020 Jul	31	Wages	GJ	105 600	2020 Jul	31	Work-in-Progress	GJ	# 302 124	
		Rent expense	GJ	48 000						
		Insurance	GJ	16 000						
		Maintenance	GJ	32 500						
		Depreciation	GJ	28 600						
		Indirect Material	GJ	71 424						

Indirect Material cost	
Consumables on hand	1 590
Bank	70 890
Consumables on hand	(1 0560)
Factory overheads	71 424

THE PRODUCTION COST STATEMENT FORMAT

PRODUCTION COST STATEMENT		
	Note	R
Direct material costs	1	xxx
Direct labour costs	2	xxx
Prime costs		xxx
Factory overhead costs	3	xxx
Total manufacturing costs		xxx
Work-in-process at the beginning of the year		xxx
		xxx
Work-in-process at the end of the year		(xxx)
Cost of production of finished goods		xxx

NOTES TO THE FINANCIAL STATEMENTS																													
<table> <tr> <th>1. Direct material costs</th><th>R</th></tr> <tr> <td>Balance at the beginning of the year</td><td>xxx</td></tr> <tr> <td>Net purchases</td><td>xxx</td></tr> <tr> <td>Carriage on purchases</td><td>xxx</td></tr> <tr> <td>Custom duties</td><td>xxx</td></tr> <tr> <td></td><td>xxx</td></tr> <tr> <td>Less: Balance at the end of the year</td><td>(xxx)</td></tr> <tr> <td>Direct material costs</td><td>xxx</td></tr> </table>	1. Direct material costs	R	Balance at the beginning of the year	xxx	Net purchases	xxx	Carriage on purchases	xxx	Custom duties	xxx		xxx	Less: Balance at the end of the year	(xxx)	Direct material costs	xxx	<table> <tr> <th>2. Direct labour costs</th><th>R</th></tr> <tr> <td>Factory wages</td><td>xxx</td></tr> <tr> <td>Pension fund contributions</td><td>xxx</td></tr> <tr> <td>Medical aid contributions</td><td>xxx</td></tr> <tr> <td>UIF contributions</td><td>xxx</td></tr> <tr> <td>Direct labour cost</td><td>xxx</td></tr> </table>	2. Direct labour costs	R	Factory wages	xxx	Pension fund contributions	xxx	Medical aid contributions	xxx	UIF contributions	xxx	Direct labour cost	xxx
1. Direct material costs	R																												
Balance at the beginning of the year	xxx																												
Net purchases	xxx																												
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Factory wages	xxx																												
Pension fund contributions	xxx																												
Medical aid contributions	xxx																												
UIF contributions	xxx																												
Direct labour cost	xxx																												

3. Factory overhead costs	R
Indirect material	xxx
Indirect labour	xxx
Depreciation: Machinery and equipment	xxx
Maintenance: Machinery and equipment	xxx
Rent for factory buildings	xxx
Factory electricity and water	xxx
Factory overhead cost <i>(to be taken to the production cost statement)</i>	xxx

4. Cost of finished goods sold	R
Opening stock of finished goods sold	xxx
Cost of finished goods produced during the year	xxx
	xxx
Closing stock of finished goods	(xxx)
Cost of finished goods sold	xxx



ILLUSTRATIVE ACTIVITY TWO

The activity will illustrate possible transactions in the manufacturing process and the following Accounting records

- ledger accounts
- Production Cost Statement
- Notes to the statement

**REQUIRED:**

- 1 Complete the Ledger Accounts, Production cost statement and Notes

INFORMATION:

Balances on 1 March:	2019	2020
Raw materials stock	R 10	R 15
Work in process stock	150	45
Finished goods stock	100	55
Indirect material/ Consumables stores on hand	3	4

Summary of transactions for the year ended 29 February 2020

	R
Sales	1 000
Raw materials bought on credit	30
Paid in cash transport cost of Raw materials purchased	20
Returned incorrect raw materials delivered	5
More consumables/indirect materials were purchased during the year; cash R4, on credit R5 and incorrect consumables returned R3.	
Wages of direct labourers and UIF contributions	85
Salaries and wages – factory indirect workers and UIF contributions	15
Salary of bookkeeper / receptionist	4
Water and electricity (to be apportioned between the factory and the office in the ratio 5:1) [$R6 \div 5/6 = R5$]	6
Factory Rent expense	5
Depreciation on machinery	5

A. MANUFACTURING PROCESS AND THE STOCK ACCOUNTS.



Check the flow of stock through different stages up to the point of sale

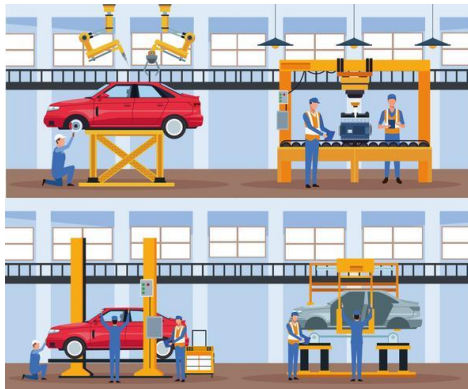
1. Warehouse
2. Factory
3. Showroom in section 'D' and 'E'

Stock accounts'	Different stations in Manufacturing	Notes to the Production cost account (gr 12)																
1 Raw materials or called Direct materials	This is the <u>warehouse/storeroom</u> where the raw materials and indirect materials are placed before transferring the stock needed in the factory. 	Note 1: <table><tr><th>Direct material Stock issued</th><th>R</th></tr><tr><td>Opening stock</td><td>10</td></tr><tr><td>+ Purchases(net)</td><td>45</td></tr><tr><td>(20 +30 -5)</td><td></td></tr><tr><td>+ Carriage on purchases</td><td>-</td></tr><tr><td>+ Custom duties</td><td>-</td></tr><tr><td>-Closing stock</td><td>(15)</td></tr><tr><td>= Direct material issued (Direct material cost)</td><td>40</td></tr></table>	Direct material Stock issued	R	Opening stock	10	+ Purchases(net)	45	(20 +30 -5)		+ Carriage on purchases	-	+ Custom duties	-	-Closing stock	(15)	= Direct material issued (Direct material cost)	40
Direct material Stock issued	R																	
Opening stock	10																	
+ Purchases(net)	45																	
(20 +30 -5)																		
+ Carriage on purchases	-																	
+ Custom duties	-																	
-Closing stock	(15)																	
= Direct material issued (Direct material cost)	40																	
2 Indirect materials/ Consumable stores 	The stock transferred to the factory is called Direct material issued (R40)																	



3 Work in process stock

This is in the **factory** where the raw material stock is used to manufacture the products. The closing stock will be the incomplete stock at year end.



The completed stock transferred to the show room is called '**Cost of production of finished goods**' (R265)

PRODUCTION COST STATEMENT

R

Direct materials cost	40
+ Direct labour cost	85
= Prime / Direct cost	125
+ Factory overhead cost	35
= Total cost of production	160
+ Work-in process at the beginning of the year	(45)
- Work-in process at the end of the year	265
= Cost of production of finished goods	

In the production factory area, the **variable cost** and the **fixed cost** can be identified.



In the production factory area, the **indirect labour** will be the cleaners, factory manager, security, etc. Remember that they qualify for employers contributions as well.

Note 2: Direct labour

Note 3: Indirect Labour will be classified as Factory overheads costs incurred during the Manufacturing process.

4

Finished goods stock

This is the **show room** where the completed products are transferred from the factory ready to be sold.



The stock sold and leaving the show room will be regarded and recorded as **Cost of Sales**.

Note 4:

Cost of goods sold/
Cost of sales R

Opening stock	100
+ Cost of Production of finished goods	265
- Closing stock	(55)
= Cost of sales	310

Administration costs and selling and distribution costs can be identified this stage

B. PROGRESSION OF CONTENT FROM GRADE 11 TO GRADE 12

Study the template below and identify the similarities between the:

- General ledger accounts and the
- Production Statement.

If you understand the flow of the ledger accounts from the raw materials to Work in process to finished goods account, you will understand the format of the Production Statement.



GENERAL LEDGER ACCOUNTS (Gr. 11)

PRODUCTION COST STATEMENT (Gr.12)

Raw material stock					Note 1: Raw material/ Direct material cost	
Dr				Cr		
Balance	b/d	10	Creditors contr. CAJ	5	Opening stock	10
Bank	CPJ	20	Work in process GJ	40	+Purchases(net) (20 +30 -5)	45
Creditors' contr.	CJ	30	Balance	c/d	+Carriage on purchases	-
		60			+Custom duties	-
					-Closing stock	(15)
Balance	b/d	15			=Stock issued (Direct material cost)	40

Take note: The amount, **R40**, is the direct stock issued to the next station in manufacturing **and it is similar to total in note 1.**

GENERAL LEDGER ACCOUNTS (Gr. 11)

PRODUCTION COST STATEMENT

Direct labour				Note 2: Direct labour cost		R
Dr			Cr			
Wages	WJ	77	Work in process GJ	Wages		77
UIF contribution	WJ	8		+ UIF contribution		8
		85		= Direct labour		85

Work in process				PRODUCTION COST STATEMENT			Note	R
Dr			Cr					
Balance	b/d	150	Finished goods GJ	Direct materials cost	N 1	40		
Raw material issued	GJ	40	Balance	+ Direct labour cost	N 2	85		
Direct labour	GJ	85		= Prime / Direct cost		125		
Factory overheads	GJ	35		+ Factory overhead cost	N 3	35		
		310		= Total cost of production		160		
Balance	b/d	45		+ Work-in process at the beginning of the year		150		
				- Work-in process at the end of the year		(45)		
				= Cost of production of finished goods		265		

TAKE NOTE: The amount, **R265**, is the finished stock transferred to the next station in manufacturing process and is **similar to total in production cost statement**.

GENERAL LEDGER ACCOUNTS (Gr. 11)

PRODUCTION COST STATEMENT

GENERAL LEDGER ACCOUNTS (Gr. 11)				PRODUCTION COST STATEMENT	
Dr.	Factory overheads		Cr.	Note 3 Factory overhead costs	R
Consumable stores	5	Work in process	35	Consumable stores (3+4+5-3-4)	5
Indirect labour	15			+ Indirect labour	15
Water and elec.	5			+ Water and electricity	5
Rent expense	5			+ Rent expense	5
Depreciation	5			+ Depreciation	5
	35		35	= Total factory overheads	35

Dr	Consumable stores account		Cr
Consumable stores on hand	3	Creditors CAJ	3
Bank CPJ	4	Factory overheads	5
Creditors CJ	5	Consumable stores on hand	4
	12		12

Take note

The Contra Account for Consumables/indirect material **USED** is Factory overheads.



GENERAL LEDGER ACCOUNTS (Gr. 11)

PRODUCTION COST STATEMENT

Dr. Finished Goods Cr.				Note 4: Cost of finished goods(Cost of sales) R	
Balance b/d	100	Cost of Sales GJ	310	Opening stock	100
Work in process GJ	265	Balance c/d	55	+ Cost of Production of finished goods	265
	365		365	-Closing stock	(55)
Balance b/d	55			= Cost of finished goods sold /Cost of sales	310
				This is the figure that will appear in the Trading Statement OR Trading Account	

Take note: The amount, **R310**, is the final stock sold and transferred to Cost of Sales **and it is similar to total cost of finished goods.**

SESSION 18: COST ACCOUNTING

BREAK-EVEN POINT

- It is the number of units that need to be sold to cover all costs, but no profit is made. It is a point where total income is **equal** to total costs.
- It is the point where there is **no** profit or loss incurred
- The break-even point can be calculated in **UNITS** as well as **RAND VALUE**

REMEMBER THE FORMULA BREAK-EVEN POINT

$$\frac{\text{Total Fixed Costs}}{\text{Selling Price} - \text{Variable Cost per Unit}}$$

OR

$$= \frac{\text{Total Fixed Costs}}{\text{Contribution per Unit (Profit)}}$$

FIXED COSTS	VARIABLE COSTS				
Factory overheads cost (FOHC) + Administration costs = TOTAL FIXED COSTS	Direct material cost (DMC) + Direct labour cost (DLC) + Selling and Distribution costs (SDC) = VARIABLE COSTS				
	<table><tr><td>DMC +DLC+SDC</td><td rowspan="2">=</td><td rowspan="2">Variable cost per unit</td></tr><tr><td>No. of units produced</td></tr></table>	DMC +DLC+SDC	=	Variable cost per unit	No. of units produced
DMC +DLC+SDC	=	Variable cost per unit			
No. of units produced					

The following areas of Break – even analysis are assessed by most examination papers :

- Compare **Production levels** and **break-even point** for current and past year
[More marks are allocated]
- Compare Break-even point for current and previous year
[expressed in **UNITS** or **RANDS** –most examiners prefer units]
- Compare the number of units produced in the current and past year
- Compare profit made on units, current year and past year
[More marks are allocated]

EXAMPLE - PRODUCTION COST STATEMENT**QUESTION: COST ACCOUNTING****SNAZZY HANDBAGS**

The information below relates to the financial year ended 30 September 2020. The business manufactures one type of handbag.

REQUIRED:

Prepare the Production Cost Statement on 30 September 2020. Show ALL workings (21)

INFORMATION:**A Figures provided by the bookkeeper on 30 September 2020**

	R
Administration cost	380 000
Direct material cost	976 000
Direct labour cost	755 000
Factory overhead cost	442 080
Selling and distribution cost	219 200
Work-in-process: 1 October 2019	74 000
30 September 2020	?
Total cost of production of finished goods	2 187 500

B An internal audit revealed the following:

- Damaged raw material, valued at R17 000, that had been returned to the supplier was omitted in the calculation of the direct material cost.
- The factory overhead cost total included the full amount of R62 400 for rent expense. Only $\frac{2}{3}$ of this expense must be allocated to the factory. The remainder must be split equally between the office and the sales department
- The salary of a factory foreman on leave was not recorded. Details of his salary are as follows:

Deduction for SARS: PAYE	R2 560
Deduction for pension fund and UIF	?
Net salary	R8 320

- The employer's contribution for pension fund and UIF amounts to R1 920. The business contributes on a rand-for-rand basis

SOLUTION ON REFLECTIVE ACTIVITY

SNAZZY HANDBAGS

PRODUCTION COST STATEMENT ON 30 SEPTEMBER 2020

*Direct material cost (976 000 – 17 000)	959 000
*Direct labour cost	755 000
Prime Cost	1 714 000
*Factory overhead cost 14 720 (4 marks) (442 080 – 20 800 + 2 560 + 8 320 + 1 920 + 1 920) 12 800 (3 marks)	436 000
Manufacturing cost	2 150 000
Work-in-process (1 October 2019)	74 000
	2 224 000
Work-in-process (30 September 2020) Operation TCOP – subtotal above; ignore brackets	(36 500)
Total cost of production	2 187 500



Always indicate
calculations in brackets

The formula to
calculate prime cost is

$$DL + DM = PC$$

Damaged raw
materials
returned to
suppliers should
be subtracted

Calculation for work in process at the end
R2 224 000 – TCOP R2 187 500 = R36 500
W-I-P at the end

ACTIVITY 1: COST ACCOUNTING**2021 MAY- JUNE EXAM****(35 marks; 25 minutes)**

- 1.1 Choose a cost category from COLUMN B that matches a description in COLUMN A. Write only the letter (A-E) next to the question numbers (1.1.1 to 1.1.3) in the ANSWER BOOK, e.g., 1.1.4 F.

COLUMN A	COLUMN B
1.1.1 Commission to salespersons	A factory overhead cost
1.1.2 Wages of factory maintenance staff	B administration cost
1.1.3 Office stationery expenses	C direct labour cost
	D direct material cost
	E selling and distribution cost

(3 x 1) (3)

1.2 **MEISIES OUTFITTERS**

The business manufactures clothing products. The owner is Minnie Zitha. The information relates to school dresses which is one of the products they manufacture. Dresses are manufactured according to orders received and there is no work-in-progress. The financial year ended on 30 April 2021.

REQUIRED:

- 1.2.1 Refer to Information D.
Complete the Factory Overhead Cost Note for the school dresses. (10)
- 1.2.2 Calculate the total cost of production of school dresses produced. (4)
- 1.2.3 Minnie is concerned about wastage of fabric in the dressmaking section. Calculate the cost of this wastage to the business. (5)
- 1.2.4 The internal auditor expressed concern about the direct labour cost for the school dresses.
- Explain the problem that is of concern to the auditor. Quote figures. (3)
 - State TWO possible causes of this problem (2)
- 1.2.5 Provide a calculation to confirm that the break-even point for the current financial year is 17 000 units. (3)
- 1.2.6 Comment of the level of production achieved and the break-even point calculated above. Quote figures. (2)
- 1.2.7 Calculate the extra profit that would be earned if an additional 500 dresses are made and sold. Assume that all costs are unchanged. (3)

INFORMATION:**A.** Raw material stock (fabric used to make the dresses):

Fabric is issued to the factory using the weighted-average method.

	UNITS (metres)	COST per metre	TOTAL COST
Stock of fabric on 1 May 2020	9 000	R14,20	R 127 800
Fabric purchased during the year	33 000	R17,00	R 561 000
	42 000		R 688 800
Fabric issued to the factory	29 000	R16,40	R 475 600

B. Production and sales:

- Manufacturing one dress required 1.6 metres of fabric.
- 17 800 dresses were produced and sold during the financial year at R75 per dress.

C. Direct labour cost for the year:

	WORKERS	HOURS PER WORKER	RATE	TOTAL
Basic wage (normal time) *	8	1 250	R25	R 250 000
Total overtime worked	8	720	R45	R 259 200
Total employer's contributions				R 26 250
TOTAL		1 970		R 535 450

* Normal time comprises a 5-day week of 8 hours per day. The factory operates for 46 weeks each year.

D. Factory overhead costs:

The following costs were extracted from the records on 30 April 2021:

Factory rent expense	R 122 400
Water and electricity	81 600
Insurance on factory equipment	20 720
Salary of the dressmaking supervisor	76 960
Delivery expenses	36 800
Wages of cleaners	155 760
Depreciation: dressmaking machines	30 300
Sundry factory expenses (dressmaking section)	10 670

- Factory rent is split according to floor space occupied. The dressmaking section occupies 320 m² of the total factory space of 1 280 m².
- 15% of the total water and electricity account must be allocated to the dressmaking section.
- Insurance on factory equipment was paid up to 30 June 2021. Dressmaking equipment comprises $\frac{1}{3}$ of the total factory equipment.
- Only one of the six cleaners, Susan, was allocated to the dressmaking section. Susan earns 10% less than the other five cleaners.

E. Additional information relating to the dressmaking section:

- Total variable costs amounted to R1 094 700 (R61,50 per unit)
- Fixed costs, comprising factory overhead costs and administration costs, totalled R 229 500

ACTIVITY 1: MANUFACTURING**COST ACCOUNTING 2021 MAY-JUNE EXAM (35 marks; 25 minutes)****1.1**

1.1.1	
2.1.2	
1.1.3	

3

1.2**MEISIES OUTFITTERS****1.2.1****FACTORY OVERHEAD COST NOTE**

Salary of dressmaking supervisor	76 960
Depreciation on machines	30 300
Sundry factory expenses	10 670
TOTAL	

10

1.2.2**Calculate the total cost of production of school dresses produced**

WORKINGS	ANSWER

4

1.2.3

Minnie is concerned about wastage of fabric in the dressmaking section.

Calculate the cost of this wastage to the business.

WORKINGS	ANSWER

5

1.2.4

The internal auditor expressed concern about the direct labour cost for the school dresses.

Explain the problem that is of concern to the auditor. Quote figures.

Explain the problem that is of concern to the auditor. Quote figures.

3

2

1.2.5

Provide a calculation to confirm that the break-even point for the current financial year is 17 000 units.

Provide a calculation to confirm that the break-even point for the current financial year is 17 000 units.

3



1.2.6 Comment on the level of production achieved and the break-even point calculated above. Quote figures.

2

1.2.7 Calculate the extra profit that would be earned if an additional 500 dresses are made and sold. Assume that all costs are unchanged.

WORKINGS	ANSWER

3

TOTAL MARKS
35

2020 NSC NOV**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 weremade

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.

Information and Adjustments	Calculations	Production Cost Statement																																		
<table><tr><td colspan="2">Extracted from B</td></tr><tr><td>Direct material cost</td><td>R1 575 000</td></tr><tr><td>Selling and distribution cost</td><td>R385 000</td></tr><tr><td>Administration cost</td><td>R256 400</td></tr><tr><td>Direct labour cost</td><td>?</td></tr><tr><td>Factory overhead cost</td><td>R518 800</td></tr></table>	Extracted from B		Direct material cost	R1 575 000	Selling and distribution cost	R385 000	Administration cost	R256 400	Direct labour cost	?	Factory overhead cost	R518 800	Note: Carriage on goods is added to Direct Material cost: <table><tr><td>Direct material cost</td><td>R1 575 000</td></tr><tr><td>Carriage</td><td>R75 000</td></tr><tr><td></td><td>1 650 000</td></tr></table> Direct Labour cost: Prime costs LESS Direct material costs 2 550 000 -1 650 000 =900 000	Direct material cost	R1 575 000	Carriage	R75 000		1 650 000	<table><tr><td colspan="3">PRODUCTION COST STATEMENT</td></tr><tr><td></td><td>Note</td><td>R</td></tr><tr><td>Direct material costs</td><td>1</td><td>1 650 000</td></tr><tr><td>Direct labour costs</td><td>2</td><td>900 000</td></tr><tr><td>Prime costs</td><td></td><td>2 550 000</td></tr></table> Prime cost is a given figure – check the answer book	PRODUCTION COST STATEMENT				Note	R	Direct material costs	1	1 650 000	Direct labour costs	2	900 000	Prime costs		2 550 000	
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Information and Adjustments	Calculations	Calculations																																										
	<table><tr><th colspan="3">Correct allocation of 196 000</th></tr><tr><td>Factory</td><td>Admin</td><td>Selling & Dist.</td></tr><tr><td>5</td><td>4</td><td>1</td></tr><tr><td>?</td><td>?</td><td>?</td></tr></table> 196 000 x 5/10 = 98 000 correct amounts NOTE: to your factory overhead ADD 98 000 and DEDUCT 117 600	Correct allocation of 196 000			Factory	Admin	Selling & Dist.	5	4	1	?	?	?	SHORT CUT 117 600 X 10/6 X 5/10 =98 000 OR 117 600 X 5/6 = 98 000																														
Correct allocation of 196 000																																												
Factory	Admin	Selling & Dist.																																										
5	4	1																																										
?	?	?																																										
CHECK ABOVE 117 600 x 10/6=196 000 Admin: 196 000 x 3/10 = 58 800 Selling and Dist.: 196 000 x 1/10= 19 600 Correct Figures 196 000 x 5/10 = 98 000 196 000 x 4/10 =78 400 196 000 x 1/10 =19 600	Note <table><tr><th colspan="2">Factory</th><th colspan="2">Admin</th><th colspan="2">Selling & Dist.</th></tr><tr><td>6</td><td rowspan="2"><i>Incorrect</i></td><td>3</td><td rowspan="2"><i>Incorrect</i></td><td>1</td><td rowspan="2"><i>Correct</i></td></tr><tr><td>117 600</td><td>58 800</td><td>19 600</td></tr><tr><td>5</td><td rowspan="2"><i>Correct</i></td><td>4</td><td rowspan="2"><i>Correct</i></td><td>1</td><td rowspan="2"><i>Correct</i></td></tr><tr><td>98 000</td><td>78 400</td><td>19 600</td></tr><tr><td colspan="2"></td><td colspan="2"></td><td colspan="2"></td></tr><tr><td colspan="2">ADD 98 000 and LESS 117 600 or write -19 600</td><td colspan="2">ADD 78 400 and LESS 58 800 or write +19 600</td><td colspan="2">NO DIFFERENCE</td></tr><tr><td colspan="2"></td><td colspan="4">Check your abridged I/S</td></tr></table>		Factory		Admin		Selling & Dist.		6	<i>Incorrect</i>	3	<i>Incorrect</i>	1	<i>Correct</i>	117 600	58 800	19 600	5	<i>Correct</i>	4	<i>Correct</i>	1	<i>Correct</i>	98 000	78 400	19 600							ADD 98 000 and LESS 117 600 or write -19 600		ADD 78 400 and LESS 58 800 or write +19 600		NO DIFFERENCE				Check your abridged I/S			
Factory		Admin		Selling & Dist.																																								
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ADD 98 000 and LESS 117 600 or write -19 600		ADD 78 400 and LESS 58 800 or write +19 600		NO DIFFERENCE																																								
		Check your abridged I/S																																										

Abridged Income Statement	
Sales	4 860 000
Cost of sales 4 860 000 - 1 494 000	(3 366 000)
Gross profit (check calculation)	1 494 000
Selling and distribution cost 385 000 - 75 000	(310 000)
Administration cost 256 400 – 25 200 + 8 400 - 58 800 + 78 400 OR 256 400 - 16 800 + 19 600	(259 200)
Net profit	924 800

Information and Adjustments

Gross profit earned on sale of shirts:

	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

Calculations

Sales	4 860 000	These amounts are transferred to the Abridged Income Statement
Less Cost of Sales	(3 366 000)	
Gross profit	1 494 000	

Opening stock	342 000
Total cost of production	3 192 000
Less closing stock	(168 000)
	3 366 000

**Closing stock: (400 X 420)
= 168 000**

**NOTE: The stock of units on hand is
included in the 7 600 units that were
produced at R420**

Information and Adjustments

Calculate the mark-up % achieved on shirts

Calculations

Gross profit	1 494 000	x	100	=	44,4%
Cost of sales	3 366 000		1		

ACTIVITY 2 : COST ACCOUNTING NOV 2021**(45 marks; 35 minutes)****2.1 PRUDY MANUFACTURERS**

The information relates to the financial year ended 28 February 2021. The business produces one style of travelling bag. The owner is Prudy Sithole.

REQUIRED:

Complete the following for the year ended 28 February 2021:

- 2.1.1 Production Cost Statement (10)
 2.1.2 Abridged Statement of Comprehensive Income (Income Statement) (11)

INFORMATION:**A. Stock balances:**

	29 FEBRUARY 2021	1 MARCH 2020
Finished goods stock	R96 000	R72 000

There is no work-in-progress at the beginning or end of the year.

B. Raw material issued to the factory for production, R1 494 000.**C. Production wages:**

Information extracted from the production wages records:

NET WAGES PAID TO PRODUCTION WORKERS	TOTAL DEDUCTIONS
R647 400	22% of gross wages

D The bookkeeper calculated the following costs for the year ended 28 February 2021: Factory overhead cost:

Factory overhead cos	R520 280
Selling and distribution cost	R224 960
Administration cost	R187 760

It was discovered that she did not take the following into account:

- The telephone account of R22 400 was posted in error to the factory overhead cost. This expense relates to the office.
- The entire amount of rent expense, R98 400, was posted to the factory overhead cost. This expense should have been split in the ratio 7: 2: 1 between the factory, sales and administration departments
- The insurance expense of R26 400 was divided equally between the factory overhead cost and the sales department in error. 60% of this expense relates to the factory and the balance applies to the sales department

E Sales

Total sales for the year amounted to R4 433 600.

After completing the statements in QUESTION 2.1, the internal auditor of Prudy Manufacturers suspects that the raw material (fabric) is not being controlled well in the storeroom and the factory

2.2.1 Calculate:

- The metres of fabric missing from the storeroom
- The metres of fabric wasted in the factory

Apart from installing cameras, provide a specific strategy to improve internal control in the storeroom and factory. In EACH case, provide a different point (6)

2.2.2 Calculate the total cost of fabric lost and wasted and explain how this loss should be shown in the statements mentioned in QUESTION 2.1. (3)

INFORMATION:

A. Raw material (fabric):

Fabric used in production is issued to the factory from the storeroom, as required. The record of fabric is as follows:

	METRES	TOTAL AMOUNT
Raw material issued to factory	12 450	R1 494 000
Balance on 1 March 2020	2 700	324 000
Purchase of fabric during the yea	10 800	1 296 000
Balance on 28 February 202	850	102 000

B. Additional information:

- Fabric is purchased at a fixed cost price of R120 per metre.
- It takes 1,5 metres of fabric to make one travel bag
- 7 800 bags were produced during the financial year.

2.3 ROSEMARY'S TOY FACTORY

This factory manufactures toy teddy bears. There is no work-in-progress stock at the beginning or end of each year. The financial year ends on 31 December.

Rosemary decided to address the problem of low profits made in 2020 by making some changes to improve sales and production.

REQUIRED:

2.3.1 Provide a calculation to confirm that the break-even point for the 2021 financial year is correct (3)

2.3.2 Explain why Rosemary is pleased with the production level, sales, and break-even point. Quote figures. (4)

2.3.3 Explain to Rosemary why the fixed cost per unit decreased from R56, 00 to R45, 71. (2)

2.3.4 Rosemary made deliberate decisions regarding variable costs to improve the business.

Explain the decisions that she might have taken on these costs and how these could have had positive effects on the business. Quote figures. (6)

INFORMATION:

	31 DECEMBER 2021		31 DECEMBER 2020	
	AMOUNT R	UNIT COST R	AMOUNT R	UNIT COST R
Direct material cos	490 000	100,00	320 000	80,00
Direct labour cos	274 400	56,00	288 000	72,00
Selling and distribution cost	176 400	36,00	96 000	24,00
VARIABLE COST	940 800	192,00	704 000	176,00
Factory overhead costs	160 000	32,65	160 000	40,00
Administration cost	64 000	13,06	64 000	16,00
FIXED COST	224 000	45,71	224 000	56,00
Selling price per unit	R255		R240	
Units produced and sold	4 900 units		4 000 units	
Break-even point	3 556 units		3 500 units	

COST ACCOUNTING –MANUFACTURING**ACTIVITY 2: ANSWER SHEET****2021 NOV NSC P2****2.1 PRUDY MANUFACTURERS****2.1.1 PRODUCTION COST STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 2021**

Direct material cost	1 494 000	
Prime cost		
Factory overhead cost 520 280		
Cost of production of finished goods		
		10

2.1.2 ABRIDGED STATEMENT OF COMPREHENSIVE INCOME (INCOME STATEMENT) FOR THE YEAR ENDED 28 FEBRUARY 2021

Sales	4 433 600	
Cost of sales		
Gross profit		
Other expenses		
Selling and distribution costs 224 960		
Administration cost 187 760		
Net profit for the year		11

2.2 CONTROL OF RAW MATERIAL

2.2.1	Calculate the metres of fabric	Internal control strategy
	Missing from the storeroom	
	Wasted in the factor	

6

2.2.2	Calculate the total cost of fabric lost and wasted.						
	<table> <tr> <th>WORKINGS</th><th>ANSWER</th></tr> <tr> <td></td><td></td></tr> <tr> <td></td><td></td></tr> </table>	WORKINGS	ANSWER				
WORKINGS	ANSWER						
	Explain how this loss should be shown in the statements mentioned in QUESTION 2.1.						

3

2.3 ROSEMARY'S TOY FACTORY

2.3.1	Provide a calculation to confirm that the break-even point for the 2021 financial year is correct.
--------------	---

3

2.3.2	Explain why Rosemary is pleased with the production level, sales and break-even point. Quote figures.
--------------	--

4

2.3.3 Explain to Rosemary why the fixed cost per unit decreased from R56, 00 to R45, 71.

2

2.3.4 Rosemary made deliberate decisions regarding variable costs to improve the business.

Explain the decisions that she might have taken on these costs and how these could have had positive effects on the business. Quote figures.

Cos	Comment and positive effect (with figures)
Direct material cost	
Direct labour cost	
Selling and distribution cost	

6

TOTAL MARKS
45

ACTIVITY 3: MANUFACTURING AND COST ACCOUNTING

EC PRELIM 2020

(50 marks; 45 minutes)

3.1 CONCEPTS

Indicate whether the following statements are TRUE or FALSE. Write only 'true' or 'false' next to the question number (3.1.1 to 3.1.2) in the ANSWER BOOK.

- 3.1.1 Carriage on raw materials purchased increases the cost of raw materials issued for production (1)
- 3.1.2 Commission on sales will be classified as an administration cost (1)

3.2 PRODUCTION COST STATEMENT

The following information was extracted from the accounting records at the end of the 2020 financial year.

REQUIRED:

- 3.2.1 Complete the note for Direct Material costs. (7)
- 3.2.2 Complete the Production cost statement on 29 February 2020. (15)
- 3.3.3 Complete the Income Statement for the year ended 29 February 2020. (11)

INFORMATION:

- A. Railage on raw materials purchased, R180 000.
- B. Salaries and wages amounted to R724 160 for the financial year. 50% of this can be attributed to wages of the employees who work directly on the product. The rest is shared equally between Factory overheads and Administration cost.
- C. 96 000 completed units were manufactured during the financial year. The cost price of each finished unit was R20.
- D. Sales for the year amounted to R3 804 000. Goods are sold at a mark-up of 100% on cost.
- E. Selling and distribution costs amounted to R594 860.
- F. Administration costs are R 571 100. These do not include salaries and wages.

3.3 COST ACCOUNTING

You are provided with information from the records of Healthy Living, the producers of one type of breakfast cereal. The financial year ends on 31 August 2020.

REQUIRED:

- 3.3.1 Calculate the break-even point for the year ended 31 August 2020. (4)
- 3.3.2 Should the business be satisfied with the number of units that they produced and sold during the current financial year? Explain. Quote figures (3)
- 3.3.3 Give TWO possible reasons for the increase in the direct material cost per unit in the current financial year. (4)
- 3.3.4 Tyler the owner suggests that, to improve financial results in the new financial year, the quantity of cereal per box must be reduced by 10% and the selling price must remain the same. Give TWO valid reasons why he should not do this. (4)

INFORMATION:

The following information was taken from the accounting records:

	31 August 2020		31 August 2019	
	Total	Per unit	Total	Per unit
Sales	R1 792 000	R28,00	R1 794 000	R23,00
Variable costs	R1 024 000	R16,00	R 975 000	R12,50
Fixed costs	R736 000	R11,50	R 630 000	R8,08
Direct material cost	R656 000	R10,25	R 592 800	R7,60
Break-even point	?		60 000 units	
Number of units produced and sold	64 000 units		78 000 units	

TOTAL 50

MANUFACTURING AND COST ACCOUNTING EC PRELIM 2020 (50 marks; 45 minutes)

3.1 Indicate whether the following statements are TRUE or FALSE. Write only 'true' or 'false' next to the question number (3.1.1 to 3.1.2).

3.1.1	
3.1.2	

2

3.2.1 **Note for Direct Material Costs**

Balance at the beginning of the year	210 000
Purchases	
Railage on purchases	
Balance at the end of the year	

7

3.2.2 **Production Cost statement on 29 February 2020**

Direct Material	1 240 000
Total manufacturing costs	
Work-in-progress at the end of the year	(90 000)
Cost of production of finished goods	

15

INCOME STATEMENT FOR THE YEAR ENDED 29 FEBRUARY 2020

3.2.3

Sales	
Administration cost	

11

3.3

Cost Accounting:

3.3.1

Calculate the break-even point for 2020.

4

3.3.2

Should the business be satisfied with the number of units that they produced and sold during the current financial year? Explain. Quote figures

3

3.3.3

Give TWO possible reasons for the increase in the direct material cost per unit in the current financial year.

--

4

3.3.4

Tyler the owner suggests that, to improve financial results in the new financial year, the quantity of cereal per box must be reduced by 10% and the selling price must remain the same. Give TWO valid reasons why he should not do this.

--

4

	50

ACTIVITY 4: MANUFACTURING

(45 marks; 35 minutes)

LIMPOPO PRELIM 2020

4.1 CONCEPTS

Give one word/term for each of the following descriptions by choosing a word/term from the list below. Write only the word/term next to the question number (4.1.1 – 4.1.4) in the ANSWER BOOK.

(4)

Direct material cost	Direct labour cost
Factory overhead cost	Administrative cost
Sales and distribution cost	Break-even point

- 4.1.1 Fuel cost for the delivery of leather handbags.
- 4.1.2 The cost of leather for manufacturing leather handbags
- 4.1.3 The salary of the accountant for the business producing leather handbags.
- 4.1.4 The salary of the employee cutting the leather for the leather handbags.

4.2 IMPACT COVERS

Johnny Good is the owner of Impact Covers, a business that produces shockproof cell phone covers. The financial year ended on 30 June 2020. A mark-up of 25% on cost price is used

REQUIRED

- 4.2.1 **Refer to Information B.** Calculate the Direct Labour cost. (7)
- 4.2.2 **Refer to Information C.** Complete the correct Factory Overhead Cost note. (12)
- 4.2.3 Complete the missing figures in the Production Cost Statement for the year ended 30 June 2020. (9)

INFORMATION

A

List of balances on:	30 June 2020	1 July 2019
Indirect materials	5 000	6 100
Work in Process	?	52 400
Finished products	26 000	31 000

B. Factory workers:

- The factory workers worked 220 normal hours per month for the first three quarters of the year, at a rate of R60 per hour.
- Due to the Covid-19 situation, the factory workers only worked 30 hours in total over the last quarter of the year at the normal hourly rate.

- Over the whole financial year, the workers worked 60 hours overtime at a rate of 1,5 of the normal rates.

C. The bookkeeper calculated the factory overhead cost for the year ended 30 June 2020:

Sundry factory expenses	R43 320
Indirect material	R73 000
Insurance	R22 100
Water and electricity	R30 000
Marketing	R14 700
Rent expense	R163 800
Factory manager's salary	R126 800

With closer inspection, the following errors were noticed and should be rectified:

- The balances for Indirect materials were not considered. All Indirect materials are used in the factory.
- Insurance includes the payment for July 2020. The bookkeeper forgot that 30% of Insurance should be allocated to the administrative department.
- Only 60% of Water and electricity was allocated to the factory. It should have been 70%.
- The Rent expense is the total amount paid for the whole year. This should be allocated between the Factory, Sales and Administrative departments in the ratio of 5: 3: 1.
- The factory manager received an increase of R700 per month on 1 November 2019. He will forfeit his whole salary for the last month due to the Covid-19 pandemic. The bookkeeper was not aware of this arrangement.

D. Sales:

- Sales for the year ended **30 June 2019** was R1 760 000.
- Sales for the year ended **30 June 2020** showed a decrease of 40% from the previous year.

4.3 SUNNY DESKS

Sunny Desks produces desks for children, which is sold at a mark-up of 50%. The financial year ended 31 August 2020.

REQUIRED

(4)

4.3.1 Calculate the following for the year ended 31 August 2020:

(a) Variable cost per hat

(4)

(b) Break-even point

(5)

4.3.2 James, the owner of Sunny Hats, is concerned about the production and cost management of the past year. Examine the information and identify TWO different cost items that cause concern. Provide advice on how to improve in each case.

(4)

INFORMATION

	2020	2019
Factory overhead cost	R702 000	R640 000
Prime cost per unit	R110	R70
Direct material	R70	R35
Direct labour	R40	R35
Fixed sales price per unit	R260	R260
Sales and distribution cost	R219 000	R189 000
Commission	R44 000	R54 000
Fuel cost	R96 000	R73 000
Maintenance of vehicles	R79 000	R62 000
Administrative cost	R221 000	R200 900
Salaries of office staff	R151 000	R132 900
Insurance	R70 000	R68 000
Units produced during the year	9 300	9 900
Units sold during the year	7 300	9 000
Break-even point	?	3 400

ACTIVITY 4

ANSWER SHEET:

MANUFACTURING AND COST ACCOUNTING LIMPOPO PRELIM 2020 (45 marks; 35 minutes)

4.1 CONCEPTS

4.1.1	
4.1.2	
4.1.3	
4.1.4	

4

4.2 IMPACT COVERS

4.2.1 Refer to Information B. Calculate the Direct Labour cost.

7

4.2.2 Factory Overhead Cost

12

4.2.2 Production Cost Statement for the year ended 31 May 2020

Direct material	
Direct labour	
Prime cost	
Factory overhead cost	
Total production cost	849 700
Work in process	
Work in process	
Total cost of production of complete products	

9

4.3 SUNNY DESKS

4.3.1 Calculate the following for the year ended 31 August 2020:

(a) Variable cost per unit.

4

(b) The break-even point.

5

4.3.2 James, the owner of Sunny Hats, is concerned about the production and cost management of the past year. Examine the information and identify TWO different cost items that cause concern. Use figures to support your answer. Provide advice on how to improve in each case.

Problem (with figures)	Advice

4

45

SESSION 19: BANK RECONCILIATION

BANK RECONCILIATION CONCEPTS AND NOTES

WHAT IS BANK RECONCILIATION?

- Bank reconciliation is the process by which the bank account balance in an entity's books is reconciled to the balance in the most recent bank statement. Any difference between the two figures needs to be examined and, if appropriate, be rectified to bring the two records into agreement.

Reasons for preparing the Bank Reconciliation

- To ensure that all entries relating to cash transactions are accurately recorded.
- Fraudulent transactions can be detected.
- Errors or omissions can be detected

It also enables the business or individual to keep track of the following:

- Outstanding Electronic Funds transfers (EFT)
- Outstanding deposits
- Bank charges/ service fees
- Electronic transfers made by the business or person
- Electronic transfers /direct deposits in favour of the business
- Interest on overdrafts
- Interest earned on the credit balance

CONCEPTS UNIQUE TO BANK RECONCILIATION

Current Bank account	An account from which money can be drawn immediately without notice, payments can be made by cheque, electronic transfers or debit card.
Bank charges	Amounts deducted by the bank as payment for the services it provides. This is reflected on the statement.
Bank overdraft	The business has withdrawn more money than was deposited in the bank account.
Interest on overdraft	Represents a payment (expense) to the bank for an overdraft bank balance.
Interest on current account	A receipt (income) from the bank for reflecting a favourable bank balance.
Credit card	This is used to buy goods or services from suppliers, and the amounts used is paid back to the bank at a later date.
Debit card	This is used to buy goods/services and the amount is immediately deducted from your bank account balance.
Deposit slip	This form is used to record the total cash and cheques received for the day and is proof of the amount deposited in the current account.
Electronic funds transfer (EFT)	Electronic transfer of money from one bank account to another, without direct interaction of the bank staff.

COMPARISON BETWEEN THE BANK STATEMENT AND THE RECORDS OF THE BUSINESS

Records of the business

- ▶ Cash transactions recorded in the **CRJ** and **CPJ** and ultimately posted to the **Bank Account**.
- ▶ Cash received and deposited is reflected on the **DEBIT** side of the Bank Account.
- ▶ Payments made by the business are reflected on the **CREDIT** side of the bank account.

Records of the bank

- ▶ A **statement** sent by bank to the business reflects all the transactions affecting the balance of the business.
- ▶ The Bank will **CREDIT** all **deposits** made by the business.
- ▶ **Payments, withdrawals, debit orders** made by the business are recorded on the **DEBIT** side of the bank statement.

FAVOURABLE AND UNFAVOURABLE BANK BALANCE

Favourable

Business Records

A favourable balance is reflected on the **DEBIT** side of the Bank account

Bank Records

A favourable bank balance is reflected on the **CREDIT** side of the Bank statement.

Unfavourable

Business records

An unfavourable bank balance (bank overdraft) is reflected on the **CREDIT** side of the Bank account.

Bank Records

An unfavourable bank balance is reflected on the **DEBIT** side of the Bank statement.

- is an asset to the business
- is a liability to the bank

Favourable balance

- is a liability to the business
- is an asset to the Bank

Unfavourable balance

STEPS TO FOLLOW WHEN COMPLETING THE BANK RECONCILIATION:

Steps	Action and Reconciliation		
Step 1:	Compare the CRJ with the Credits (+) entries on the bank statement. Compare the CPJ with the Debits (-) entries on the bank statement.	Tick off (✓) all the entries that agree in the Journals and the Bank statement and, <u>circle</u> entries that only appear in a journal or that only appear on the bank statement.	
<i>The above action will be classified as step one only when the entity has just opened the current bank account or just started to operate as a business.</i>			
Step	2.1	<i>The entries circled in the Bank statement</i>	<i>Record those entries in CRJ OR CPJ (except errors made by the bank)</i>
	2.2	Entries circled in the CRJ and CPJ	Record entries in Bank Reconciliation (except errors made by the business)
	2.3	Total the CRJ and CPJ	
Step 3:	Draw up the Bank account and balance it.		
Step 4:	Draw up the Bank Reconciliation Statement		
<i>Assume that the above records are completed at the end of February 2021</i>			

NOTE THE FOLLOWING:

- Errors made by the business will be corrected in the Cash Journals
- Errors made by the Bank will be corrected in the Bank Reconciliation statement

Steps		Action and Reconciliation for the end of March 2021
Step 1:	Compare Bank Reconciliation Statement for February 2021 with Bank statement of March 2021.	<i>If the entries appear in the Bank Statement, only tick it off.</i> <i>If the entry does not appear on the bank statement, circle and record the entry again in the current month's BRS.</i>
Step 2.1	Entries circled in the Bank reconciliation statement for February 2021.	<i>Record those entries again in Bank Reconciliation – March 2021</i> <i>Entries could involve the outstanding deposit if it the business has not taken the decision to write the amount off.</i>
		<i>These steps will be followed by the steps that were followed In February, check the information above.</i>

EXAMPLE: BANK RECONCILIATION

The bookkeeper of Majozi Stores received the Bank Statement from the First Rand Bank on 31 January 2021.

REQUIRED:

1. Compare the Bank Statement with the CRJ and the CPJ.
2. Supplement (add the relevant extra entries to Cash Journals and total the Bank columns only)
3. Post the bank totals in the CRJ and CPJ to the bank account in the general ledger
4. Draw up the Bank Reconciliation Statement on 31 January 2021
5. Explain one reason why it is important for a business to prepare a monthly Bank Reconciliation Statement

INFORMATION:

A. Majozi Stores

Cash Receipt Journal for January 2021

Doc	Day	Details	Bank	Sales	Cost of sales	Sundry Accounts	
						Amount	Details
CRT	10	S. Marray	2 500			2 500	Debtors control
28	17	DF Malan	2 800			2 800	Debtors control
CRT	30	Sales	7 500	7 500	5 000		
			12 800	7 500	5 000	5 300	

B. Cash Payment Journal for January 2021

Doc	Day	Details	Bank	Sundry Accounts	
				Amount	Details
EFT 91	19	Mino Stores	3 750	3 750	Equipment
EFT 92	20	CNA	350	350	Stationery
EFT 93	26	Faff Traders	1 200	1 200	Creditors control
EFT 94	30	Karl Motors	2 300	2 300	Repairs
			7 600	7 600	

C. Bank Statement received from First Rand bank

Date	Transaction details	Debit	Credit	Balance
1 Jan	Opening balance			9 200
10 Jan	Deposit: S Marray		2 500	11 700
15 Jan	Debit order: OBE Insurers	1 400		10 300
17 Jan	DF Malan		2 800	13 100
19 Jan	EFT (Mino Stores)	3 750		9 350
20 Jan	EFT (CNA)	350		9 000
21 Jan	Deposit (EFT by tenant: S Omar)		1 500	10 500
25 Jan	Debit order: Multi choice	1 000		9 500
26 Jan	EFT (Faff Traders)	1 200		8 300
29 Jan	Cash deposit fee	95		8 205
31 Jan	Service fee	70		8 135
31 Jan	Interest income		240	8 375

ADDITIONAL INFORMATION:

1. The bank account in the General ledger has a favourable balance of R9 200 on 1 January 2021
2. The Bank Statement is received on the 28th of each month.

EXPECTED ANSWER**Majozi Stores****1. Cash Receipt Journal for January 2021**

Doc	Day	Details	Fol	Bank	Sundry Accounts	
					Amount	Details
	1	Totals		12 800		
B/S	31	S Omar		1 500	1 500	Rent Income
B/S	31	First Rand bank		240	240	Interest Income
				14 540		

2. Cash Payment Journal for January 2021

Doc	Day	Details	Fol	Bank	Sundry Accounts	
					Amount	Details
	1	Totals		7 600		
B/S	31	OBE Insurers		1 400	1 400	Insurance
B/S		Multi Choice		1 000	1 000	DSTV fees
B/S		First Rand Bank		165	165	Bank charges
				10 165		

3. Bank account									
Jan	1	Balance	b/d	9 200	Jan	31	Total payments	CPJ	10 165
	31	Total Receipts	CRJ	14 540			Balance	c/d	13 575
				23 740					23 740
Feb	1	Balance	b/d	13 575					

4. Bank Reconciliation Statement on 31 January 2021		
	Debit	Credit
Cr Balance as per bank statement		8 375
Cr Outstanding deposit		7 500
Dr Outstanding EFT's		
EFT 94	2 300	
Dr Balance as per bank account	13 575	
	15 875	15 875

5. Explain ONE reason why it is important for a business to prepare a monthly Bank Reconciliation Statement.

- To confirm the accuracy of the bank balance in the business books with external source, the bank statement.
- To identify errors and timeously do corrections
- To follow up on outstanding deposits and EFT's
- To update the bank balance with the amounts that were directly deducted or deposited to your account. e.g. bank charges, interest, debit orders etc.

ACTIVITY 1

Use the following Cash Journals of Chloe Traders and the Bank Statement received from AJ Bank to complete the following:

Required:

- 1.1 Complete the Cash Journals for January 2021. Enter the provisional totals first.
- 1.2 Post to the Bank account in the General ledger.
- 1.3 Prepare the Bank Reconciliation Statement on 31 January 2021

Information:

Chloe Traders

Cash Receipt Journal for January 2021

Doc	Day	Details	Fol	Bank	Sundry Accounts	
					Amount	Details
CRT	2	Sales		1 900		
23	8	H Lene		4 800		
CRT	11	Sales		2 500		
				9 200		

Cash Payment Journal for January 2021

Doc	Day	Details	Fol	Bank	Sundry Accounts	
					Amount	Details
EFT1 15	5	Icon Traders		2 200		
EFT1 16	7	City Treasurer		1 900	1 900	Water & Electricity
EFT1 17	11	S Sly		1 680		
EFT1 18	20	V Batim		6 400		
				10 280	1 900	

Bank Statement (Extract)

Date	Transaction details	Debit	Credit	Balance
1 Jan	Balance b/f			13 890
2 Jan	Deposit		1 900	15 790
5 Jan	Electronic transfer (Icon Traders)	2 200		13 590
11 Jan	Deposit		2 500	16 090
	Electronic transfer (S Sly)	1 680		14 410
14 Jan	Cash deposit fee	29		14 381
20 Jan	Electronic transfer (V Batim)	6 400		8 981
28 Jan	Service fee	56		8 925
	Electronic transfer(tenant: S Mart)		2 400	11 325

Additional information:

1. The bank account in the General ledger has a favourable balance of R13 890 on 1 January 2021
2. EFT payment 118 on the 20 January 2021 appeared on the January bank statement with the correct amount of R5 400. Payment was made to a creditor in settlement of our account.
3. The Bank Statement is received on the 25 the of each month.

ACTIVITY 1**ANSWER SHEET ONE**

1.1

CASH RECEIPT JOURNAL - JANUARY 2021 CRJ 1

Doc	Day	Details	Bank	Amount	Details

5

CASH PAYMENT JOURNAL - JANUARY 2021 CPJ 1

Doc	Day	Details	Bank	Amount	Details

8

1.2

GENERAL LEDGER OF CHLOE TRADERS**Bank**

7

1.3

Prepare a Bank Reconciliation Statement for JANUARY 2021.

	Debit	Credit

5

2.1 Indicate whether the following statements are TRUE or FALSE: (3)

- 2.1.1 A payment made by EFT, must be recorded in the Cash payment journal when it reflects on the bank statement.
- 2.1.2 A business must record cash losses immediately when suspected according to the materiality concept of GAAP.
- 2.1.3 A debit balance on the bank statement indicates a bank overdraft.

2.2 Bank Reconciliation

Lucky Jimmy, the cashier of Franco's Deli, is in charge of collecting, receipting and banking all cash receipts as well as all payments done via EFT. He feels that there is no need to prepare a bank reconciliation statement because the bank keeps accurate records of all transactions as reflected on the bank statement.

REQUIRED:

- 2.2.1 Calculate the correct bank account balance in the General Ledger on 31 July 2020. (9)
- 2.2.2 Prepare a Bank Reconciliation Statement on 31 July 2020. (7)
- 2.2.3 Provide ONE reason why the internal auditor expressed concern about Lucky's job description. (2)
- 2.2.4 Explain to Lucky why it was necessary to prepare a bank reconciliation statement each month. Provide TWO points (4)

INFORMATION:

- A
- Favourable balance as per bank account on 31 July 2020 was R11 743 before receipt of the bank statement from Money Bank.
 - Balance as per bank statement on 31 July 2020. R?
- B Items on the July bank statement but not shown in the Cash Journals:

	RAND
Service fees	45
Cash deposit fees	132
Interest income	23
Debit order payment for insurance to Xi Insurers. This amount appeared twice on the statement in error	800
Commission income from LUVLI Pastries	522
Direct deposit by debtor, Y Knot	189

- C EFT payments made on 31 July 2016, were not on the bank statement:
EFT 1 for R675 and
EFT 2 for R2 010
- D Deposit on 31 July 2016 for R3 935 was not on the bank statement.

2.1.1	
2.1.2	
2.1.3	

3

9

[illegible]

7

2

4

SESSION 20: BANK RECONCILIATION

LIST OF POSSIBLE ERRORS ,DIFFERENCES AND OMISSIONS

When comparing the Cash Journals against the Bank statement the following errors, differences omissions will be identified:



Entries on Bank Statement	Records Corrected or Updated
Credit Entries - Interest on current account - Direct deposits - Internet deposits	Entries appearing in the Bank Statement only, will be recorded in CRJ.
Debit Entries - Interest on overdraft - Stop orders and Debit orders - Bank charges - Service fees - Levy on debit transactions - Credit card costs, etc.	Entries appearing in the Bank Statement only, will be recorded in CPJ.

Entries in Cash Journals	Records Corrected or Updated	
Cash Receipts Journal - Amounts received or EFT's incorrectly recorded - Overstated - Understated	Overstated Difference should be recorded in the CPJ	Understated Difference should be recorded in the CRJ
Cash Payments Journal - Amounts or EFT's paid incorrectly recorded - Overstated - Understated	Overstated Difference should be recorded in the CRJ	Understated Difference should be recorded in the CPJ

Bank Reconciliation Statement Entries	
- Closing balance of the Bank Statement - Deposits not yet credited by the Bank - EFTs not yet reflected - Debit wrongly credited amount - Credit wrongly debited amount - Closing balance according to the Bank account	- Favourable (CR) or unfavourable balance (DR) - Credit entry – you may have more than one deposit - Debit outstanding EFT's - Correction of wrongly debited or credited amounts by the bank does not affect our Journals/Records, these errors will be recorded in the BRS. - Favourable (DR) or unfavourable balance (CR)

Internal control processes that should be implemented to safeguard cash are:

- Ensure deposits are done on regular basis
- Rotate duties and times of banking to avoid creating a pattern
- Provide security when going to bank ,at least two people should go
- Divide duties ,the person who receives cash cash cannot be the person who banks or prepare the financial records.
- Use the collection companies to collect cash on a daily/regular basis.
- Check documentation ,receipts against deposit slips
- Senior personnel should check via internet banking / deposit slips that deposits reflected daily.
- Request SMS from bank for all transactions.
- Encourage debtors to make direct transfers (EFT).
- use of electronic notification of cash/bank deposits

ACTIVITY THREE

The information was extracted from the records of Hilton Traders for June 2020.

REQUIRED:

- 3.1 Complete the Cash Journals for June 2020. (**Note:** The information from the Bank Statement was not taken into account) (31)
- 3.2 Prepare the Bank Account on 30 June 2020. (6)
- 3.3 Prepare the Bank Reconciliation Statement on 30 June 2020. (9)
- 3.4 Provide TWO suggestions that the business can use to prevent a situation like the one experience on 26 May 2020 in the future. (4)
- 3.5 Identify the problem that is revealed by the previous reconciliation, and list TWO internal control measures to solve this problem. (5)
- 3.6 Refer to the debit order for R2 244. Provide a possible explanation how this may have occurred, and provide advise on how this can be rectified. (4)

INFORMATION:

A. Extract from the Bank Reconciliation statement on 31 May 2020:

Outstanding deposits: 17 May 2020	R32 100
26 May 2020	7 300
Outstanding EFT: No. 123	17 600
Unfavourable balance as per bank account	3 456

NOTE:

- The outstanding deposit of R32 100 appeared on the June 2020 bank statement.
- The outstanding deposit on the 26 May 2020 was reflected as R5 700 on the April statement. Upon enquiry, the bank confirmed that it was because of counterfeit notes included in the total deposit. This was cash received for repair services rendered. It was decided to write-off this difference.

EFT 123 appeared on the Bank Statement for June 2020.

B. Provisional totals from the Cash Journals on 30 June 2020:

- Cash Receipt Journal, R56 200
- Cash Payment Journal, R67 400

C. The following information on the June 2020 Bank Statement from XXZ Bank did not appear in the June 2020 Cash Journals:

- Debit orders:

Pro Insurers	R5 890	Monthly insurance premium
Matjhabeng Metro	R6 000	R4 500 is for the business' rates and taxes and the balance is for the owner's private property.
YEN Bank	R5 300	Monthly repayment of loan

- EFT Fees, R189
- Cash handling fee, R112
- Service Fees, R292
- Interest on bank overdraft, R317
- A deposit from P. Nel, R11 600 for his monthly rent.
- A debit order for R2 244 appeared on the business bank statement, on 29 April 2020. This was not an account of the business and fortunately, the owner was able to instruct the bank to cancel this entry. This reversal will be reflected on the next statement.
- A direct deposit of R16 300 was wrongly reflected on the business Bank Statement. The bank will rectify the error.
- A deposit from N. Botha for R3 400 in settlement of his account of R3 500.

E. The following information in the June 2020 Cash Journals did not appear on the Bank Statement for June 2020:

- Outstanding deposit, R17 800
- EFT 654 for R5 555 to BP Suppliers for sanitizing supplies purchased.

ACTIVITY THREE

3.1

CASH RECEIPT JOURNAL - JUNE 2020 CRJ 3

Doc	Day	Details	Bank	Amount	Details
	30	Total	56 200	56 200	

10

CASH PAYMENT JOURNAL - JUNE 2020 CPJ 3

Doc	Day	Details	Bank	Amount	Details
	30	Total	67 400	67 400	

21

3.2

GENERAL LEDGER OF HILTON TRADERS
Bank

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3.6

Refer to the debit order for R2 244. Explain a possible reason how this may have occurred, and provide advice on how this can be rectified.

POSSIBLE EXPLANATION:

POINT OF ADVICE

4

EXAMPLE 2: BANK RECONCILIATION (2022 FREE STATE)

2.2 MASALA TRADERS

The information relates to June 2022. The business receives its official bank statements on the 25th day of each month.

REQUIRED:

- 2.2.1 • Complete the CRJ and CPJ on 30 June 2022. (11)
- Calculate the correct bank balance in the ledger on 30 June 2022. Indicate whether the balance is favourable or unfavourable. (5)
- 2.2.2 Prepare the Bank Reconciliation Statement on 30 June 2022. (9)
- 2.2.3 **See Information H:** Explain why the internal auditor would be concerned (provide figures) and what action he or the owner should take. (4)

INFORMATION:

- A. The following Bank Reconciliation Statement was prepared on 31 May 2022:

	DEBIT R	CREDIT R
Balance as per Bank Statement	87 150	
Outstanding deposit (from cash sales; dated 31 May 2022)		31 600
Outstanding EFT (no. 555)	16 850	
Correction of error		22 700
Balance as per bank account		49 700
	104 000	104 000

Amounts can be written in one column, you should be able to identify debits and credits

- B. Provisional totals on 30 June 2022:

CRJ: R47 220

CPJ: R97 860

- C. When comparing the May reconciliation statement to the June 2022 bank statement, the following was noticed:

- (i) The outstanding EFT no. 555, outstanding deposit, and correction of the error of were correctly reflected on the June bank statement.

- D. The following items on the June 2022 bank statement did not appear in the June Cash Journals:

- EFT received from KZN Promotions for commission earned, R36 400.
- Monthly debit order in favour of Far Call for cell-phone charges, R2 800.

That will assist in calculating the amount that is not provided, normally it's a bank balance

- A deposit of R23 000 appeared in the current account of Masala Traders on 24 June 2022. The deposit has been identified as an error made by the bank. The bank has agreed to correct the error on the July bank statement.
- Cash deposit fees, R1 250.
- Service fees, R880.
- Interest on a debit balance, R2 160
- A debit card entry to withdraw cash for wages of R11 000 was recorded on the statement.
- A debit order for R10 570 dated 24 June 2022; in favour of Vodacell for cell-phone purchases. Masala Traders did not deal with this service provider and informed the bank immediately. The bank agreed to rectify this entry on the July 2022 bank statement.

E. Differences noticed when journals and June's bank statement were compared:

- An EFT of R15 300 was recorded in the CPJ with an incorrect beneficiary. The bank will rectify this on the next statement. Correct the error.
- Credit card sales appear on the bank statement as R32 300, but in the CRJ as R23 200. The bank statement is correct. Correct the error.

Our books
are
understated

F. Items in the journals but not in the June bank statement:

- EFT no. 633 for R24 800 dated 30 June 2022 in the CPJ.
- Cash deposit of R34 620 dated 30 June 2022 for sales (CS977-986's) in the CRJ.

G. The June 2022 bank statement reflected a balance of R?

H. In July 2022, the internal auditor discovered that CS977-986's actual total was R44 620. The entry in the CRJ was as follows:

Doc	Date	Details	Analysis	Bank
CS977–986	30 June	Cash	R34 620	R34 620

2.2.1

COMPLETE THE CRJ AND CPJ:

Cash Receipts Journal (figures only)		Cash Payments Journal (figures only)
47 220		97 860
36 400 ✓✓		2 800 ✓
15 300 ✓✓	# 2 130 Two marks	# 1 250 ✓
9 100 ✓✓	32 300 CRJ 23 200 CPJ	# 880 ✓
		2 160 ✓
		11 000 ✓
108 020		115 950

$$32\,300 - 23\,200 = 9\,100$$

Always add figures printed in your answer

11

5

Bank balance on 30 June 2022:

– 49 700 ✓ + 108 020 ✓ – 115 950 ✓ = – 57 630 ✓ one part correct

Unfavourable ✓

2.2.2

Prepare the Bank Reconciliation Statement on 30 June 2022.

	Debit	Credit
Debit balance as per bank statement balancing figure	55 020 ✓	
Credit outstanding deposit		34 620 ✓
Debit amount incorrectly credited	23 000 ✓✓	
Rectify error		10 570 ✓✓
Debit outstanding EFT 633	24 800 ✓	
Credit balance as per bank account		57 630 ✓ see 1.2.1
	102 820	✓102 820 Both must be the same

Use the total from CRJ and CPJ to calculate

Transfer bank balance to BRS

9

2.2.3

Refer to Information H.

Explain why the internal auditor would be concerned (provide figures). What actions should be taken? Provide TWO points.

Concern (with figures): ✓✓

- R10 000 less cash from sales were recorded and deposited.

Actions:

Any ONE action ✓✓

- Division of duties
- Control deposits before going to the bank
- Apply for SMS notification to monitor movement of cash.

4

Prepare the Bank Reconciliation Statement on 30 June 2022

	Debit	Credit

An examiner may decide to provide a structure that is not written **debit** or **credit** compare Free State, Eastern Cape 2022 and NSC NOV 2022

CORRECTION OF ERROR

Extracted from Mpumalanga - 2022

A debit order on the 5th, R1 850 for the monthly insurance appeared twice on the Bank Statement, but no entry has been made in the Journals. The bank will rectify this on the Bank Statement next month.

Expected answer

CASH RECEIPTS JOURNAL		CASH PAYMENT JOURNAL	
Details	Amount	Details	Amount
Provisional totals	R510 600	Provisional totals	R486 300
		Petty Insurers	1 850 ✓

BANK RECONCILIATION STATEMENT ON 31 JULY 2022			
	ONE COLUMN METHOD	DEBIT	CREDIT
Balance per Bank Statement	R43 310	Balancing figure	R43 310 ✓
Credit incorrect amount	R1 850		R1 850 ✓

ACTIVITY 4: BANK RECONCILIATION**(Adapted from NSC Nov 2022)**

4.1 **Indicate whether the following statements are TRUE or FALSE. Write only 'true' or 'false' next to the question numbers.**

- 4.1.1 Debit card fees form part of bank charges.
- 4.1.2 Interest on current account is recorded in the Cash Payments Journal.
- 4.1.3 A credit balance on the Bank Statement reflects an unfavourable balance.

(3 x 1) (3)

4.2 **BANK RECONCILIATION**

The information provided relates to Super Stores. The business is owned by Thandi Zondi.

- Thandi receives the official Bank Statement on the 26th day of each month. She uses this to do the bank reconciliation.

REQUIRED:

- 4.2.1 Use the table provided to calculate the final totals of the Cash Journals on 31 March 2023. (10)
- 4.2.2 Calculate the correct bank balance in the ledger on 31 March 2023. (4)
- 4.2.3 Prepare the Bank Reconciliation Statement on 31 March 2023. (8)

INFORMATION:

- A. On 1 March 2023, the Bank Account in the ledger reflected a favourable balance of R55 700.
- B. The Bank Reconciliation Statement prepared on 28 February 2023 showed the following outstanding deposits and EFTs:
- | | |
|----------------------------------|---------|
| • Deposit dated 15 February 2023 | R17 500 |
| • Deposit dated 28 February 2023 | R15 600 |
| • EFT 297 | R8 600 |
| • EFT 298 | R13 300 |

NOTE:

- (i) The deposit on 15 February 2023 appeared on the March Bank Statement as R13 000. An investigation revealed that the cashier at that time has resigned. The outstanding amount must be written off.
- (ii) EFT 297 was correctly reflected as R6 800 on the March Bank Statement.
- (iii) The other outstanding amounts from the previous month appeared on the March Bank Statement.

C. Before receiving the March 2023 Bank Statement, the Cash Journals reflected the following provisional totals:

CASH RECEIPTS JOURNAL	CASH PAYMENTS JOURNAL
R105 100	R137 225

D. The following items on the March Bank Statement must still be recorded:

- (i) A debit card payment of R1 700 for petrol for the business vehicle. Thandi neglected to submit the transaction document to the bookkeeper.
- (ii) The direct deposit received from debtor D Stephan, R5 500, in settlement of his account of R5 800.
- (iii) A debit order to Peace Insurers for the business insurance, R1 900.
- (iv) A direct deposit of R75 000 from Smart College. This is an error on the statement as it does not apply to Super Stores. The bank was notified of this error.
- (v) Total bank charges, R625
- (vi) Interest earned on savings account, R140

E. Entries in the Cash Journals after 26 March 2023:

- Deposit on 29 March 2023 R28 400
- EFT 350 to PNA Stationers, dated 28 March 2023 R 3 100
- EFT 351 to XY Couriers, dated 30 March 2023 R 3 200

F. Bank Statement balance at end of March 2023: R?

ACTIVITY 4: BANK RECONCILIATION STATEMENTS

4.1

4.1.1	
4.1.2	
4.1.3	

3

4.2 BANK RECONCILIATION

4.2.1

CASH RECEIPTS JOURNAL			CASH PAYMENT JOURNAL	
	Amount			Amount
Total	105 100		Total	137 225

10

4.2.2

Calculate the correct bank balance in the ledger on 31 March 2023.

WORKINGS	ANSWER

4

4.2.3

BANK RECONCILIATION STATEMENT ON 31 MARCH 2023

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