NEW ERA

# Accounting

Grade 12

# Teacher's Guide

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# PREFACE

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# INTRODUCTION

The new Accounting curriculum for Grade 12 is a most welcome innovation because it remains relevant to the needs of learners in providing them with the necessary skills for success in modern times. The balance of topics covering financial accounting, managerial accounting, auditing, corporate governance and business ethics will serve learners well, both as a general life skill in any chosen career, or specifically in preparation towards further study and a career in one of the many fields of accounting.

The changes to the content in the curriculum result from the new Companies Act, No. 71 of 2008. Companies were studied under the previous curriculum but new developments in company law have brought in the following changes to the Grade 12 curriculum:

- The curriculum and the law no longer refer to the par value of shares. Par value has now become irrelevant to companies as it gives no indication of the value of a share other than on the day when the company was first formed. Shares are now recorded at issue price, i.e. the price that the market is prepared to pay for the share at any time. Consequently, the share premium account falls away.
- Companies can repurchase or 'buy-back' shares from shareholders. This involves calculating a weighted average price and making entries in the share capital and / or retained income account. This will not only have an effect on the ledger but also on the financial statements including the cash flow statement.
- Financial statements are now referred to as the Statement of Comprehensive Income (Income Statement) and the Statement of Financial Position (Balance Sheet).
- Although basic GAAP concepts are still relevant, and is still referred to in the curriculum, the IFRS plays a more prominent role in the detailed preparation of financial statements. South African companies will need to take cognisance of the international standards.
- This Act also has an impact on Close Corporations. In terms of the Act no new Close Corporations can be registered in South Africa. However, present CC's can still operate. For this reason certain aspects of CC's are still covered in the curriculum.

This is the latest version of the New Era Accounting Grade 12 and has been adapted to take into account the latest developments in the subject, e.g. the National Credit Act, Consumer Protection Act and the King Codes I, II and III, etc. This version also takes into account the requirements of CAPS. In particular ethics and internal control have been allocated their own Modules (Modules 6 and 9) but several further Tasks have been integrated into each and every Module. Teachers are urged to adopt a flexible approach to the teaching of these two very important topics. It needs to be reinforced throughout the year so that learners become trained to think along these lines at all times. No longer is it sufficient for learners at school to just make the appropriate entries, but they are required to analyse and interpret and this to a large extent involves ethics and internal control.

Although a significant number of Tasks are provided within each Module, Teachers are advised to be selective in their choice of Tasks in order to cover the topics and achieve the objectives of the syllabus. The Tasks provided cover basic, intermediate and advanced concepts (refer to the icons used in this connection). They also cater for the full range of cognitive abilities from skills relating to knowledge through to evaluation. Furthermore Tasks are deliberately varied to cover individual work, group work, data-response activity, presentations, case studies, project work and problem-solving. Tasks may also be used to take advantage of information technology facilities available.

Teachers will need to consider the nature of their specific class groups and constantly adapt and vary the Tasks provided in order to achieve the desired objectives at the appropriate times. Teachers must be cognisant of the fact that the term 'activity' is not necessarily synonymous with the terms 'outcome' or 'objective' or 'aim' hence Tasks undertaken should be crucially evaluated by the Teacher to assess whether or not they facilitate the achievement of the objectives for their specific class groups.

Two defining characteristics of the Information Age are the rapid rate of technological, social and economic change being experienced world-wide, and the widespread access to information by all participants in the modern economic world. The modern world has moved beyond simply a Knowledge economy, to an Emotion/Relation economy, where success is determined in large part by the quality of inter-personal relationships and the manner in which participants relate to the world around them. This brings new factors such as the critical evaluation of the mass of information, ethical business conduct, technological expertise, teamwork and emotional intelligence into prominence, factors that were not cornerstones of syllabi of the past. The authors consequently advise Teachers not to be influenced by previous texts and examination papers set under the Grade 12 curriculum prior to 2006.

The syllabus content has been expanded beyond the processing and interpretation of historical financial data and information, into the realms of managerial accounting, forward-looking in nature, and into the efficient, effective, and ethical managing of resources. Successful learners will need to expand their experience of the subject beyond simply the recording and processing function. The bookkeeping aspects of the subject have been included in the syllabus to provide a basis for understanding. However, the financial statements are the end-product of the Accounting process and their ultimate purpose is to provide information for appropriate decision-making. It should be borne in mind at all times that the bookkeeping process is a means to an end, not an end in itself. It is essential that studies in the subject ultimately focus on the appropriate use of the financial information.

There is a school of thought that a focus on bookkeeping aspects of the subject could well work against the achievement of the main aims of the syllabus, such as the critical evaluation of information and the solution of business problems. It should be an over-riding priority for learners to be able to conceptualise the items reflected in the financial statements to enable them to achieve the over-riding aims.

Throughout this book, learners are encouraged to adopt a questioning approach to the subject which will be of benefit in their personal lives as well their future careers. Teachers are encouraged to reinforce this approach in the activities chosen and in their setting of formative and summative assessment Tasks. The authors are confident that the new curriculum will provide an enjoyable and meaningful learning experience for all learners.

**ACCOUNTING: THE SUBJECT**

The subject Accounting develops learners' knowledge, skills, values, attitudes and ability to make meaningful and informed personal and collaborative financial decisions in economic and social environments.

By engaging in Accounting, learners will be able to:

- Record analyse and interpret financial and other relevant data in order to make informed decisions;
- Present and/or communicate financial information effectively by using generally accepted accounting practice in line with current developments and legislation;
- Develop and demonstrate an understanding of fundamental accounting concepts;
- Relate skills, knowledge and values to real-world situations in order to ensure the balance between theory and practice, to enter the world of work and/or move to higher education, and to encourage self-development;
- Organise and manage own finances and activities responsibly and effectively;
- Apply principles to solve problems in a judicious and systematic manner in familiar and unfamiliar situations, thus developing the ability to identify and solve problems;
- Develop critical, logical, and analytical abilities and thought processes to enable them to apply these skills to current and new situations;
- Develop the necessary characteristics including:
  - ethical behaviour
  - sound judgement
  - thoroughness
  - orderliness
  - accuracy
  - neatness
- Deal confidently with the basic demands of an accounting occupation manually and/or electronically.

**SCOPE**

This subject encompasses accounting knowledge, skills and values focusing on the financial, managerial and auditing fields. These knowledge, skills and values must address and underpin the constitutional goals of South Africa (e.g. legitimacy, accountability, accessibility, transparency and ethical behaviour). To meet the requirements of a multicultural and democratic environment financial accounting, cost and managerial accounting and auditing serve as a framework to capture the essence of Accounting and should be seen as progression for further development within this subject.

This scope embraces the following features:

- ✓ Financial accounting
  - Financial accounting includes the logical, systematic and accurate recording of financial transactions as well as the analysis, interpretation and communication of financial statements by understanding the fundamental concepts regarding basic accounting principles and practice.

- ✓ Managerial accounting
  - Managerial accounting includes concepts such as costing and budgeting. It puts emphasis on the analysis, interpretation and communication of financial and managerial information for decision-making purposes.

- ✓ Tools in managing resources
  - Tools in managing resources include basic internal controls, audit processes and code of ethics. These features put emphasis on the knowledge, understanding and adherence to ethics in pursuit of human dignity, acknowledging human rights, values and equity, in financial and managerial activities.

**SELECTING TASKS:**

**ICONS USED IN THIS BOOK**

This textbook comprises a variety and an extensive number of Tasks. It is not possible for every learner to undertake every task in this book. However, every examination will comprise easy, moderate or difficult questions. Learners should aim at practice at each level.

Learners with the help of their Teachers should aim at selecting the appropriate tasks as follows:

1. Undertake all the tasks that cover the essential prior knowledge and the basics of the topic.
2. Undertake one or two easy comprehensive tasks to develop your confidence in the topic.
3. Then move on to more difficult tasks to extend your capabilities.
4. In preparing for exams, revise the errors you have made in some of the tasks you have already done, and also do one or two of the other tasks that you have not already done.

In order to assist you in selecting the tasks, the following icons are provided in each task:

⌘ Tasks covering essential basics of the topic. These Tasks must be completed by the learners.

 Tasks rated as 'easy'.

 Tasks rated as 'moderate or of medium difficulty'.

 Tasks rated as 'difficult'.

**NOTES CONCERNING THE TEACHING PLAN**

The attention of Teachers is drawn to the official CAPS document. This sets out the recommended time-lines for covering the curriculum content.

For your convenience, this is summarised in the table below, with reference to the specific relevant pages in the Learner's Book.

As stated above, please note that a considerable number of Tasks have been provided in the Learner's Book and it is not possible for all these Tasks to be completed in an academic year. Teachers must select the most appropriate Tasks for incorporation in lessons and for learners' homework. Teachers should also assist learners in selecting additional Tasks for revision, remedial, study or extension purposes.

# WEEKLY PLANNER FOR GRADE 12
# TERM 1

| WEEK | MODULE | TOPIC | IMPORTANT ISSUES TO COVER AND SUGGESTED TASKS | EXTRA RESOURCES |
|---|---|---|---|---|
| 1-2 | 1 | Companies: Introduction & unique transactions | **Concepts**: Public & private companies; Companies Act; Registrar of Companies / Companies and Intellectual Properties Commissioner; Memorandum of Incorporation; Income tax; Provisional income tax; Dividends; Shares; Issue price; Earnings; Shareholders; Directors; Limited liability; Separation of ownership from control; Retained income; Authorised share capital; JSE.<br><br>**Accounting cycle**: Journals; Ledgers; Trial Balance.<br><br>**Transactions**: Issuing of shares at issue price; Buying back of shares; Loans and interest; Capitalised interest on mortgage loans; Income tax; Dividends; Directors' fees; Audit fees. | Newspaper cuttings on stock prices |
| 3 | 2 | Companies: GAAP, Year-end adjustments & Final accounts | **GAAP principles**: Historical cost; Prudence; Materiality; Business entity rule; Matching.<br><br>**Year-end adjustments**: Trading stock surplus/deficit; Consumable stores on hand; Depreciation; Bad debts; Bad debts recovered; Correction of errors/omissions; Income receivable (accrued); Deferred income (received in advance); Expenses prepaid; Expenses payable (accrued); Provision for bad debts; Income tax; Dividends.<br><br>**Final accounts**: Trading account; Profit & loss account; Appropriation account.<br><br>**Reversals**: Reversals of accruals, prepayments and deferred income. | Teachers must make learners aware that GAAP is in a state of change and that International Financial Reporting Standards are now becoming more relevant. According to CAPS, the traditional GAAP concepts must still be covered. However since the recent release of the IFRS Conceptual Framework, certain of the traditional GAAP principals are being reconsidered by the Accounting profession. For example, the rule of prudence is being superseded by the IFRS concepts of Faithful representation and Neutrality. |

**TERM 1 (Continued)**

| WEEK | MODULE | TOPIC | IMPORTANT ISSUES TO COVER AND SUGGESTED TASKS | EXTRA RESOURCES |
|---|---|---|---|---|
| 3-7 | 3 | Companies: Financial statements & notes | **Financial Statements**: Income Statement (Statement of Comprehensive Income); Balance Sheet (Statement of Financial Position); Cash Flow Statement.<br><br>**Year-end adjustments**: Incorporation of all stipulated year-end adjustments (see above)<br><br>**Accounting Equation**: Effect of all transactions affecting companies.<br><br>**Reporting & control of fixed assets**<br><br>**Integration of ethical considerations affecting companies**: Roles of shareholders and directors; Manipulation of share prices; Corporate governance etc.<br><br>**Application of GAAP and IFRS**. | Printed financial statements – in newspapers or from the companies directly or their websites.<br><br>In processing adjustments, teachers should remind learners about GAAP and IFRS (see above – Module 3).<br><br>Introduce ethical issues that are current. |
| 8-9 | 4 | Companies: Analysis & interpretation | Analysis & interpretation of Income Statement, Balance Sheet and Notes.<br><br>**Revision of financial indicators**: Gross profit on sales; Gross profit on cost of sales; Net profit on sales; Operating expenses on sales; Operating profit on sales; Current ratio; Acid-test ratio; Stock turnover rate; Stock holding period; Average debtors' collection period; Average creditors' payment period; Solvency ratio.<br><br>**Introduction & coverage of financial indicators with specific reference to companies**: Debt/equity ratio; Return on shareholders' equity; Return on total capital employed; Net asset value per share; Dividends per share; Earnings per share. | Company financial statements.<br>Spar and Mr Price are included in the Teacher's Guide as additional resources. |
| 10 | 5 | Companies: Analysis of published financial statements and audit reports | Analysis and interpretation of company annual report: Directors' Report; Independent Auditor's Report; Abridged Income Statement (Statement of Comprehensive Income); Balance Sheet (Statement of Financial position; Cash Flow Statement; Additional information relating to corporate governance and the company's activities. | Refer to summaries of annual reports at the back of the Teacher's Guide. |

# WEEKLY PLANNER FOR GRADE 12
# TERM 2

| WEEK | MODULE | TOPIC | IMPORTANT ISSUES TO COVER AND SUGGESTED TASKS | EXTRA RESOURCES |
|---|---|---|---|---|
| 1 | 6 | Ethics | Role of professional bodies, e.g. SAICA & SAIPA.<br><br>Disciplinary and punitive measures for non-compliance with Code of Professional Conduct.<br><br>Policies governing ethical behaviour in the financial environment, namely King Code III.<br><br>Legislation governing companies as per Companies Act: Directors' performance evaluation; Remuneration policies; Dispute resolution; Business rescue; Conflict of interests; Responsibilities of directors. | Visit their websites.<br>Try to arrange for an auditor to come and address the learners on the role of auditing. |
| 1 | 7 | Fixed assets | Interpretation and reporting on movements of fixed assets: age of assets; replacement rate; life span of assets.<br><br>Integration of GAAP (and IFRS) principles.<br><br>Integration of ethical issues.<br><br>Integration of internal audit and control processes. | |
| 2 | 8 | Close corporations | Definition and differences between a close corporation and a partnership / company.<br><br>Founding statement.<br><br>Loans and distribution. | Example of a founding statement.<br>Important that learners realise that no new CC can be registered in terms of the new companies Act. |
| 2 | 9 | Internal control | Application of internal control and internal audit processes: Means of gathering audit evidence; Basis for gathering audit samples; Basic sampling techniques; Internal audit reports; Accountable management of resources.<br><br>The difference between the roles of internal and external auditors. | Speak to an auditor on the procedures they follow when conducting an audit. |

**TERM 2 (Continued)**

| WEEK | MODULE | TOPIC | IMPORTANT ISSUES TO COVER AND SUGGESTED TASKS | EXTRA RESOURCES |
|---|---|---|---|---|
| 3-4 | 10 | Inventory systems | Revision on the perpetual and periodic stock systems.<br><br>Discuss the different methods of stock valuation:<br>Specific identification.<br>FIFO.<br>Weighted average.<br>LIFO – not covered in the curriculum.<br><br>GAAP, IFRS and ethical issues | Try to visit a supermarket/shop in your area for learners to understand how stock valuation methods differ. |
| 5-6 | 11 | Reconciliations | Analysis & interpretation of bank, Debtors' and Creditors' Reconciliations: reconcile Creditors' statements with their personal accounts; reconcile Debtors' Lists and Creditors' Lists with Control accounts; analyse and interpret Debtors' Age Analysis; analyse and interpret bank statements and Bank Reconciliation Statements.<br><br>Integration of ethical issues relating to cash, debtors and creditors, e.g. payment periods, interest, credit ratings, fraud, etc.<br><br>Integration of internal audit and control processes relating to cash, debtors and creditors. | Bank statements.<br>Statement of accounts.<br>Current articles on ethical issues concerning bank, debtors and creditors. |
| 7-8 | 12 | Value Added Tax | Revision on the principles of VAT.<br>Calculations of VAT.<br>VAT ledger accounts.<br>Internal control and ethical issues. | Use tax invoices as examples.<br>Current articles on tax fraud. |
| 9-10 | | Mid-year Examination | | |

## WEEKLY PLANNER FOR GRADE 12
## TERM 3

| WEEK | MODULE | TOPIC | IMPORTANT ISSUES TO COVER AND SUGGESTED TASKS | EXTRA RESOURCES |
|---|---|---|---|---|
| 1-3 | 13 | Cost accounting | Revision on cost concepts.<br>Production Cost Statement with notes; Trading Statement; Profit & Loss Statement.<br>Unit costs and Break-even point.<br>Ethical issues.<br>Need for internal control. | Learners can make sandwiches, fudge, cakes, etc. to understand the different concepts and costing. |
| 4-6 | 14 | Budgeting | Analyse and interpret a projected income statement and a cash budget.<br>Differences need to be understood.<br>Ethical and internal control issues. | Use the school budget or any other budget that you can obtain and hopefully the learners will be able to relate to. |
| 7-8 | 15 | Revision | | |
| 9-10 | | Trial Examinations | | |

## WEEKLY PLANNER FOR GRADE 12
## TERM 4

| WEEK | MODULE | TOPIC | IMPORTANT ISSUES TO COVER AND SUGGESTED TASKS | EXTRA RESOURCES |
|---|---|---|---|---|
| 1-4 | | Revision | | |
| 5-9 | | NSC examinations | | |

# ASSESSMENT PROGRAMME: GRADE 12

**Note to Teacher:**

- Refer to **Module 15** for Tasks that can be used as tests, reports or case studies. Refer to **Module 5** for a further project on published financial statements.
- Revision Tasks within each chapter can also be used for tests or presentations.
- Exemplar examination papers are filed in **Module 16**.
- Learners are advised to make use of past NSC papers, but questions relating to companies must be adapted for shares of no par value and repurchase of shares.

| Term | Form of assessment | Possible topics | Marks | Converted to | Examples of Tasks |
|---|---|---|---|---|---|
| 1 | **Written report** | Company theory | 50 | 10 | Task 15.2: Media report<br>Task 15.5: Three companies<br>Task 15.9: Bingo Ltd & Umlozi Ltd |
| | **Test** | Income Statement; Balance Sheet; Cash Flow Statement | 100 | 10 | Task 15.10: Tentilo Ltd |
| 2 | **Project** | Published financial statements | 50 | 20 | Task 5.4: Spar<br>Task 5.5: Company of your choice |
| | **Mid-year examination** | All topics to date: Companies, CCs, Ethics, Internal Control, Inventory valuation, Reconciliations, VAT | 300 | 20 | Module 16: Mid-year examination |
| 3 | **Test** | Cost accounting; Budgeting | 100 | 10 | Task 15.38: JJ Jerseys |
| | **Case study** | Cost accounting; Budgeting | 50 | 10 | Task 15.42: High Class Jackets (15 marks)<br>Waterside Stores (35 marks) |
| | **Trial examination** | All topics as above | 300 | 20 | Module 16: Year-end examination |

# MODULE 1
# COMPANIES:
# Introduction; Basic concepts & Unique transactions

**Important note to Teachers concerning changes to the Companies Act**:

The Companies Act No. 71 of 2008 (applicable from 2011) has introduced several significant changes to company law in South Africa. Two of the most significant changes in terms of their effect on Accounting entries in the Grade 12 curriculum are:

- **Shares of no par value**: Section 35 (2) states that 'a share does not have a nominal or par value'.
- **Buy-back of shares**: Section 48 allows companies to repurchase its shares from shareholders under certain conditions.

Tasks in this Module will address these issues.

The main reason for the dispensing of par value is that this bears no resemblance to the true worth of a share other than on the first day of a company's existence and was often confusing to uninformed investors. All shares are now of 'no par value'. Shares are issued at an 'issue price'. This means that:

- The full proceeds of the share issue are credited to the Share Capital account.
- The Share Premium account no longer applies.
- New shares may be issued at a higher or lower price than any previous issue price.

There are several reasons for allowing a company to repurchase or 'buy-back' some of the shares that it has previously issued. Companies with surplus funds might wish to reduce the share capital account thereby increasing returns for the remaining shareholders. A company might wish to buy out a difficult or troublesome shareholder who creates problems for the company. The heirs of a deceased estate might prefer to be paid out for the shares they have inherited. A private company might wish to buy back shares in order for a family to maintain control of the private company. A share repurchase will also allow a company to adjust its debt : equity ratio as economic circumstances change.

In terms of a share repurchase under the new Act, a company's directors have to satisfy a solvency and liquidity test before concluding a contract to repurchase shares to ensure that the payment for the shares will not result in solvency or liquidity problems thereafter. The decision regarding the repurchase of shares is authorised and minuted at a meeting of the board of directors, together with the results of the solvency and liquidity test. The following conditions will have to apply in respect of the **solvency and liquidity test**:

- Assets (fairly valued) must exceed liabilities (fairly valued) – note historical cost does not apply.
- The company will be able to pay is debts as they become due for a period of 12 months after the dividends are distributed.

The complications that buy-back of shares causes for the entries in the books is that if the buy-back price exceeds the average issue price of the shares, the difference between these prices effectively relates to a pay-out of retained income to the shareholder selling the shares. In this case both the Share Capital and Retained Income accounts will be reduced by the appropriate amounts.

Also note that companies are no longer registered with the **Registrar of Companies**. They are now registered with the **Companies and Intellectual Property Commission** ('the Commission' or 'the Commissioner').

## TASK 1.1 ⌘ Theory: Basic concepts relating to Companies

| CONCEPT | | DESCRIPTION |
|---|---|---|
| **1.** | Shareholders. | G |
| **2.** | Directors. | D |
| **3.** | Independent auditor. | A |
| **4.** | Directors' fees. | K |
| **5.** | Audit fees. | B |
| **6.** | Shares. | J |
| **7.** | Dividends. | C |
| **8.** | Companies Act No. 71 of 2008. | L |
| **9.** | Limited liability. | E |
| **10.** | Separation of ownership from control of a company. | F |
| **11.** | Memorandum of Incorporation. | H |
| **12.** | Companies and Intellectual Property Commission. | I |

## TASK 1.2 ⌘ Theory: Concepts relating to companies

| **1.2.1** | **What is meant by the concept of 'limited liability' and 'separate legal identity' in connection with companies?** |
|---|---|

**Limited liability:**
The owners of the company (shareholders) are not liable for debts of the company beyond the amount invested by them in the form of capital.
**Separate legal identity:**
A company has a legal personality of its own – in the eyes of the law it is regarded as a person – this concept results in limited liability for owners (i.e. one person cannot be held liable for the debts of another).

| **1.2.2** | **Why could the concept of limited liability not be allowed in the cases of businesses operating as doctors, lawyers or accountants?** |
|---|---|

These people perform professional services – they cannot be protected by the concept of limited liability as their decisions have far-reaching consequences (due care is necessary).

| **1.2.3** | **Why are big companies important to a country?** |
|---|---|

They provide employment, they assist with regard to foreign exchange, they address the needs and wants of the country, and they pay large amounts of tax.

| **1.2.4** | **How does the concept of limited liability assist big companies to exist in a country?** |
|---|---|

If this concept did not exist, shareholders would not want to invest in companies over which they have no direct control.
The companies would not exist.

| **1.2.5** | **Why it is important for companies to contain the word 'LIMITED' in their names.** |
|---|---|

So that people dealing with them are forewarned that they can claim payment of debts only from the company itself, not its owners.

| **1.2.6** | **Why does a company pay Income tax, yet a sole proprietor or partnership does not?** |
|---|---|

A company is a person.
It exists separate from its owners.
All persons in a country pay tax.

| 1.2.7 | **What role does a director of a company fulfil, and what is meant by the 'separation of ownership from control' in respect of a company?** |
|---|---|

He acts as the arms, ears, eyes and legs of the company.
He performs tasks on behalf of the company.
**Separation of ownership from control:**
The shareholders own the company, the directors control it.

| 1.2.8 | **In your opinion, what personal characteristics should a director of a company possess? Explain why each of these characteristics is important.** |
|---|---|

Honesty, integrity, intelligence, expertise.
They perform a fiduciary or stewardship duty, i.e. they are entrusted with the use of assets owned by others.

| 1.2.9 | **What are the advantages of a company over a partnership?** |
|---|---|

Limited liability, large amounts of capital, maybe the tax rate is favourable (30%) in comparison to tax the partners would pay individually.

| 1.2.10 | **What are the advantages of a partnership over a company?** |
|---|---|

Direct personal control by the owners, direct relationship with customers, maybe partners would pay less tax personally than a company would (depends on profit level).

| 1.2.11 | **Why is it important for all companies to be registered with the Companies and Intellectual Properties Commission?** |
|---|---|

Members of the public will be investing in the companies.
An organisation like CIPRO should exist to control and monitor companies and the people running them because people running the companies could abuse the privilege of limited liability.
Numerous investors could lose their money if companies are not well run.

## TASK 1.3 Theory: The MOI, the Prospectus and forming a company

| 1.3.1 | **Make a list of and briefly describe the important steps you will have to go through in forming this company. Use the following key words in your list: Promoters, Company name, Initial price of the share, Prospectus, Companies and Intellectual Properties Commission (CIPRO), Memorandum of Incorporation (MOI), Allotment of shares. Present your list to the rest of the class.** |
|---|---|

Promoters decide to form a company.
They compile the Memorandum of Incorporation.
CIPRO issues Certificate of Incorporation.
Initial shareholders provide capital.
CIPRO issues registration number and Certificate of Incorporation.
Prospectus published for the Initial Public Offering.
Shares allotted to successful applicants.
Share certificates issued (hard-copy or electronic format)

| 1.3.2 | **Make a list of the important items you would include in a Prospectus which will entice members of the public to buy shares in your company. Present your list to the rest of the class.** |
|---|---|

Prospects for the future.
Names of directors.
Price of shares.
Number of shares offered for sale.
Share application forms.
Names of auditors.

| 1.3.3 | **Make a list of the important items you would include in the MOI which will govern the company, bearing in mind that it is a hotel business. Present your list to the rest of the class.** |
|---|---|

- The name of the company.
- Its objectives, purpose and business activity.
- Details of contracts which existed prior to incorporation.
- The amount of authorised share capital and its division into shares, together with special conditions relating to specified classes of shares.
- Powers and rights of shareholders e.g. right to vote at AGM.
- Shares, share certificates and share transfers.
- Shareholders' meetings and resolutions.
- The appointment, removal, duties and powers of directors.
- Borrowing powers.
- Accounting records and financial statements and audit thereof.
- Liquidation of the company.

**Note to Teacher:**
Be alert for public offerings of shares by companies. These will be advertised in the press and/or by way of brochures issued by the companies concerned. These should be used in the classroom to illustrate the procedures in the raising of capital by public companies. Teachers should encourage awareness in their learners of events in the business world.

## TASK 1.4 ⌘ Theory: Shareholders and Auditors

| 1.4.1 | **Why is it important for a shareholder to attend the AGM of his company? What questions should the shareholder raise at the AGM? In your opinion, why do many shareholders not attend the AGM?** |
|---|---|

Shareholders own the company.
They make the most important decisions.
They appoint the directors to run the company for them.
They must raise incisive questions about how the company is run by the directors.
Many shareholders do not attend the AGMs for various reasons:
Apathy, lack of interest, satisfaction with the performance of the directors, long distance to travel (especially if the meeting is in another city or country), maybe they have a small minority shareholding which is insignificant with few voting rights.

**Note to Teacher:**
Ensure that learners are aware that this sort of lack of interest creates a problem – the shareholders should serve as a check on the ethical conduct of the directors – a number of frauds have occurred because the shareholders did not exercise their voting rights).

| 1.4.2 | **Why is it important for the shareholders to appoint the directors and the auditor at the AGM?** |
|---|---|

The directors fill a position of trust in controlling assets belonging to the company, the auditor is the 'watchdog' and also fills a position of trust for the shareholders.
The auditors must not feel that they work for the directors.
They have to be independent and responsible to the shareholders.

| 1.4.3 | **What is the difference in roles between an internal auditor and an external, independent auditor? Why can the final annual financial statements not be audited by the internal auditor?** |
|---|---|
| The internal auditor does on-going checks within the company.<br>He is employed by the company, i.e. appointed by the directors.<br>The external auditor expresses his opinion on the financial statements to the shareholders.<br>He must not be influenced by employees of the company.<br>The internal auditor might feel beholden to the directors.<br>Hence his opinion might be regarded as unreliable. | |

| 1.4.4 | **What qualifications does an external independent auditor require?** |
|---|---|
| Chartered Accountant, i.e. CA (SA). | |

| 1.4.5 | **Obtain a copy of an independent auditor's report from a published set of financial statements or from the business reports in a newspaper. List the important points made in this report.** |
|---|---|
| Scope of the audit, test basis, express opinion on fair presentation – on the Income Statement, Balance Sheet and Cash Flow. | |

## TASK 1.5 ⌘ ABC Ltd: Initial public offering (IPO)

| 1.5.1 | **How many shares will be allocated to you on 1 July 20.1?** |
|---|---|
| 25 000 shares | |

| 1.5.2 | **What amount will be refunded to you on 1 July 20.1?** |
|---|---|
| R60 000 – R50 000 = R10 000 | |

| 1.5.3 | **What effect will the issue of shares have on the Accounting Equation of the company?** |
|---|---|
| A +800 000 O +800 000 | |

| 1.5.4 | **What will you pay for your 12 000 new shares on 1 July 20.2?** |
|---|---|
| 12 000 x R2.80 = R33 600 | |

| 1.5.5 | **What effect will the second issue of shares have on the Accounting Equation of the company?** |
|---|---|
| A +280 000 O +280 000 | |

| 1.5.6 | **What is your % shareholding in the company on 2 July 20.2?** |
|---|---|
| 25 000 + 12 000 = 37 000 → this is 7.4% of the total shares of the company | |

| 1.5.7 | **On 31 August 20.2 you decide to sell all your shares through the Securities Exchange for 320 cents each. The commission to be paid to the stock broker is 4% of the selling price. How much will you receive for the sale of the shares, how much commission will you pay and how much profit will you make on the sale of your shares?** |
|---|---|
| Gross proceeds = 37 000 x R3.20 = R118 400<br>Commission = R4 736<br>Net proceeds = R113 664<br>Cost of shares = R50 000 + R33 600 = R83 600<br>Profit = R30 064 | |

| 1.5.8 | **When you sell your shares on 31 August 20.2, how much will ABC Ltd receive? Explain your answer.** |
|---|---|
| ABC Ltd receives nothing – the exchange is between the new shareholder and the previous shareholder. | |

| 1.5.9 | **What will ABC Ltd be required to enter in their records on 31 August 20.2? Explain your answer.** |
|---|---|

ABC Ltd will simply change the name in their share register – name of a new shareholder replaces the previous shareholder.

## TASK 1.6 ⌘ XYZ Ltd: Buying shares through the JSE

| 1.6.1 | **What is the maximum number of shares you can buy in XYZ Ltd on the JSE?** |
|---|---|

R40 000 ÷ R6.30 = 6 349.2
6 300 shares can be bought.

| 1.6.2 | **How much will be spent on the shares? How much cash will be left over? You decide to place this amount in a savings account.** |
|---|---|

Spent on shares = 6 300 x R6.30 = R39 690
Amount left over = R310

| 1.6.3 | **Analyse your investment portfolio as follows:** |
|---|---|

| **Investment Portfolio** | **10 Jan 20.5** |
|---|---|
| **Value of shares in XYZ Ltd** | **R39 690** |
| **Amount in savings account** | **R310** |
| **Total portfolio** | R40 000 |

| 1.6.4 | **You decide to check your portfolio on the 10th day of each month. On 10 February 20.5 the price of XYZ Ltd shares on the JSE is reflected at 590 cents. You decide to keep the shares despite the drop in value. Revalue your portfolio on 10 February 20.5 as follows:** |
|---|---|

| **Investment Portfolio** | **10 Jan 20.5** | **10 Feb 20.5** |
|---|---|---|
| **Value of shares in XYZ Ltd** | **R39 690** | **R37 170** |
| **Amount in savings account** | **R310** | **R310** |
| **Total portfolio** | R40 000 | **R37 480** |

| 1.6.5 | **On 10 March 20.5 the price of XYZ Ltd shares on the JSE is reflected at 720 cents. Revalue your portfolio on 10 February 20.5 as follows:** |
|---|---|

| **Investment Portfolio** | **10 Jan 20.5** | **10 Feb 20.5** | **10 Mar 20.5** |
|---|---|---|---|
| **Value of shares in XYZ Ltd** | **R39 690** | **R37 170** | **R45 360** |
| **Amount in savings account** | **R310** | **R310** | **R310** |
| **Total portfolio** | R40 000 | **R37 480** | **R45 670** |

| 1.6.6 | **What causes the price of shares to fluctuate on the JSE? If the price of the shares of XYZ Ltd drops in April, would you sell your shares? Explain.** |
|---|---|

Demand for the shares determines the price.
Decision to keep or sell depends on perception of prospects for the future.

| 1.6.7 | **On 10 April 20.5 the price of XYZ Ltd shares on the JSE is 740 cents. You decide to sell all your shares in the company. How much profit or loss have you made overall?** |
|---|---|

Proceeds of shares: 6 300 shares x R7.40 = R46 620
Cash on hand = R310
Total portfolio = R46 920
Original investment = R40 000
Profit = R6 920

## TASK 1.7 ⌘ Business Report: JSE information

| 1.7.1 | Identify the codes used at the top of each column. |
|---|---|
| **Name**: | Abbreviated company name |
| **S**: | Suspended |
| **Close**: | Market closing price of the share |
| **High**: | Highest price for the day |
| **Low**: | Lowest price for the day |
| **DM**: | Daily movement in price |
| **YM%**: | Last 12 months' % movement in price |
| **DY**: | Dividend Yield (i.e. dividends per share divided by price) |
| **PE**: | Price Earnings ratio (i.e. Price per share compared to Earnings per share) |
| **DV**: | Day's volume in shares traded |

| 1.7.2 | Identify the sections into which the companies are divided. |
|---|---|
| Self-explanatory from the share page. | |

| 1.7.3 | Choose a company under the 'retailers' section. What is the name of the company, what is its current price on the JSE, what was the movement in its price from the previous day, and how many shares were sold on the day? |
|---|---|
| Depends on share chosen by the learner. | |

| 1.7.4 | If you had R10 000 to invest in shares that company, how many could you buy? |
|---|---|
| Depends on share chosen by the learner (divide R10 000 by share price and round down to nearest 100 shares). | |

## TASK 1.8 Research: Investing in a company listed on the JSE

**Note to Teacher:**
Follow the process in Task 1.6 with regard to the calculations each week.

## TASK 1.9 ⌘ Berg Ltd: Shares issued by a company

**1.9.1 CASH RECEIPTS JOURNAL OF BERG LTD – APRIL 20.1** **CRJ1**

| Doc | D | Details | Fol | Analysis of receipts | Bank | Sundry accounts | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | Amount | Fol | Details |
| R1 | 30 | Shareholders | | 1 500 000 | 1 500 000 | 1 500 000 | B1 | Ordinary share capital |
| | | | | | | | | |

**1.9.2** **GENERAL LEDGER OF BERG LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **ORDINARY SHARE CAPITAL** **B1** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.1 | | | | | |
| | | | | | Apr | 30 | Bank | CRJ1 | 1 500 000 | |
| | | | | | | | | | | |

**BANK** **B2**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.1 | | | | | | | | | | |
| Apr | 30 | Ordinary share capital | CRJ1 | 1 500 000 | | | | | | |
| | | | | | | | | | | |

**1.9.3 NAME OF COMPANY: BERG LIMITED**
**BALANCE SHEET AT 30 APRIL 20.1 (Extract)**

| **ASSETS** | **Note** | |
|---|---|---|
| **Current assets** | | 1 500 000 |
| Cash and cash equivalents | | 1 500 000 |
| | | |
| | | |
| | | |
| **SHAREHOLDERS' EQUITY & LIABILITIES** | | |
| **Shareholders' equity** | | 1 500 000 |
| Ordinary share capital | 7 | 1 500 000 |
| Distributable reserves (Retained income) | | - |
| | | |
| | | |
| | | |

**NOTES TO THE FINANCIAL STATEMENTS ON 30 APRIL 20.1**
**7. ORDINARY SHARE CAPITAL**

| | |
|---|---|
| **Authorised** | |
| 5 000 000 Ordinary shares | |
| | |
| **Issued** | |
| 3 000 000 ordinary shares at R0.50 each issued during the year | 1 500 000 |
| 3 000 000 ordinary shares at R0.50 each in issue on 30 April 20.1 | **1 500 000** |

## TASK 1.10 Mount Ltd: Shares issued by a company

**1.10.1 CASH RECEIPTS JOURNAL OF MOUNT LTD – JUNE 20.1** **CRJ1**

| **Doc** | **D** | **Details** | **Fol** | **Analysis of receipts** | **Bank** | **Sundry accounts** | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | **Amount** | **Fol** | **Details** |
| R01 | 30 | Shareholders | | 2 500 000 | 2 500 000 | 2 500 000 | B1 | Ordinary share capital |
| | | | | | | | | |

**1.10.2** **GENERAL LEDGER OF MOUNT LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **ORDINARY SHARE CAPITAL** **B1** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.1 | | | | | |
| | | | | | June | 30 | Bank | | CRJ1 | 2 500 000 |
| | | | | | | | | | | |

**BANK** **B2**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.1 | | | | | | | | | | |
| June | 30 | Ordinary share capital | CRJ1 | 2 500 000 | | | | | | |
| | | | | | | | | | | |

**1.10.3 MOUNT LTD**
**BALANCE SHEET AS AT 30 JUNE 20.1 (Extract)**

| **ASSETS** | **Note** | |
|---|---|---|
| **Current assets** | | 2 500 000 |
| Cash and cash equivalents | | 2 500 000 |
| | | |
| | | |
| | | |
| **SHAREHOLDERS' EQUITY & LIABILITIES** | | |
| **Shareholders' equity** | | 2 500 000 |
| Ordinary share capital | 7 | 2 500 000 |
| Distributable reserves (Retained income) | | - |
| | | |
| | | |
| | | |

**NOTES TO THE FINANCIAL STATEMENTS ON 30 JUNE 20.1**
**7. ORDINARY SHARE CAPITAL**

| **Authorised** | |
|---|---|
| 1 000 000 Ordinary shares | |
| **Issued** | |
| 500 000 shares of R5.00 each issued during the year | 2 500 000 |
| 500 000 shares of R5.00 each in issue on 30 June 20.1 | **2 500 000** |

## TASK 1.11 ⌘ Zinto Ltd: Directors' fees, Audit fees & Interest

**1.11.1**

| **No.** | **Debit** | **Credit** | **Amount** |
|---|---|---|---|
| **1.** | Fixed deposit | Bank | R90 000 |
| **2.** | Directors' fees | Bank | R135 000 |
| **3.** | Audit fees | Bank | R44 000 |
| **4.** | Fixed deposit | Interest income | R5 400 |
| | Bank | Fixed deposit | R95 400 |
| **5.** | Directors' fees | Expenses payable (accrued) | R405 000 |
| **6.** | Audit fees | Expenses payable (accrued) | R51 000 |
| **7.** | Interest expense | Mortgage loan | R47 700 |
| **8.** | Mortgage loan | Bank | R7 300 |

**1.11.2**

| **Profit & loss account** | |
|---|---|
| **Debits** | **Credits** |
| Directors fees: 135 000 + 405 000 = R540 000 | Interest income: 95 400 – 90 000 = R5 400 |
| Audit fees: 44 000 + 51 000 = R95 000 | |
| Interest expense: R47 700 | |

| **1.11.3** | **Calculate the balance on the Mortgage loan account on 30 September 20.5. State whether the balance will be debit or credit.** |
|---|---|
| R530 000 + R47 700 – (12 x R7 300) = R490 100 (Credit) | |

## TASK 1.12 ⌘ Totem Ltd: Directors' fees, Audit fees & Interest

**1.12.1 CASH PAYMENTS JOURNAL OF TOTEM LTD – JANUARY 20.7** **CPJ1**

| Doc | D | Details | Fol | Bank | | Sundry accounts | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | Amount | Fol | Details |
| BS | 1 | Vula Bank | | 50 000 | | 50 000 | B11 | Fixed deposit |
| C5633 | 11 | Preen & Shembe | | 65 000 | | 65 000 | N8 | Audit fees |
| C5634 | 20 | G. Glen | | 350 000 | | 350 000 | N9 | Directors' fees |
| C5635 | | K. Kunene | | 410 000 | | 410 000 | N9 | Directors' fees |
| BS | 25 | Brand Bank | | 9 800 | | 9 800 | B10 | Mortgage loan |
| | | | | | | | | |

**1.12.2 GENERAL JOURNAL OF TOTEM LTD FOR JUNE 20.7** **GJ6**

| Doc | D | Details | Fol | Debit | Credit |
|---|---|---|---|---|---|
| JV1 | 30 | Audit fees | N8 | 72 000 | |
| | | Expenses payable (accrued) | B12 | | 72 000 |
| | | Amount owed to Preen & Shembe | | | |
| | | Directors' fees | N9 | 760 000 | |
| | | Expenses payable (accrued) | B12 | | 760 000 |
| | | Amounts owed to directors | | | |
| | | Interest expense | N10 | 63 140 | |
| | | Mortgage loan | B10 | | 63 140 |
| | | Interest capitalised for the year | | | |
| | | | | | |
| | | Fixed deposit | B11 | 1 375 | |
| | | Interest income | N11 | | 1 375 |
| | | Interest capitalised for 6 months | | | |
| | | Interest income | N11 | 1 375 | |
| | | Profit & loss account | | | 1 375 |
| | | Closing transfer | | | |
| | | Profit & loss account | | 1 720 140 | |
| | | Audit fees | N8 | | 137 000 |
| | | Directors' fees | N9 | | 1 520 000 |
| | | Interest expense | N10 | | 63 140 |
| | | Closing transfers | | | |

**1.12.3** **GENERAL LEDGER OF TOTEM LTD**

**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **MORTGAGE LOAN: BRAND BANK** **B10** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.6 | | | | | 20.6 | | | | |
| July | 25 | Bank | CPJ7 | 9 800 | July | 1 | Balance | b/d | 600 000 |
| Aug | 25 | Bank | CPJ8 | 9 800 | 20.7 | | | | |
| Sep | 25 | Bank | CPJ9 | 9 800 | June | 30 | Interest expense | GJ6 | 63 140 |
| Oct | 25 | Bank | CPJ10 | 9 800 | | | | | |
| Nov | 25 | Bank | CPJ11 | 9 800 | | | | | |
| Dec | 25 | Bank | CPJ12 | 9 800 | | | | | |
| 20.7 | | | | | | | | | |
| Jan | 25 | Bank | CPJ1 | 9 800 | | | | | |
| Feb | 25 | Bank | CPJ2 | 9 800 | | | | | |
| Mar | 25 | Bank | CPJ3 | 9 800 | | | | | |
| Apr | 25 | Bank | CPJ4 | 9 800 | | | | | |
| May | 25 | Bank | CPJ5 | 9 800 | | | | | |
| June | 25 | Bank | CPJ6 | 9 800 | | | | | |
| | 30 | Balance | c/d | 545 540 | | | | | |
| | | | | **663 140** | | | | | **663 140** |
| | | | | | 20.7 | | | | |
| | | | | | July | 1 | Balance | b/d | 545 540 |

**FIXED DEPOSIT: VULA BANK** **B11**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.7 | | | | |
| Jan | 1 | Bank | CPJ1 | 50 000 | June | 30 | Balance | c/d | 51 375 |
| June | 30 | Interest income | GJ6 | 1 375 | | | | | |
| | | | | **51 375** | | | | | **51 375** |
| July | 1 | Balance | b/d | 51 375 | | | | | |

**EXPENSES PAYABLE** **B12**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.7 | | | | |
| June | 30 | Balance | c/d | 832 000 | June | 30 | Audit fees | GJ6 | 72 000 |
| | | | | | | | Directors fees | GJ6 | 760 000 |
| | | | | **832 000** | | | | | **832 000** |
| | | | | | July | 1 | Balance | b/d | 832 000 |

**NOMINAL ACCOUNTS SECTION**

**AUDIT FEES** **N8**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.7 | | | | |
| Jan | 11 | Bank | CPJ1 | 65 000 | June | 30 | Profit & loss | GJ6 | 137 000 |
| Jun | 30 | Expenses payable | GJ6 | 72 000 | | | | | |
| | | | | **137 000** | | | | | **137 000** |

**Dr** **DIRECTORS' FEES** **N9** **Cr**

| 20.7 | | | | | 20.7 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Jan | 20 | Bank | CPJ1 | 350 000 | June | 30 | Profit & loss | GJ6 | 1 520 000 |
| | | Bank | CPJ1 | 410 000 | | | | | |
| Jun | 30 | Expenses payable | GJ6 | 760 000 | | | | | |
| | | | | **1 520 000** | | | | | **1 520 000** |

**INTEREST EXPENSE** **N10**

| 20.7 | | | | | 20.7 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Mortgage loan | GJ6 | 63 140 | June | 30 | Profit & loss | GJ6 | 63 140 |

**INTEREST INCOME** **N11**

| 20.7 | | | | | 20.7 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Jun | 30 | Profit & loss | GJ6 | 1 375 | Jun | 30 | Fixed deposit | GJ6 | 1 375 |

## TASK 1.13 ⌘ FT Ltd: Income tax

**Note to Teacher:**
Learners must appreciate that much of the information that will be required for year-end adjustments will become evident well after the date of the year-end. This is particularly the case for income tax and final dividends. Nevertheless, the entry must be matched to the correct accounting period ('Matching Principle') and it will be necessary for the accountant to back-date the entry to the year end-date. This principle will apply in all tasks requiring the preparation of final accounts or financial statements.

**1.13.1 GENERAL JOURNAL OF FT LTD – FEBRUARY 20.2** **GJ1**

| Doc | D | Details | Fol | Debit | Credit |
|---|---|---|---|---|---|
| JV12 | 28 | Income tax | N9 | 90 600 | |
| | | SARS – Income tax | B3 | | 90 600 |
| | | Tax liability for the year | | | |
| | | Profit and Loss account | F2 | 302 000 | |
| | | Appropriation account | F3 | | 302 000 |
| | | Net profit transferred | | | |
| | | Appropriation account | F3 | 90 600 | |
| | | Income tax | N9 | | 90 600 |
| | | Closing transfer | | | |
| | | Appropriation account | F3 | 211 400 | |
| | | Retained income | B2 | | 211 400 |
| | | Transfer of retained income | | | |

**1.13.2** **GENERAL LEDGER OF FT LTD**

**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **RETAINED INCOME** **B2** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.2 | | | | | |
| | | | | | Feb | 28 | Appropriation | GJ1 | | 211 400 |
| | | | | | | | | | | |

**SARS – INCOME TAX** **B3**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.2 | | | | | |
| | | | | | Feb | 28 | Income tax | GJ1 | | 90 600 |
| | | | | | | | | | | |

**NOMINAL ACCOUNTS SECTION**

**INCOME TAX** **N9**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | | |
| Feb | 28 | SARS – Income tax | GJ1 | 90 600 | Feb | 28 | Appropriation | GJ1 | | 90 600 |
| | | | | | | | | | | |

**FINAL ACCOUNTS SECTION**

**PROFIT AND LOSS** **F2**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | | | | | | |
| Feb | 28 | Appropriation | GJ1 | 302 000 | | | | | | |
| | | | | | | | | | | |

**APPROPRIATION ACCOUNT** **F3**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | | |
| Feb | 28 | Income tax | GJ1 | 90 600 | Feb | 28 | Profit and loss | GJ1 | | 302 000 |
| | | Retained income | GJ1 | 211 400 | | | | | | |
| | | | | **302 000** | | | | | | **302 000** |
| | | | | | | | | | | |

| **1.13.3** | **Explain how the above items will be treated in the financial statements.** |
|---|---|
| Retained income: | Show under Note 8 (Retained income) |
| SARS – Income tax: | Show under Note 9 (Trade and other payables) |

## TASK 1.14 ⌘ NB Ltd: Income tax and Dividends

**1.14.1 GENERAL JOURNAL OF NB LTD – 30 JUNE 20.1** **GJ1**

| Doc | D | Details | Fol | Debit | Credit |
|---|---|---|---|---|---|
| 12 | 30 | Dividends on ordinary shares | N9 | 120 000 | |
| | | Shareholders for dividends | B3 | | 120 000 |
| | | Final dividend of 6c declared | | | |
| 13 | | Income tax | N10 | 78 000 | |
| | | SARS – Income tax | B4 | | 78 000 |
| | | Tax liability for the year | | | |
| | | Profit and Loss account | F2 | 260 000 | |
| | | Appropriation account | F3 | | 260 000 |
| | | Net profit transferred | | | |

**1.14.1 GENERAL JOURNAL OF NB LTD – 30 JUNE 20.1 (Contd)** **GJ1**

| Doc | D | Details | Fol | Debit | Credit |
|---|---|---|---|---|---|
| | 30 | Appropriation account | F3 | 198 000 | |
| | | Dividends on ordinary shares | N9 | | 120 000 |
| | | Income tax | N10 | | 78 000 |
| | | Closing transfer | | | |
| | | Appropriation account | F3 | 62 000 | |
| | | Retained income | B2 | | 62 000 |
| | | Transfer of retained income | | | |

**1.14.2 GENERAL LEDGER OF NB LTD**

**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **RETAINED INCOME** **B2** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.2 | | | | | |
| | | | | | June | 30 | Appropriation | GJ1 | | 62 000 |

**SHAREHOLDERS FOR DIVIDENDS** **B3**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.2 | | | | | |
| | | | | | June | 30 | Dividends on ordinary shares | GJ1 | | 120 000 |

**SARS – INCOME TAX** **B4**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.2 | | | | | |
| | | | | | June | 30 | Income tax | GJ1 | | 78 000 |

**NOMINAL ACCOUNTS SECTION**

**DIVIDENDS ON ORDINARY SHARES** **N9**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | | |
| June | 30 | Shareholders for dividends | GJ1 | 120 000 | June | 30 | Appropriation | GJ1 | | 120 000 |

**INCOME TAX** **N10**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | | |
| June | 30 | SARS – Income tax | GJ1 | 78 000 | June | 30 | Appropriation | GJ1 | | 78 000 |

**FINAL ACCOUNTS SECTION**

**PROFIT AND LOSS** **F2**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | | | | | | |
| June | 30 | Appropriation | GJ1 | 260 000 | | | | | | |

**APPROPRIATION ACCOUNT** **F3**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | | |
| June | 30 | Div. on ord. shares | GJ1 | 120 000 | June | 30 | Profit and loss | GJ1 | | 260 000 |
| | | Income tax | GJ1 | 78 000 | | | | | | |
| | | Retained income | GJ1 | 62 000 | | | | | | |
| | | | | **260 000** | | | | | | **260 000** |

| 1.14.3 | **Explain how the above items will be treated in the financial statements.** |
|---|---|
| Retained income: | Show under Note 8 (Retained income) |
| SARS – Income tax: | Show under Note 9 (Trade and other payables) |
| Shareholders for dividends: | Show under Note 9 (Trade and other payables) |

## TASK 1.15 ⌘ KD Ltd: Income tax and Dividends

**Note to Teacher**: You are advised to not transfer the Retained income at the beginning of the year to the Appropriation account. Simply transfer the Retained income for the year from the Appropriation account to the Retained income account. The balance will still be correct. The reason is that the old method is complicated by the buy-back of shares as you will see later in the Module.

**GENERAL LEDGER OF KD LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **RETAINED INCOME** **B2** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.1 | | | | | |
| June | 30 | Balance | c/d | 404 000 | July | 30 | Balance | b/d | 320 000 |
| | | | | | 20.2 | | | | |
| | | | | | June | 30 | Appropriation | | 84 000 |
| | | | | **404 000** | | | | | **404 000** |
| | | | | | July | 1 | Balance | b/d | 404 000 |

**SARS – INCOME TAX** **B3**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.1 | | | | | 20.2 | | | | |
| Dec | 31 | Bank | | 105 000 | June | 30 | Income tax | | 216 000 |
| 20.2 | | | | | | | | | |
| June | 30 | Bank | | 105 000 | | | | | |
| | | Balance | c/d | 6 000 | | | | | |
| | | | | **216 000** | | | | | **216 000** |
| | | | | | July | 1 | Balance | b/d | 6 000 |

**SHAREHOLDERS FOR DIVIDENDS** **B4**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.2 | | | | |
| | | | | | June | 30 | Dividends on ordinary shares | | 300 000 |

**NOMINAL ACCOUNTS SECTION**

**INCOME TAX** **N10**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | |
| June | 30 | SARS – Income tax | | 216 000 | June | 30 | Appropriation | | 216 000 |

**DIVIDENDS ON ORDINARY SHARES** **N11**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.1 | | | | | 20.2 | | | | |
| Dec | 30 | Bank | | 120 000 | June | 30 | Appropriation | | 420 000 |
| 20.2 | | | | | | | | | |
| June | 30 | Shareholders for dividends | | 300 000 | | | | | |
| | | | | **420 000** | | | | | **420 000** |

**FINAL ACCOUNTS SECTION**

**Dr** **APPROPRIATION ACCOUNT** **F3** **Cr**

| 20.2 | | | | | 20.2 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Div. on ord. shares | | 420 000 | June | 30 | Profit and loss | | 720 000 |
| | | Income tax | | 216 000 | | | | | |
| | | Retained income | | 84 000 | | | | | |
| | | | | **720 000** | | | | | **720 000** |

## TASK 1.16 ⌘ Delebi Ltd: Issuing new shares

**1.16.1 CASH RECEIPTS JOURNAL OF DELEBI LTD – APRIL 20.2** **CRJ1**

| Doc | D | Details | Fol | Analysis of re-ceipts | Bank | Sundry accounts | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | Amount | Fol | Details |
| Rec 1 | 30 | Shareholders | | 440 000 | 440 000 | 440 000 | B1 | Ordinary share capital |

**1.16.2** **GENERAL LEDGER OF DELEBI LTD**

**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **ORDINARY SHARE CAPITAL** **B1** **Cr**

| | | | | | 20.2 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Mar | 1 | Balance | b/d | 300 000 |
| | | | | | Apr | 30 | Bank | CRJ1 | 440 000 |

**BANK** **B2**

| 20.2 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Apr | 30 | Sundry accounts | CRJ1 | 440 000 | | | | | |

**1.16.3 NAME OF COMPANY: DELEBI LTD**

**BALANCE SHEET AT 30 APRIL 20.2 (Extract)**

| **ASSETS** | **Note** | |
|---|---|---|
| **Total assets** | | 940 000 |
| | | |
| | | |
| | | |
| **SHAREHOLDERS' EQUITY & LIABILITIES** | | |
| **Shareholders' equity** | | 940 000 |
| Ordinary share capital | 7 | 740 000 |
| Retained income | | 200 000 |
| | | |
| | | |
| | | |

**NOTES TO THE FINANCIAL STATEMENTS ON 30 APRIL 20.2**

| **Authorised** | |
|---|---|
| 500 000 Ordinary shares | |
| | |
| **Issued** | |
| 300 000 shares in issue at the beginning of the year | 300 000 |
| 200 000 shares of R2.20 each issued during the year | 440 000 |
| 500 000 shares in issue at the end of the year | **740 000** |

**Note to Teacher:**
Calculate the net asset value of the share with the class and discuss this in order to prepare learners for interpretation in Module 6, and to get them to think about the effect of the entries that they are processing in this Module.

| **1.16.4** | **Calculate the average issue price of all the ordinary shares issued on 30 April 20.2.** |
|---|---|
| 740 000 ÷ 500 000 shares = **148 cents per share** | |
| **1.16.5** | **If the company closes down on this date, how much will each shareholder receive for each share that he owns?** |
| R948 000 ÷ 500 000 shares = **189.6 cents per share** | |
| **1.16.6** | **Why would the company want to issue the new shares at a higher price (premium)? Why would the new shareholders be prepared to pay this higher price? Why would the existing shareholders want the company to charge a higher price on the new shares?** |
| Companies would charge a higher price (premium) when shares are sold as this often means that the market price of the shares has increased and in this way the existing shareholders are compensated for the growth that has already taken place in the company. | |

## TASK 1.17 Cwele Ltd: Issuing new shares

**1.17.1 CASH RECEIPTS JOURNAL OF CWELE LTD – APRIL 20.7** **CRJ1**

| Doc | D | Details | Fol | Analysis of receipts | Bank | Sundry accounts | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | Amount | Fol | Details |
| Rec 1 | 30 | Shareholders | | 2 450 000 | 2 450 000 | 2 450 000 | B1 | Ordinary share capital |
| | | | | | | | | |

**1.17.2** **GENERAL LEDGER OF CWELE LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **ORDINARY SHARE CAPITAL** **B1** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.7 | | | | | |
| | | | | | Mar | 1 | Balance | b/d | 6 000 000 | |
| | | | | | Apr | 30 | Bank | CRJ1 | 2 450 000 | |
| | | | | | | | | | | |

**BANK** **B2**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | | | | | | |
| Apr | 30 | Sundry accounts | CRJ1 | 2 450 000 | | | | | | |
| | | | | | | | | | | |

**1.17.3 NAME OF COMPANY: CWELE LTD**
**BALANCE SHEET AT 30 APRIL 20.7 (Extract)**

| **ASSETS** | **Note** | |
|---|---|---|
| **Total assets** | | 9 350 000 |
| | | |
| | | |
| | | |
| **SHAREHOLDERS' EQUITY & LIABILITIES** | | |
| **Shareholders' equity** | | 9 350 000 |
| Ordinary share capital | 7 | 8 450 000 |
| Retained income | | 900 000 |
| | | |
| | | |
| | | |

**NOTES TO THE FINANCIAL STATEMENTS ON 30 APRIL 20.7**

| **Authorised** | |
|---|---|
| 2 000 000 Ordinary shares | |
| | |
| **Issued** | |
| 1 500 000 shares in issue at the beginning of the year | 6 000 000 |
| 500 000 shares of 490 cents each issued during the year | 2 450 000 |
| 2 000 000 shares in issue at the end of the year | **8 450 000** |

**Note to Teacher:**
Calculate the net asset value of the share with the class and discuss this in order to prepare learners for interpretation in Module 5, and to get them to think about the effect of the entries that they are processing in this Module.

| **1.17.4** | **Calculate the average issue price of all the ordinary shares issued on 30 April 20.7.** |
|---|---|
| R8 450 000 ÷ 2 000 000 shares = **422.5 cents per share** | |
| **1.17.5** | **If the company closes down on this date, how much will each shareholder receive for each share that he owns?** |
| R9 350 000 ÷ 2 000 000 shares = **467.5 cents per share** | |
| **1.17.6** | **Why would the company want to issue the new shares at a higher price (premium)? Why would the new shareholders be prepared to pay this higher price? Why would the existing shareholders want the company to charge a higher price on the new shares? In your opinion, has the company charged enough for the new shares?** |
| Companies would charge a higher price when shares are sold as this often means that the market price of the shares has increased and in this way the existing shareholders are compensated for the growth in the shares.<br>The new shareholders are thus paying a premium for the goodwill and growth that has already taken place in the company (the existing shareholders took a risk in starting the company and therefore they should benefit from a lower issue price).<br>Learner to give their own opinion on the higher price charged, together with reasons, e.g. they have bought into an existing company and therefore they should pay more than the original issue price of 400 cents; the R900 000 allocated over the original 1 500 000 shares is 60 cents, so the new shareholders should pay at least R4.60 – in fact they were charged R4.90. | |

## TASK 1.18 Umtweni Ltd: Share issue, Income tax and Dividends

**GENERAL LEDGER OF UMTWENI LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **ORDINARY SHARE CAPITAL** **B1** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.3 | | | | | |
| | | | | | July | 1 | Balance | b/d | | 2 820 000 |

**RETAINED INCOME** **B2**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.3 | | | | | |
| June | 30 | Appropriation | | 297 000 | July | 1 | Balance | b/d | | 550 000 |
| | | Balance | c/d | 253 000 | | | | | | |
| | | | | **550 000** | | | | | | **550 000** |
| | | | | | July | 1 | Balance | b/d | | 253 000 |

**SARS – INCOME TAX** **B3**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.3 | | | | | |
| Aug | 1 | Bank | | 8 000 | July | 1 | Balance | b/d | | 8 000 |
| 20.3 | | | | | 20.4 | | | | | |
| Dec | 28 | Bank | | 237 000 | June | 30 | Income tax | | | 405 000 |
| 20.4 | | | | | | | Balance | c/d | | 69 000 |
| June | 30 | Bank | | 237 000 | | | | | | |
| | | | | **482 000** | | | | | | **482 000** |
| July | 1 | Balance | b/d | 69 000 | | | | | | |

**SHAREHOLDERS FOR DIVIDENDS** **B4**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.3 | | | | | |
| Aug | 1 | Bank | | 135 000 | July | 1 | Balance | b/d | | 135 000 |
| 20.4 | | | | | 20.4 | | | | | |
| June | 30 | Balance | c/d | 810 000 | June | 30 | Div. on ord. shares | | | 810 000 |
| | | | | **945 000** | | | | | | **945 000** |
| | | | | | July | 1 | Balance | b/d | | 810 000 |

**NOMINAL ACCOUNTS SECTION**

**INCOME TAX** **N10**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.4 | | | | | |
| June | 30 | SARS – Income tax | | 405 000 | June | 30 | Appropriation | | | 405 000 |

**NOMINAL ACCOUNTS SECTION**

**Dr** **DIVIDENDS ON ORDINARY SHARES** **N11** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.4 | | | | |
| Dec | 28 | Bank | | 432 000 | June | 30 | Appropriation | | 1 242 000 |
| 20.4 | | | | | | | | | |
| June | 30 | Shareholders for dividends | | 810 000 | | | | | |
| | | | | **1 242 000** | | | | | **1 242 000** |

**FINAL ACCOUNTS SECTION**

**APPROPRIATION ACCOUNT** **F3**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.4 | | | | |
| June | 30 | Div. on ord. shares | | 1 242 000 | June | 30 | Profit and loss | | 1 350 000 |
| | | Income tax | | 405 000 | | | Retained income | | 297 000 |
| | | | | **1 647 000** | | | | | **1 647 000** |

## TASK 1.19 ⌘ Sukude Ltd: Buy-back of shares

**1.19.1 CASH PAYMENTS JOURNAL OF SUKUDE LTD – JUNE 20.5** **CPJ6**

| Doc | D | Details | Fol | Bank | | Sundry accounts | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | Amount | Fol | Details |
| C1043 | 30 | P. Parker | | 405 000 | | 239 000 | B1 | Ordinary share capital |
| | | | | | | 166 000 | B2 | Retained income |
| | | | | **405 000** | | **405 000** | | |
| | | | | B3 | | | | |

**1.19.2**

**GENERAL LEDGER OF SUKUDE LTD**

**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **ORDINARY SHARE CAPITAL** **B1** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.5 | | | | | 20.4 | | | | |
| June | 30 | Bank | CPJ6 | 239 000 | July | 1 | Balance | b/d | 4 780 000 |
| | | Balance | c/d | 4 541 000 | | | | | |
| | | | | **4 780 000** | | | | | **4 780 000** |
| | | | | | July | 1 | Balance | b/d | 4 541 000 |

**RETAINED INCOME** **B2**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.5 | | | | | 20.4 | | | | |
| June | 30 | Bank | CPJ6 | 166 000 | July | 1 | Balance | b/d | 1 700 000 |
| | | Balance | c/d | 1 534 000 | | | | | |
| | | | | **1 700 000** | | | | | **1 700 000** |
| | | | | | 20.5 | | | | |
| | | | | | July | 1 | Balance | b/d | 1 534 000 |

**BANK** **B3**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.5 | | | | | 20.5 | | | | |
| June | 30 | Balance | b/d | 577 000 | June | 30 | Total payments | CPJ6 | 405 000 |

## TASK 1.20 ⌘ Mpele Ltd: Buy-back of shares

**1.20.1 CASH PAYMENTS JOURNAL OF MPELE LTD – AUGUST 20.7** **CPJ8**

| Doc | D | Details | Fol | Bank | | Sundry accounts | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | Amount | Fol | Details |
| B/S | 30 | Shareholders | | 620 000 | | 340 800 | B1 | Ordinary share capital |
| | | | | | | 279 200 | B2 | Retained income |
| | | | | **620 000** | | **620 000** | | |
| | | | | B3 | | | | |

**1.20.2** **GENERAL LEDGER OF MPELE LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **ORDINARY SHARE CAPITAL** **B1** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.6 | | | | | |
| Aug | 31 | Bank | CPJ8 | 340 800 | Sep | 1 | Balance | b/d | 2 556 000 |
| | | Balance | c/d | 2 215 200 | | | | | |
| | | | | **2 556 000** | | | | | **2 556 000** |
| | | | | | July | 1 | Balance | b/d | 2 215 200 |

**RETAINED INCOME** **B2**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.6 | | | | |
| Aug | 31 | Bank | CPJ8 | 279 200 | Sep | 1 | Balance | b/d | 2 100 000 |
| | | Balance | c/d | 1 820 800 | | | | | |
| | | | | **2 100 000** | | | | | **2 100 000** |
| | | | | | July | 1 | Balance | b/d | 1 820 800 |

**BANK** **B3**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.7 | | | | |
| Aug | 31 | Balance | b/d | 1 130 000 | Aug | 31 | Total payments | CPJ8 | 620 000 |

## TASK 1.21 Taco Ltd: Dividends, Tax and buy-back of shares

**GENERAL LEDGER OF TACO LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **ORDINARY SHARE CAPITAL** **B1** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.3 | | | | |
| Oct | 31 | Bank | CPJ10 | 472 000 | Nov | 1 | Balance | b/d | 3 200 000 |
| | | Balance | c/d | 5 428 000 | | | Bank | | 2 700 000 |
| | | | | **5 900 000** | | | | | **5 900 000** |
| | | | | | 20.4 | | | | |
| | | | | | Nov | 1 | Balance | b/d | 5 428 000 |

**Dr** **RETAINED INCOME** **B2** **Cr**

| 20.4 | | | | | 20.3 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Oct | 31 | Bank | | 88 000 | Nov | 1 | Balance | b/d | 640 000 |
| | | Appropriation | | 15 000 | | | | | |
| | | Balance | c/d | 537 000 | | | | | |
| | | | | **640 000** | | | | | **640 000** |
| | | | | | Nov | 1 | Balance | b/d | 537 000 |

**SARS – INCOME TAX** **B4**

| 20.3 | | | | | 20.3 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Nov | 20 | Bank | | 11 000 | Nov | 1 | Balance | b/d | 11 000 |
| 20.4 | | | | | 20.4 | | | | |
| Apr | 30 | Bank | | 230 000 | Oct | 31 | Income tax | | 390 000 |
| Oct | 31 | Bank | | 180 000 | | | Balance | c/d | 20 000 |
| | | | | **421 000** | | | | | **421 000** |
| Nov | 1 | Balance | b/d | 20 000 | | | | | |

**SHAREHOLDERS FOR DIVIDENDS** **B5**

| 20.3 | | | | | 20.3 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Nov | 20 | Bank | | 140 000 | Nov | 1 | Balance | b/d | 140 000 |
| 20.4 | | | | | 20.4 | | | | |
| Oct | 31 | Balance | c/d | 550 000 | Oct | 31 | Div. on ordinary shares | | 550 000 |
| | | | | **690 000** | | | | | **690 000** |
| | | | | | Nov | 1 | Balance | b/d | 550 000 |

**NOMINAL ACCOUNTS SECTION**

**INCOME TAX** **N10**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Oct | 31 | SARS – Income tax | | 390 000 | Oct | 31 | Appropriation | | 390 000 |

**DIVIDENDS ON ORDINARY SHARES** **N11**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Apr | 30 | Bank | | 375 000 | Oct | 31 | Appropriation | | 925 000 |
| Oct | 31 | Shareholders for dividends | | 550 000 | | | | | |
| | | | | **925 000** | | | | | **925 000** |

**FINAL ACCOUNTS SECTION**

**APPROPRIATION ACCOUNT** **F3**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Oct | 31 | Income tax | | 390 000 | Oct | 31 | Profit and loss | | 1 300 000 |
| | | Dividends on ordinary shares | | 925 000 | | | Retained income | | 15 000 |
| | | | | **1 315 000** | | | | | **1 315 000** |

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Explain the concepts related to companies. | | | |
| Define the term 'legal personality' or 'separate legal identity' and how it relates to companies as a form of enterprise. | | | |
| Define the term 'limited liability' and how this affects shareholders. | | | |
| Explain the significance of the Companies Act and registration with the Companies and Intellectual Properties Commissioner. | | | |
| Explain the procedure for the formation of a company. | | | |
| Identify the contents of the Memorandum of Incorporation (MOI). | | | |
| Explain the main differences between a private and public company. | | | |
| Understand that a company can choose its own year-end for tax purposes. | | | |
| Explain the role of the JSE. | | | |
| Explain the rights and duties of shareholders. | | | |
| Understand the role of the independent auditor and how this affects shareholders. | | | |
| Compare the financial statements of sole proprietor, partnership and company. | | | |
| Explain the difference between authorised and issued shares and the effect this has on the Balance Sheet. | | | |
| Explain how and where shares are bought and sold (traded) and the effect this has on the company and its financial statements. | | | |
| Explain the buying back of shares by a company and understand the relevant entries and their effect on the financial statements. | | | |
| Understand what is meant by different classes of shares. | | | |
| Explain the difference between distributable and non-distributable reserves and how they affect the shareholders. | | | |
| Understand the new overhead expenses affecting companies such as directors fees and audit fees. | | | |
| Calculate the number of shares and the rand value of the total shares issued. | | | |
| Draw up and complete a Trading account, Profit & loss account and Appropriation account. | | | |
| Indicate how share capital is recorded in the share register of a company. | | | |
| Process bookkeeping entries for income tax and provisional tax. | | | |
| Process bookkeeping entries for interim dividends and final dividends. | | | |
| Process bookkeeping entries for retained income at the beginning and end of a financial year. | | | |

# MODULE 2
# COMPANIES:
# GAAP, Year-end Procedures & Final accounts

## TASK 2.1 ⌘ Baseline assessment: GAAP

**2.1.1**

| Principle | | Description |
|---|---|---|
| **1.** | Business entity | **D** |
| **2.** | Historical cost | **F** |
| **3.** | Matching | **E** |
| **4.** | Prudence | **B** |
| **5.** | Materiality | **A** |
| **6.** | Going-concern | **C** |

**2.1.2**

| Principle | | Example |
|---|---|---|
| **1.** | Business entity | **E** |
| **2.** | Historical cost | **C** |
| **3.** | Matching | **A** |
| **4.** | Prudence | **F** |
| **5.** | Materiality | **B** |
| **6.** | Going-concern | **D** |

## TASK 2.2 ⌘ Baseline assessment: Accounting cycle & year-end procedures

**2.2.1**

| Steps in the Accounting cycle | Sequence |
|---|---|
| A Trial Balance is prepared from the ledger. | 5 |
| The ledger accounts are totalled or balanced. | 4 |
| Documents are entered into journals. | 2 |
| Financial statements are prepared from the Trial Balance. | 6 |
| Transactions are entered on documents. | 1 |
| Journals are posted to the ledger. | 3 |

**2.2.2**

| Financial year-end procedures | Sequence |
|---|---|
| The financial statements are prepared and interpreted. | 6 |
| The Post-Adjustment Trial Balance is prepared. | 3 |
| The Post-Closing Trial Balance is prepared. | 5 |
| The Pre-Adjustment Trial Balance is prepared. | 1 |
| Reversals are entered in the General Journal and then posted to the General Ledger. | 7 |
| Adjusting entries are entered in the general journal and then posted to the General Ledger (or other ledgers if applicable). | 2 |
| Closing transfers are entered in the General Journal and then posted to the General Ledger. | 4 |

## TASK 2.3 ⌘ Baseline assessment: Year-end adjustments & Accounting Equation

| No. | Details | Entries in the ledger | | Effect on Accounting Equation | | |
|---|---|---|---|---|---|---|
| | | Debit | Credit | A | O | L |
| 1. | A trading stock deficit has been identified. | Trading stock deficit | Trading stock | – | – | 0 |
| 2. | Packing materials counted at the end of the year. | Consumable stores on hand | Packing material | + | + | 0 |
| 3. | An insurance premium expires three months into the next accounting period. | Expenses prepaid | Insurance | + | + | 0 |
| 4. | Amount owed for advertising. | Advertising | Expenses payable | 0 | – | + |
| 5. | The provision for bad debts must be increased. | Provision for bad debts adjustment | Provision for bad debts | – | – | 0 |
| 6. | Commission income receivable. | Income receivable | Commission income | + | + | 0 |
| 7. | Interest owed by the bank on the fixed deposit. The interest is capitalised to the fixed deposit. | Fixed deposit | Interest income | + | + | 0 |
| 8. | Interest on the mortgage loan is capitalised to the loan. | Interest on loan | Mortgage loan | 0 | – | + |
| 9. | Bank charges reflected on the bank statement but not yet recorded in the books. The bank balance is positive. | Bank charges | Bank | – | – | 0 |
| 10. | The independent auditors are owed their fees at the year-end. | Audit fees | Expenses payable | 0 | – | + |
| 11. | A final dividend has been declared but not yet paid. | Dividends on ordinary shares | Shareholders for dividends | 0 | – | + |
| 12. | The full amount of tax for the year has not been entered (this is lower than the provisional payments made). | Income tax | SARS (Income tax) | 0 | – | + |

**Note to Teachers:**
If learners do not understand these entries, most of which were covered in Grade 11, then Teachers are advised to set additional similar Tasks for learners to gain an understanding of the basic adjustments. Failure to understand these adjustments will lead to under-achievement in the next Module on preparation of financial statements.

**NOTE TO TEACHERS:**

**TREATMENT OF RETAINED INCOME & APPROPRIATION ACCOUNTS:**

The worked example of AMI (Pty) Ltd. reflects two methods of dealing with Retained income and the Appropriation account. Method A is preferred because it creates fewer complications regarding the buy-back of shares.

**METHOD A:**

It is possible to leave the Retained income at the beginning of the year in the Retained income account and not transfer it to the Appropriation account. Using this method, the balancing figure will then be the Retained income for the year which will be transferred to the Retained income account. The balance on the Retained income account at the end of the financial year will be the same under both methods. The relevant ledger accounts will appear as follows:

**Dr** **RETAINED INCOME** **B2** **Cr**

| 20.3 | | | | | 20.2 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Bank | CJ6 | 14 000 | July | 1 | Balance | b/d | 120 000 |
| | | Balance | c/d | 119 530 | 20.3 | | | | |
| | | | | | June | 30 | Appropriation | GJ6 | 13 530 |
| | | | | **133 530** | | | | | **133 530** |
| | | | | | 20.3 | | | | |
| | | | | | July | 1 | Balance | b/d | 119 530 |

**APPROPRIATION ACCOUNT** **F3**

| 20.3 | | | | | 20.3 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Income tax | GJ6 | 19 845 | June | 30 | Profit and loss | GJ6 | 70 875 |
| | | Div. on ord. shares | GJ6 | 37 500 | | | | | |
| | | Retained income | GJ6 | 13 530 | | | | | |
| | | | | **70 875** | | | | | **70 875** |

**METHOD B:**

**Dr** **RETAINED INCOME** **B2** **Cr**

| 20.3 | | | | | 20.2 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Appropriation | GJ6 | 120 000 | July | 1 | Balance | b/d | 120 000 |
| | | Bank | CJ6 | 14 000 | 20.3 | | | | |
| | | Balance | c/d | 119 530 | June | 30 | Appropriation | GJ6 | 133 530 |
| | | | | **253 530** | | | | | **253 530** |
| | | | | | 20.3 | | | | |
| | | | | | July | 1 | Balance | b/d | 119 530 |

**APPROPRIATION ACCOUNT** **F3**

| 20.3 | | | | | 20.3 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Income tax | GJ6 | 19 845 | June | 30 | Profit and loss | GJ6 | 70 875 |
| | | Div. on ord. shares | GJ6 | 37 500 | | | Retained income | GJ6 | 120 000 |
| | | Retained income | GJ6 | 13 530 | | | | | |
| | | | | **190 875** | | | | | **190 875** |

**NOTE TO TEACHERS:**

**POSTING FROM JOURNALS TO FINAL ACCOUNTS:**

Learners might well be confused with the treatment of the posting from the General Journal to the Final accounts section. They might well question why it is not possible to post only the totals from the journal entries as follows:

**Dr** **PROFIT AND LOSS ACCOUNT** **F2** **Cr**

| 20.3 | | | | | 20.3 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Sundry accounts | GJ6 | 172 025 | June | 30 | Trading account | GJ6 | 220 000 |
| | | Appropriation a/c | GJ6 | 70 875 | | | Sundry accounts | GJ6 | 22 900 |
| | | | | **242 900** | | | | | **242 900** |

**APPROPRIATION ACCOUNT** **F3**

| 20.3 | | | | | 20.3 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Sundry accounts | GJ6 | 57 345 | June | 30 | Profit and loss | GJ6 | 70 875 |
| | | Retained income | GJ6 | 13 530 | | | | | |
| | | | | **70 875** | | | | | **70 875** |

Although this method is technically correct, it is not advised for examination or class purposes as it will be impossible to mark if an error has been made on any one item. Explain to the class that it is common practice for the individual items to be entered in the final accounts as per the example in the textbook. It also helps when the Income Statement is prepared because the figures are readily available in the detailed format.

## TASK 2.4 ⌘ Palamo (Pty) Ltd: Year-end procedures

**Note to Teachers:**
Ensure that learners understand all the adjusting journal entries before proceeding with the other parts of this Task. These concepts were covered in Grade 11, but should this continue to be a problem for learners, Teachers are advised to set further tasks on basic adjustments. The next Module also contains two Tasks with similar basic adjustments.

**GENERAL JOURNAL OF PALAMO (PTY) LTD – AUGUST 20.4** **GJ1**

| No. | D | Details | Fol | Debit | Credit |
|---|---|---|---|---|---|
| 01 | 31 | Trading stock deficit | N17 | 2 200 | |
| | | Trading stock | B7 | | 2 200 |
| | | Deficit identified at year-end | | | |
| 02 | | Consumable stores on hand | B15 | 660 | |
| | | Packing materials | N13 | | 660 |
| | | Materials on hand at year-end | | | |
| 03 | | Directors' fees | N5 | 13 000 | |
| | | Expenses payable. | B16 | | 13 000 |
| | | Fees owed at year-end | | | |
| 04 | | Audit fees | N6 | 3 300 | |
| | | Expenses payable | B16 | | 3 300 |
| | | Fees owed at year-end | | | |

**GENERAL JOURNAL OF PALAMO (PTY) LTD – AUGUST 20.4 (Continued)** **GJ1**

| No. | D | Details | Fol | Debit | Credit |
|---|---|---|---|---|---|
| 05 | 31 | Depreciation | N18 | 2 400 | |
| | | Accumulated depreciation on equipment | B6 | | 2 400 |
| | | Depreciation of fixed assets | | | |
| 06 | | Prepaid expenses | B17 | 80 | |
| | | Insurance | N14 | | 80 |
| | | Amount paid in advance | | | |
| 07 | | Bad debts | N8 | 300 | |
| | | Debtors control | B8 | | 300 |
| | | Bad debts written off | | | |
| 08 | | Provision for bad debts adjustment | N19 | 485 | |
| | | Provision for bad debts | B9 | | 485 |
| | | Adjustment of provision to 5% of debtors | | | |
| 09 | | Income receivable (accrued) | B18 | 900 | |
| | | Rent income | N9 | | 900 |
| | | Amount due at year-end | | | |
| 10 | | Commission income | N10 | 1 000 | |
| | | Deferred income (Received in advance) | B19 | | 1 000 |
| | | Amount received in advance | | | |
| 11 | | Dividends on ordinary shares | N16 | 8 000 | |
| | | Shareholders for dividends | B20 | | 8 000 |
| | | Final dividend of 2c declared | | | |
| 12 | | Income tax | N20 | 7 252 | |
| | | SARS – Income tax | B14 | | 7 252 |
| | | Tax liability for the year | | | |
| | | **CLOSING ENTRIES:** | | | |
| | 31 | Sales | N1 | 8 000 | |
| | | Debtors allowances | N2 | | 8 000 |
| | | Closing transfer | | | |
| | | Sales | N1 | 378 000 | |
| | | Trading account | F1 | | 378 000 |
| | | Closing transfer | | | |
| | | Trading account | F1 | 208 000 | |
| | | Cost of sales | N3 | | 208 000 |
| | | Closing transfer | | | |
| | | Trading account | F1 | 170 000 | |
| | | Profit & loss account | F2 | | 170 000 |
| | | Transfer of gross profit | | | |
| | | | | | |

**GENERAL JOURNAL OF PALAMO (PTY) LTD – AUGUST 20.4 (Continued)** **GJ1**

| No. | D | Details | Fol | Debit | Credit |
|---|---|---|---|---|---|
| | 31 | Rent income | N9 | 10 800 | |
| | | Commission income | N10 | 6 000 | |
| | | Interest on current account | N11 | 500 | |
| | | Interest on overdue debtors | N12 | 200 | |
| | | Profit & loss account | F2 | | 17 500 |
| | | Closing transfers | | | |
| | | Profit & loss account | F2 | 149 545 | |
| | | Salaries & wages | N4 | | 90 000 |
| | | Directors' fees | N5 | | 30 000 |
| | | Audit fees | N6 | | 7 300 |
| | | Interest on loan | N7 | | 2 000 |
| | | Bad debts | N8 | | 1 700 |
| | | Packing materials | N9 | | 1 940 |
| | | Insurance | N14 | | 320 |
| | | Sundry expenses | N15 | | 11 200 |
| | | Trading stock deficit | N17 | | 2 200 |
| | | Depreciation | N18 | | 2 400 |
| | | Provision for bad debts adjustment | N19 | | 485 |
| | | Closing transfers | | | |
| | | Profit & loss account | F2 | 37 955 | |
| | | Appropriation account | F3 | | 37 955 |
| | | Transfer of net profit | | | |
| | | Appropriation account | F3 | 20 252 | |
| | | Dividends on ordinary shares | N16 | | 13 000 |
| | | Income tax | N20 | | 7 252 |
| | | Closing transfers | | | |
| | | Appropriation account | F3 | 17 703 | |
| | | Retained income | B2 | | 17 703 |
| | | Transfer of retained income for the year | | | |
| | | **REVERSAL ENTRIES:** | | | |
| | 1 | Packing materials | N13 | 660 | |
| | | Consumable stores on hand | B15 | | 660 |
| | | Reversal | | | |
| | | Expenses payable | B16 | 16 300 | |
| | | Directors' fees | N5 | | 13 000 |
| | | Audit fees | N6 | | 3 300 |
| | | Reversal | | | |
| | | Insurance | N14 | 80 | |
| | | Prepaid expenses | B17 | | 80 |
| | | Reversal | | | |
| | | | | | |

**GENERAL JOURNAL OF PALAMO (PTY) LTD – AUGUST 20.4 (Continued)** **GJ1**

| No. | D | Details | Fol | Debit | Credit |
|---|---|---|---|---|---|
| | | Rent income | N9 | 900 | |
| | | Income receivable (accrued) | B18 | | 900 |
| | | Reversal | | | |
| | | Deferred income (received in advance) | B19 | 1 000 | |
| | | Commission income | N10 | | 1 000 |
| | | Reversal | | | |

**GENERAL LEDGER OF PALAMO (PTY) LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**ORDINARY SHARE CAPITAL** **B1**

| Dr | | | | | | | | | | Cr |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.4 | | | | | |
| | | | | | Aug | 31 | Balance | b/d | | 210 000 |

**RETAINED INCOME** **B2**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.3 | | | | | |
| Aug | 31 | Balance | c/d | 32 703 | Sept | 1 | Balance | b/d | | 15 000 |
| | | | | | 20.4 | | | | | |
| | | | | | Aug | 31 | Appropriation | GJ1 | | 17 703 |
| | | | | **32 703** | | | | | | **32 703** |
| | | | | | Sept | 1 | Balance | b/d | | 32 703 |

**LOAN FROM EAST BANK** **B3**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.4 | | | | | |
| | | | | | Aug | 31 | Balance | b/d | | 27 000 |

**LAND AND BUILDINGS** **B4**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | | | | | | |
| Aug | 31 | Balance | b/d | 160 000 | | | | | | |

**EQUIPMENT** **B5**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | | | | | | |
| Aug | 31 | Balance | b/d | 44 000 | | | | | | |

**ACCUMULATED DEPRECIATION ON EQUIPMENT** **B6**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.3 | | | | | |
| Aug | 31 | Balance | c/d | 22 400 | Sept | 1 | Balance | b/d | | 20 000 |
| | | | | | 20.4 | | | | | |
| | | | | | Aug | 31 | Depreciation | GJ1 | | 2 400 |
| | | | | **22 400** | | | | | | **22 400** |
| | | | | | Sept | 1 | Balance | b/d | | 22 400 |

**Dr** **TRADING STOCK** **B7** **Cr**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Balance | b/d | 82 000 | Aug | 31 | Trading stock deficit | GJ1 | 2 200 |
| | | | | | | | Balance | c/d | 79 800 |
| | | | | **82 000** | | | | | **82 000** |
| Sept | 1 | Balance | b/d | 79 800 | | | | | |

**DEBTORS CONTROL** **B8**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Balance | b/d | 40 000 | Aug | 31 | Sundry accounts | GJ1 | 300 |
| | | | | | | | Balance | c/d | 39 700 |
| | | | | **40 000** | | | | | **40 000** |
| Sept | 1 | Balance | b/d | 39 700 | | | | | |

**PROVISION FOR BAD DEBTS** **B9**

| 20.4 | | | | | 20.3 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Balance | c/d | 1 985 | Sept | 1 | Balance | b/d | 1 500 |
| | | | | | 20.4 | | | | |
| | | | | | Aug | 31 | Prov. for b/debts adj. | GJ1 | 485 |
| | | | | **1 985** | | | | | **1 985** |
| | | | | | Sept | 1 | Balance | b/d | 1 985 |

**BANK** **B10**

| 20.4 | | | | |
|---|---|---|---|---|
| Aug | 31 | Balance | b/d | 6 300 |

**CASH FLOAT** **B11**

| 20.4 | | | | |
|---|---|---|---|---|
| Aug | 31 | Balance | b/d | 750 |

**PETTY CASH** **B12**

| 20.4 | | | | |
|---|---|---|---|---|
| Aug | 31 | Balance | b/d | 250 |

**CREDITORS CONTROL** **B13**

| | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Aug | 31 | Balance | b/d | 12 800 |

**SARS – INCOME TAX** **B14**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Balance | b/d | 7 000 | Aug | 31 | Income tax | GJ1 | 7 252 |
| | | Balance | c/d | 252 | | | | | |
| | | | | **7 252** | | | | | **7 252** |
| | | | | | Sept | 1 | Balance | b/d | 252 |

**Dr** **CONSUMABLE STORES ON HAND** **B15** **Cr**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Packing materials | GJ1 | 660 | Sept | 1 | Packing materials | GJ1 | 660 |
| | | | | | | | | | |

**EXPENSES PAYABLE** **B16**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Balance | c/d | 16 300 | Aug | 31 | Directors fees | GJ1 | 13 000 |
| | | | | | | | Audit fees | GJ1 | 3 300 |
| | | | | **16 300** | | | | | **16 300** |
| Sept | 1 | Directors fees | GJ1 | 13 000 | Sept | 1 | Balance | b/d | 16 300 |
| | | Audit fees | GJ1 | 3 300 | | | | | |
| | | | | | | | | | |

**PREPAID EXPENSES** **B17**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Insurance | GJ1 | 80 | Sept | 1 | Insurance | GJ1 | 80 |
| | | | | | | | | | |

**INCOME RECEIVABLE** **B18**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Rent income | GJ1 | 900 | Sept | 1 | Rent income | GJ1 | 900 |
| | | | | | | | | | |

**DEFERRED INCOME** **B19**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Sept | 1 | Commission income | GJ1 | 1 000 | Aug | 31 | Commission income | GJ1 | 1 000 |
| | | | | | | | | | |

**SHAREHOLDERS FOR DIVIDENDS** **B20**

| | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Aug | 31 | Div. on ord. shares | GJ1 | 8 000 |
| | | | | | | | | | |

**NOMINAL ACCOUNTS SECTION**

**SALES** **N1**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Debtors allowances | GJ1 | 8 000 | Aug | 31 | Total | b/f | 386 000 |
| | | Trading account | | 378 000 | | | | | |
| | | | | **386 000** | | | | | **386 000** |
| | | | | | | | | | |

**DEBTORS ALLOWANCES** **N2**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Total | b/f | 8 000 | Aug | 31 | Sales | GJ1 | 8 000 |
| | | | | | | | | | |

**COST OF SALES** **N3**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Total | b/f | 208 000 | Aug | 31 | Trading account | GJ1 | 208 000 |
| | | | | | | | | | |

**Dr** **SALARIES AND WAGES** **N4** **Cr**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Total | b/f | 90 000 | Aug | 31 | Profit and loss | GJ1 | 90 000 |
| | | | | | | | | | |

**DIRECTORS' FEES** **N5**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Total | b/f | 17 000 | Aug | 31 | Profit and loss | GJ1 | 30 000 |
| | | Expenses payable | GJ1 | 13 000 | | | | | |
| | | | | **30 000** | | | | | **30 000** |
| | | | | | Sept | 1 | Expenses payable | GJ1 | 13 000 |
| | | | | | | | | | |

**AUDIT FEES** **N6**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Total | b/f | 4 000 | Aug | 31 | Profit and loss | GJ1 | 7 300 |
| | | Expenses payable | GJ1 | 3 300 | | | | | |
| | | | | 7 300 | | | | | 7 300 |
| | | | | | Sept | 1 | Expenses payable | GJ1 | 3 300 |
| | | | | | | | | | |

**INTEREST ON LOAN** **N7**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Total | b/f | 2 000 | Aug | 31 | Profit and loss | GJ1 | 2 000 |
| | | | | | | | | | |

**BAD DEBTS** **N8**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Total | b/f | 1 400 | Aug | 31 | Profit and loss | GJ1 | 1 700 |
| | | Debtors control | GJ1 | 300 | | | | | |
| | | | | **1 700** | | | | | **1 700** |
| | | | | | | | | | |

**RENT INCOME** **N9**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Profit and loss | GJ1 | 10 800 | Aug | 31 | Total | b/f | 9 900 |
| | | | | | | | Income receivable | GJ1 | 900 |
| | | | | **10 800** | | | | | **10 800** |
| Sept | 1 | Income receivable | GJ1 | 900 | | | | | |
| | | | | | | | | | |

**COMMISSION INCOME** **N10**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Deferred income | GJ1 | 1 000 | Aug | 31 | Total | b/f | 7 000 |
| | | Profit and loss | GJ1 | 6 000 | | | | | |
| | | | | **7 000** | | | | | **7 000** |
| | | | | | Sept | 1 | Deferred income | GJ1 | 1 000 |
| | | | | | | | | | |

**INTEREST ON CURRENT BANK ACCOUNT** **N11**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Profit and loss | GJ1 | 500 | Aug | 31 | Total | b/f | 500 |
| | | | | | | | | | |

**Dr** **INTEREST ON OVERDUE DEBTORS** **N12** **Cr**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Profit and loss | GJ1 | 200 | Aug | 31 | Total | b/f | 200 |
| | | | | | | | | | |

**PACKING MATERIALS** **N13**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Total | b/f | 2 600 | Aug | 31 | Cons. stores on hand | GJ1 | 660 |
| | | | | | | | Profit and loss | GJ1 | 1 940 |
| | | | | 2 600 | | | | | 2 600 |
| Sept | 1 | Cons. stores on hand | GJ1 | 660 | | | | | |
| | | | | | | | | | |

**INSURANCE** **N14**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Total | b/f | 400 | Aug | 31 | Prepaid expenses | GJ1 | 80 |
| | | | | | | | Profit and loss | GJ1 | 320 |
| | | | | **400** | | | | | **400** |
| Sept | 1 | Prepaid expenses | GJ1 | 80 | | | | | |
| | | | | | | | | | |

**SUNDRY EXPENSES** **N15**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Total | b/f | 11 200 | Aug | 31 | Profit and loss | GJ1 | 11 200 |
| | | | | | | | | | |

**DIVIDENDS ON ORDINARY SHARES** **N16**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Total | b/f | 5 000 | Aug | 31 | Appropriation | GJ1 | 13 000 |
| | | S/hldrs for dividends | GJ1 | 8 000 | | | | | |
| | | | | **13 000** | | | | | **13 000** |
| | | | | | | | | | |

**TRADING STOCK DEFICIT** **N17**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Trading stock | GJ1 | 2 200 | Aug | 31 | Profit and loss | GJ1 | 2 200 |
| | | | | | | | | | |

**DEPRECIATION** **N18**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Acc. dep. on equip. | GJ1 | 2 400 | Aug | 31 | Profit and loss | GJ1 | 2 400 |
| | | | | | | | | | |

**PROVISION FOR BAD DEBTS ADJUSTMENT** **N19**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Prov. for bad debts | GJ1 | 485 | Aug | 31 | Profit and loss | GJ1 | 485 |
| | | | | | | | | | |

**INCOME TAX** **N20**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | SARS – Income tax | GJ1 | 7 252 | Aug | 31 | Appropriation | GJ1 | 7 252 |
| | | | | | | | | | |

**FINAL ACCOUNTS SECTION**

**Dr** **TRADING ACCOUNT** **F1** **Cr**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Cost of sales | GJ1 | 208 000 | Aug | 31 | Sales | GJ1 | 378 000 |
| | | Profit and loss | GJ1 | 170 000 | | | | | |
| | | | | **378 000** | | | | | **378 000** |

**PROFIT AND LOSS ACCOUNT** **F2**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Salaries and wages | GJ1 | 90 000 | Aug | 31 | Trading account | GJ1 | 170 000 |
| | | Directors fees | GJ1 | 30 000 | | | Rent income | GJ1 | 10 800 |
| | | Audit fees | GJ1 | 7 300 | | | Commission income | GJ1 | 6 000 |
| | | Interest on loan | GJ1 | 2 000 | | | Interest on current a/c | GJ1 | 500 |
| | | Bad debts | GJ1 | 1 700 | | | Int. on o/due debtors | GJ1 | 200 |
| | | Packing materials | GJ1 | 1 940 | | | | | |
| | | Insurance | GJ1 | 320 | | | | | |
| | | Sundry expenses | GJ1 | 11 200 | | | | | |
| | | Trading stock deficit | GJ1 | 2 200 | | | | | |
| | | Depreciation | GJ1 | 2 400 | | | | | |
| | | Prov. for b/debts adj. | GJ1 | 485 | | | | | |
| | | Appropriation | GJ1 | 37 955 | | | | | |
| | | | | **187 500** | | | | | **187 500** |

**APPROPRIATION ACCOUNT** **F3**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Div. on ord. shares | GJ1 | 13 000 | Aug | 31 | Profit and loss | GJ1 | 37 955 |
| | | Income tax | GJ1 | 7 252 | | | | | |
| | | Retained income | GJ1 | 17 703 | | | | | |
| | | | | **37 955** | | | | | **37 955** |

**PALAMO (PTY) LTD**
**TRIAL BALANCE ON 31 AUGUST 20.4**

| Balance Sheet accounts section | FoI | POST-ADJUSTMENT | | POST-CLOSING | |
|---|---|---|---|---|---|
| | | Debit | Credit | Debit | Credit |
| Ordinary share capital | B1 | | 210 000 | | 210 000 |
| Retained income | B2 | | 15 000 | | 32 703 |
| Loan from East Bank | B3 | | 27 000 | | 27 000 |
| Land and buildings | B4 | 160 000 | | 160 000 | |
| Equipment | B5 | 44 000 | | 44 000 | |
| Acc. depreciation on equipment | B6 | | 22 400 | | 22 400 |
| Trading stock | B7 | 79 800 | | 79 800 | |
| Debtors control | B8 | 39 700 | | 39 700 | |
| Provision for bad debts | B9 | | 1 985 | | 1 985 |
| Bank | B10 | 6 300 | | 6 300 | |
| Cash float | B11 | 750 | | 750 | |
| Petty cash | B12 | 250 | | 250 | |
| Creditors control | B13 | | 12 800 | | 12 800 |
| SARS – Income tax | B14 | | 252 | | 252 |
| Consumable stores on hand | B15 | 660 | | 660 | |
| Expenses payable | B16 | | 16 300 | | 16 300 |
| Prepaid expenses | B17 | 80 | | 80 | |
| Income receivable | B18 | 900 | | 900 | |
| Deferred income | B19 | | 1 000 | | 1 000 |
| Shareholders for dividends | B20 | | 8 000 | | 8 000 |
| | | | | **332 440** | **332 440** |
| **Nominal accounts section** | | | | | |
| Sales | N1 | | 386 000 | | |
| Debtors allowances | N2 | 8 000 | | | |
| Cost of sales | N3 | 208 000 | | | |
| Salaries and wages | N4 | 90 000 | | | |
| Directors fees | N5 | 30 000 | | | |
| Audit fees | N6 | 7 300 | | | |
| Interest on loan | N7 | 2 000 | | | |
| Bad debts | N8 | 1 700 | | | |
| Rent income | N9 | | 10 800 | | |
| Commission income | N10 | | 6 000 | | |
| Interest on current bank account | N11 | | 500 | | |
| Interest on overdue debtors | N12 | | 200 | | |
| Packing material | N13 | 1 940 | | | |
| Insurance | N14 | 320 | | | |
| Sundry expenses | N15 | 11 200 | | | |
| Dividends on ordinary shares | N16 | 13 000 | | | |
| Trading stock deficit | N17 | 2 200 | | | |
| Depreciation | N18 | 2 400 | | | |
| Provision for bad debts adjustment | N19 | 485 | | | |
| Income tax | N20 | 7 252 | | | |
| | | **718 237** | **718 237** | | |

**Note to Teachers:**
After completion of the final accounts, spend some time (±10 minutes) discussing the learners' impressions on the final accounts and Trial Balances prepared. In their opinion, is there any aspect that should concern the directors of this company? At this stage, do not undertake ratio analysis. Simply concentrate on general impressions. This will inculcate a questioning approach in the minds of learners which will be of benefit to them when they undertake the more detailed ratio analysis in a subsequent Module.

## TASK 2.5 Essenzi (Pty) Ltd: Year-end procedures

**Note to Teachers:**
Ensure that learners understand all the adjusting journal entries before proceeding with the other parts of this Task. These concepts were covered in Grade 11, but should this continue to be a problem for learners, teachers are advised to set further tasks on basic adjustments. The next Module contains two Tasks with similar basic adjustments.

**GENERAL JOURNAL OF ESSENZI (PTY) LTD – 30 JUNE 20.4** **GJ1**

| No. | D | Details | Fol | Debit | Credit |
|---|---|---|---|---|---|
| 01 | 30 | Salaries | | 4 000 | |
| | | SARS – PAYE | | | 580 |
| | | Pension fund | | | 120 |
| | | Creditors for salaries | | | 3 300 |
| | | Salary details updated | | | |
| 02 | | Sundry expenses | | 120 | |
| | | Pension fund | | | 120 |
| | | Pension contribution omitted | | | |
| 03 | | Loss due to fire | | 3 000 | |
| | | Accrued income | | 12 000 | |
| | | Trading stock | | | 15 000 |
| | | Stock lost in fire and insurance claim pending | | | |
| 04 | | Consumable stores on hand | | 900 | |
| | | Packing materials | | | 900 |
| | | Items on hand at year-end | | | |
| 05 | | Directors' fees | | 22 000 | |
| | | Audit fees | | 3 300 | |
| | | Accrued expenses | | | 25 300 |
| | | Fees owing at year-end | | | |
| 06 | | Depreciation | | 29 000 | |
| | | Acc. dep. on vehicles | | | 18 000 |
| | | Acc. dep. on equipment | | | 11 000 |
| | | Depreciation of fixed assets | | | |
| 07 | | Prepaid expenses | | 3 090 | |
| | | Rent expense | | | 3 000 |
| | | Insurance | | | 90 |
| | | Amount paid in advance | | | |
| 08 | | Debtors control (M. Miller) | | 400 | |
| | | Bad debts recovered | | | 400 |
| | | Correction of error in posting | | | |
| 09 | | Provision for bad debts | | 430 | |
| | | Prov. for bad debts adjustment | | | 430 |
| | | Adjustment of provision to 5% of book debts | | | |
| 10 | | Interest on loan | | 2 200 | |
| | | Accrued expenses | | | 2 200 |
| | | Amount due at year-end | | | |

**GENERAL JOURNAL OF ESSENZI (PTY) LTD – 30 JUNE 20.4 (Continued)** **GJ1**

| No. | D | Details | Fol | Debit | Credit |
|---|---|---|---|---|---|
| 11 | 30 | Prepaid expenses | | 1 600 | |
| | | Advertisements | | | 1 600 |
| | | Amount paid in advance | | | |
| 12 | | Accrued income | | 1 400 | |
| | | Interest on fixed deposit | | | 1 400 |
| | | Interest owing at year-end | | | |
| 13 | | Dividends on ordinary shares | | 24 000 | |
| | | Shareholders for dividends | | | 24 000 |
| | | Final dividend of 8c declared | | | |
| 14 | | Income tax | | 54 171 | |
| | | SARS – Income tax | | | 54 171 |
| | | Tax liability for the year | | | |
| 15 | | Ordinary share capital | | 56 000 | |
| | | Retained income | | 26 000 | |
| | | Bank | | | 82 000 |
| | | Direct transfer not recorded at year-end | | | |

**GENERAL LEDGER OF ESSENZI (PTY) LTD**
**FINAL ACCOUNTS SECTION**

**Dr** **TRADING ACCOUNT** **F1** **Cr**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Cost of sales | | 510 000 | June | 30 | Sales | | 911 000 |
| | | Profit and loss a/c | | 401 000 | | | | | |
| | | | | **911 000** | | | | | **911 000** |

**PROFIT AND LOSS ACCOUNT** **F2**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Rent expense | | 36 000 | June | 30 | Trading account | | 401 000 |
| | | Salaries and wages | | 126 000 | | | Int. on fixed deposit | | 2 200 |
| | | Directors fees | | 62 000 | | | Commission income | | 63 800 |
| | | Audit fees | | 9 300 | | | Int. on current account | | 1 000 |
| | | Interest on loan | | 4 200 | | | Bad debts recovered | | 400 |
| | | Advertising | | 3 900 | | | Prov. bad debts adj. | | 430 |
| | | Bad debts | | 900 | | | | | |
| | | Packing materials | | 3 000 | | | | | |
| | | Insurance | | 3 790 | | | | | |
| | | Sundry expenses | | 7 170 | | | | | |
| | | Loss due to fire | | 3 000 | | | | | |
| | | Depreciation | | 29 000 | | | | | |
| | | Appropriation | | 180 570 | | | | | |
| | | | | **468 830** | | | | | **468 830** |

**PREFERRED METHOD:**

**Dr** **APPROPRIATION ACCOUNT** **F3** **Cr**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Dividends ord. shares | | 54 000 | June | 30 | Profit and loss | | 180 570 |
| | | Income tax | | 54 171 | | | | | |
| | | Retained income | | 72 399 | | | | | |
| | | | | **180 570** | | | | | **180 570** |
| | | | | | | | | | |

**ALTERNATIVE METHOD (NOT ADVISED):**

**APPROPRIATION ACCOUNT** **F3**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Dividends ord. shares | | 54 000 | June | 30 | Profit and loss | | 180 570 |
| | | Income tax | | 54 171 | | | Retained income | | 133 000 |
| | | Retained income | | 205 399 | | | | | |
| | | | | **313 570** | | | | | **313 570** |
| | | | | | | | | | |

**ESSENZI (PTY) LTD: POST-ADJUSTMENT TRIAL BALANCE ON 30 JUNE 20.4**

| Balance Sheet accounts section | FoI | Post-adjustment | | Post-closing | |
|---|---|---|---|---|---|
| | | Debit | Credit | Debit | Credit |
| Ordinary share capital [420 000 – 56 000] | | | 364 000 | | 364 000 |
| Retained income* (see working below) | | | 133 000 | | 205 399 |
| Loan from Southern Lenders | | | 60 000 | | 60 000 |
| Vehicles | | 380 000 | | 380 000 | |
| Acc. depreciation on vehicles [42 000 + 18 000] | | | 60 000 | | 60 000 |
| Equipment | | 140 000 | | 140 000 | |
| Acc. dep. on equipment [30 000 + 11 000] | | | 41 000 | | 41 000 |
| Fixed deposit | | 40 000 | | 40 000 | |
| Trading stock [149 700 – 15 000] | | 134 700 | | 134 700 | |
| Debtors control [33 000 + 400] | | 33 400 | | 33 400 | |
| Provision for bad debts [2 100 – 430] | | | 1 670 | | 1 670 |
| Bank [148 770 – 82 000] | | 66 770 | | 66 770 | |
| Cash float | | 1 000 | | 1 000 | |
| Petty cash | | 500 | | 500 | |
| Creditors control | | | 26 900 | | 26 900 |
| Creditors for salaries [6 900 + 3 300] | | | 10 200 | | 10 200 |
| Pension Fund [600 + 120 + 120] | | | 840 | | 840 |
| SARS – PAYE [1 100 + 580] | | | 1 680 | | 1 680 |
| SARS – Income tax [54 171 - 62 000] | | 7 829 | | 7 829 | |
| Accrued income [12 000 + 1 400] | | 13 400 | | 13 400 | |
| Consumable stores on hand | | 900 | | 900 | |
| Accrued expenses [25 300 + 2 200] | | | 27 500 | | 27 500 |
| Prepaid expenses [3 090 + 1 600] | | 4 690 | | 4 690 | |
| Shareholders for dividends | | | 24 000 | | 24 000 |
| | | | | **823 189** | **823 189** |
| **Nominal accounts section** | | | | | |
| Sales | | | 926 000 | | |
| Debtors allowances | | 15 000 | | | |
| Cost of sales | | 510 000 | | | |
| Rent expense [39 000 – 3 000] | | 36 000 | | | |
| Salaries and wages [122 000 + 4 000] | | 126 000 | | | |
| Directors fees [40 000 + 22 000] | | 62 000 | | | |
| Audit fees [6 000 + 3 300] | | 9 300 | | | |
| Interest on loan [2 000 + 2 200] | | 4 200 | | | |
| Advertising [5 500 – 1 600] | | 3 900 | | | |
| Bad debts | | 900 | | | |
| Interest on fixed deposit [800 + 1 400] | | | 2 200 | | |
| Commission income | | | 63 800 | | |
| Interest on current bank account | | | 1 000 | | |
| Packing materials [3 900 – 900] | | 3 000 | | | |
| Insurance [3 880 – 90] | | 3 790 | | | |
| Sundry expenses [7 050 + 120] | | 7 170 | | | |
| Dividends on ordinary shares [30 000 + 24 000] | | 54 000 | | | |
| Loss due to fire | | 3 000 | | | |
| Depreciation | | 29 000 | | | |
| Bad debts recovered | | | 400 | | |
| Provision for bad debts adjustment | | | 430 | | |
| Income tax | | 54 171 | | | |
| | | **1 744 620** | **1 744 620** | | |

***Working:**
Post-Adjustment: 159 000 – 26 000
Post-Closing: 159 000 – 26 000 – 159 000 + 205 399
OR Post-Closing: 159 000 – 26 000 + 72 399

**Note to Teachers:**
After completion of the final accounts, spend some time (±10 minutes) in class discussing the learners' impressions on the final accounts and Trial Balances prepared. In their opinion, is there any aspect that should concern the directors of this company? At this stage, do not undertake ratio analysis. Simply concentrate on general impressions. This will inculcate a questioning approach in the minds of learners which will be of benefit to them when they undertake the more detailed ratio analysis in a subsequent module.

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Understand the accounting cycle. | | | |
| Understand and explain the basic GAAP principles. | | | |
| Identify relevant GAAP principles relevant to specific year-end adjustments. | | | |
| Enter year-end adjustments in the General Journal and post to the ledger. | | | |
| Enter closing transfers in the General Journal and post to the ledger. | | | |
| Understand how to prepare the final accounts at the end of a financial year. | | | |
| Understand how to prepare the Pre-Adjustment, Post-Adjustment and Post-Closing Trial Balances, and understand the difference between the three types of Trial Balances. | | | |
| Understand why reversal journal entries are required at the beginning of the next financial year for accruals and prepayments. | | | |
| Understand the Retained income account as the link between the Nominal accounts section and the Balance Sheet accounts section in the ledger. | | | |

# MODULE 3
# COMPANIES:
# Company financial reporting

## TASK 3.1 Annual Report of a company

Responses from learners will depend on the annual report of the companies chosen by them. This is an exploratory exercise in getting to know the layout of the annual report.

**Note to Teachers:**
Invite an accountant or a trainee accountant into the classroom to cover these issues, as well as career progression in the accounting profession.

## TASK 3.2 Characteristics of financial statements

| Desirable characteristic | | Description |
|---|---|---|
| 1. | Timeliness | F |
| 2. | Understandability | G |
| 3. | Fairness | B |
| 4. | Reliability | A |
| 5. | Comparability | C |
| 6. | Verifiability | E |
| 7. | Relevance | D |

## TASK 3.3 GAAP: Baseline Task

| Example | Concept |
|---|---|
| 3.3.1 | D |
| 3.3.2 | B |
| 3.3.3 | E or D |
| 3.3.4 | E |
| 3.3.5 | F |
| 3.3.6 | D |
| 3.3.7 | F |
| 3.3.8 | C |
| 3.3.9 | F |

## TASK 3.4 GAAP, IFRS, Companies Act & Professional bodies

| 3.4.1 | **Briefly explain why it is important for accountants to know the basic rules or concepts of GAAP, viz. Historical cost, Business entity, Going-concern, Prudence, Matching principle and Materiality.** |
|---|---|
| It is important for accountants to know the basic rules or concepts of GAAP so that these can guide them in making decisions about what entries to put through, e.g. in valuing stock, does one look at it from a very pessimistic angle (i.e. below cost for immediate sale) or at a reasonable value (i.e. at least at cost, knowing the business will continue for the foreseeable future under the Going concern concept); in valuing Land & buildings, use Historical cost even though it might not be realistic. | |

| 3.4.2 | **Briefly explain what is meant by IFRS and why it is important for professional accountants and auditors to keep up to date with IFRS.** |
|---|---|
| IFRS = International Financial Reporting Standards.<br>These are directives or statements developed by the IASB (International Accounting Standards Board) on how particular types of transactions should be reported in financial statements to allow for comparisons of financial statements across countries.<br>These change over time as conditions change in the financial world.<br>It is important for accountants to keep up to date on these as they are constantly changing. | |
| **3.4.3** | **Briefly explain why the Companies Act specifically mentions:** |
| | • **Accounting records that a company must keep.** |
| The Companies Act specifically mentions accounting records that a company must keep to protect the readers of the financial statements as the information on which the financial statements are based must be reliable and as accurate as possible, and these records facilitate internal control in a business.<br>Businesses should not be allowed to take short cuts in this regard. | |
| | • **IFRS.** |
| The Companies Act specifically mentions IFRS to force companies to keep up to date with international trends in financial reporting.<br>If they do not do this, it will be impossible to compare companies in different countries. | |
| **3.4.4** | **Briefly explain the role played by professional bodies such as SAICA and SAIPA in South Africa.** |
| The professional bodies such as SAICA and SAIPA provide a means of registering professional accountants to ensure that they have certain levels of training and knowledge.<br>They also provide a means to apply disciplinary measures if their members do not comply with their responsibilities in responsible financial reporting. | |

## TASK 3.5 ⌘ Types of Balance Sheet adjustments

| 3.5.1 | **Financial assets:** |
|---|---|
| | • **Explain where these are placed in the financial statements.** |
| Financial assets are placed under Non-Current Assets in the Balance Sheet (Statement of Financial Position). | |
| | • **Define what is meant by 'financial asset'.** |
| A financial asset is an investment which generates a return to the owner of that asset. | |
| **3.5.2** | **One of the fixed deposits valued at R50 000 matures (will be repaid to the business) two months after the year-end. Consider your answer in 3.5.1 above and explain how the financial statements should be adjusted at this year-end. Provide your reasons.** |
| Reduce Non-current assets (i.e. Financial assets or Investments) by R50 000.<br>Increase Current assets (Cash & cash equivalents by R50 000) as this portion is current and will not be received by the owner within 12 months. | |
| **3.5.3** | **Long-term loans:** |
| | • **Explain where these are placed in the financial statements.** |
| Long-term loans are placed under Non-Current Liabilities. | |
| | • **Define what is meant by 'long-term loans'.** |
| Long-term loans are those that are repaid over periods longer than one year. | |

| | |
|---|---|
| **3.5.4** | **The business repays this loan at R4 000 per month. It will take another five years to repay the loan. Consider your answer in 3.5.3 above and explain how the financial statements should be adjusted at the year-end. Provide your reasons.** |
| Reduce Non-Current liabilities (i.e. Loan) by R48 000; Increase Current liabilities (i.e. Current portion of loan) by R48 000.<br>This is because only part of the loan has to be repaid within the next year. | |
| **3.5.4** | **Post-dated cheques:** |
| | • **Define what is meant by the term 'post-dated cheque'.** |
| A post-dated cheque (PDC) is one which is dated for some time in the future.<br>The bank will not transfer the funds to the recipient until that date. | |
| | • **Why would a business issue post-dated cheques?** |
| A business would issue post-dated cheques to satisfy a recipient that he is about to be paid, yet it gives time to the payer to ensure that there are sufficient funds to cover the amount to be paid. | |
| | • **Which major item in the financial statements is affected by post-dated cheques? Explain how it is affected by the post-dated cheques.** |
| The major item in the financial statements affected by post-dated cheques is the Bank account.<br>It is affected by the entry that is put through when the PDC is made out (bank is reduced) although effectively there will not be a transfer of funds out of the bank account until the due date of the PDC. | |
| **3.5.5** | **The CPJ for February 20.6 contain the following cheque: Cheque 6755 for R40 000, issued to Ace Builders for repairs to the company's property (this cheque has been post-dated to 30 April 20.6). Consider your answer in 3.5.5 above and explain how the financial statements should be adjusted at the year-end. Provide your reasons.** |
| Add R40 000 to Bank; Add R40 000 to Trade & other payables (Creditors).<br>This is because the funds are not yet paid (bank should not be decreased, therefore add the amount back).<br>Also, the amount is technically still owed therefore Creditors must increase. | |

## TASK 3.6 ⌘ Reflection on format of Income Statement (Statement of Comprehensive Income)

| | |
|---|---|
| **3.6.1** | **How should negative figures be displayed?** |
| In brackets. | |
| **3.6.2** | **Why does the format contain amount columns for two years?** |
| To allow readers to compare and assess trends. | |
| **3.6.3** | **Explain the difference between gross profit, operating profit and net profit.** |
| Gross profit: Profit on buying and selling goods.<br>Operating profit: Profit in running the business through its mainline of operation.<br>Net profit: The final profit after taking into account all income and expenses including interest. | |
| **3.6.4** | **Why is income tax not shown as an operating expense?** |
| It is not related to the running of the business – it is a sharing of the profit earned with the government. | |
| **3.6.5** | **Why is interest shown at the bottom of the Income Statement, and why are there special notes for interest income and interest expense?** |
| They are not operating items – they are financing or investing activities.<br>They are material items and need to be reflected separately in detail. | |

## TASK 3.7 ⌘ Reflection on format of Income Statement (Statement of Comprehensive Income)

| | |
|---|---|
| **3.7.1** | **Why does the format cater for so many notes to the financial statements?** |
| Concept of materiality – so as not to clutter up the Balance Sheet with less important items. | |
| **3.7.2** | **Why does the note for share capital contain so much detail?** |
| It is important for a shareholder to assess his % share in the company. | |
| **3.7.3** | **Why does the note for fixed assets contain so much detail?** |
| Fixed assets are arguably the most valuable asset.<br>Also abuse can appear here as depreciation is a very subjective (uncertain) calculation.<br>Changes in assets will affect the income-earning performance of a company; hence this is an important note to the financial statements. | |
| **3.7.4** | **A loan is split into two parts. Explain where these parts are placed, and explain why this is so.** |
| Long-term part under Non-current liabilities.<br>Current part to be repaid in the next year: Show under Current liabilities. | |
| **3.7.5** | **Where in the financial statements would you place a fixed deposit which matures in a few months' time?** |
| Under Cash and cash equivalents. | |
| **3.7.6** | **Why are the current assets placed in the sequence as shown above with Inventories at the top and Cash and cash equivalents at the bottom?** |
| To reflect their degree of liquidity, i.e. the ease with which they can be converted into cash, which is needed to settle liabilities. | |
| **3.7.7** | **Interim dividends are reflected in one specific place, whereas final dividends are shown in two places. Why is this so?** |
| Interim dividends have affected Bank – they have been paid already.<br>Final dividends are a deduction from Retained income, and they are still owed. | |
| **3.7.8** | **How is it possible that SARS (Income tax) could appear under either Trade and other receivables or Trade and other payables?** |
| It depends whether or not the provisional tax payments exceed the tax due for the year.<br>If the provisional payments exceed the amount due, SARS is a debtor.<br>If the provisional payments are less than the tax for the year, then SARS is a creditor. | |

## TASK 3.8 ⌘ Thulo (Pty) Ltd: Financial statements

**3.8.1 THULO (PTY) LIMITED**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME) FOR THE YEAR ENDED 30 JUNE 20.2**

| | Note | |
|---|---|---|
| Sales [1 761 000 – 31 000] | | 1 730 000 |
| Cost of sales | | (870 000) |
| **Gross profit** | | 860 000 |
| **Other operating income** | | 125 800 |
| Commission income | | 47 000 |
| Rent income | | 78 000 |
| Provision for bad debts adjustment | | 800 |
| **Gross operating income** | | 985 800 |
| **Operating expenses** | | (600 500) |
| Salaries and wages | | 220 000 |
| Pension contributions | | 17 500 |
| Medical aid contributions | | 12 100 |
| Directors fees | | 160 000 |
| Audit fees | | 39 000 |
| Bad debts | | 12 000 |
| Packing materials | | 14 600 |
| Insurance | | 23 900 |
| Sundry expenses | | 17 600 |
| Trading stock deficit | | 14 000 |
| Depreciation | | 69 800 |
| **Operating profit** | | 385 300 |
| Interest income | 1 | 900 |
| **Profit before interest expense** | | 386 200 |
| Interest expense / financing cost | 2 | (25 200) |
| **Net profit before tax** | | 361 000 |
| Income tax | | (108 300) |
| **Net profit after tax** | 8 | **252 700** |

**3.8.2 BALANCE SHEET (STATEMENT OF FINANCIAL POSITION) ON 30 JUNE 20.2**

| **ASSETS** | **Note** | |
|---|---|---|
| **Non-current assets** | | 1 669 000 |
| Fixed/Tangible assets | 3 | 1 669 000 |
| **Current assets** | | 361 880 |
| Inventory | 4 | 281 200 |
| Trade and other receivables | 5 | 57 720 |
| Cash and cash equivalents | 6 | 22 960 |
| **Total assets** | | **2 030 880** |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | | 1 642 500 |
| Ordinary share capital | 7 | 1 260 000 |
| Retained income | 8 | 382 500 |
| **Non-current liabilities** | | 210 000 |
| Loan from Lowveld Bank | | 210 000 |
| **Current liabilities** | | 178 380 |
| Trade and other payables | 9 | 178 380 |
| **Total equity and liabilities** | | **2 030 880** |

**THULO (PTY) LIMITED**
**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 20.2**

| | |
|---|---|
| **1. INTEREST INCOME** | |
| From overdue debtors | 300 |
| From current account | 600 |
| | **900** |
| **2. INTEREST EXPENSE** | |
| On loan | 25 200 |
| | **25 200** |

| **3. FIXED/TANGIBLE ASSETS** | **Land & buildings** | **Vehicles** | **Equipment** | **Total** |
|---|---|---|---|---|
| Carrying value at beginning of year | 786 000 | 247 000 | 140 800 | 1 173 800 |
| Cost | 786 000 | 285 000 | 160 000 | 1 231 000 |
| Accumulated depreciation | - | (38 000) | (19 200) | (57 200) |
| **Movements** | 300 000 | 208 000 | (12 800) | 495 200 |
| Additions at cost | 300 000 | 265 000 | - | 565 000 |
| Disposals at carrying value | - | - | - | - |
| Depreciation | | (57 000) | (12 800) | (69 800) |
| Carrying value at end of year | **1 086 000** | **455 000** | **128 000** | **1 669 000** |
| Cost | 1 086 000 | 550 000 | 160 000 | 1 796 000 |
| Accumulated depreciation | - | (95 000) | (32 000) | (127 000) |

| | |
|---|---|
| **4. INVENTORY** | |
| Trading inventory | 280 000 |
| Consumable stores on hand | 1 200 |
| | **281 200** |
| **5. TRADE AND OTHER RECEIVABLES** | |
| Net trade debtors | 49 920 |
| Trade debtors | 52 000 |
| Provision for bad debts | (2 080) |
| Income accrued / receivable | 5 300 |
| Expenses prepaid | 2 500 |
| | **57 720** |
| **6. CASH AND CASH EQUIVALENTS** | |
| Bank | 20 460 |
| Cash float | 2 000 |
| Petty cash | 500 |
| | **22 960** |
| **7. ORDINARY SHARE CAPITAL** | |
| **AUTHORISED** | |
| Number of authorised ordinary shares: 200 000 shares | |
| **ISSUED** | |
| 110 000 ordinary shares in issue at beginning of financial year | 860 000 |
| 40 000 shares of R10.00 each issued during the year | 400 000 |
| 150 000 ordinary shares in issue at end of financial year | **1 260 000** |

| **8. RETAINED INCOME** | |
|---|---|
| Retained income at beginning of year | 195 800 |
| Net profit after tax for the year | 252 700 |
| Dividends on ordinary shares | (66 000) |
| Paid | 36 000 |
| Recommended | 30 000 |
| Retained income at end of year | **382 500** |
| | |
| **9. TRADE AND OTHER PAYABLES** | |
| Trade creditors | 43 400 |
| SARS – Income tax | 9 800 |
| Expenses payable (accrued) | 3 600 |
| Deferred income | 5 000 |
| Shareholders for dividends* | 30 000 |
| Creditors for salaries | 20 500 |
| Pension fund | 3 980 |
| Medical aid fund | 2 100 |
| Loan from Westfin Bank* | 60 000 |
| | **178 380** |

*Could be shown on the face of the Balance Sheet under Current Liabilities.

| **3.8.3** | **Should the shareholders be satisfied with the financial results? Explain briefly.** |
|---|---|

Yes.
The return on shareholders' equity is 18.7% ($^{252\ 700}/_{1\ 349\ 150}$ x 100) which is good and is higher than most other alternative investments.
The business has paid out dividends of R66 000 from its net profit after tax of R252 700.
This has resulted in an increase in the retained income.
The current ratio is 2.0 : 1 (361 880: 178 380) while the acid test ratio is 0.45 : 1 (80 680 : 178 380) so the business might well run into liquidity problems if it cannot sell its stock reasonably quickly.

## TASK 3.9 ⌘ Palamo (Pty) Ltd: Financial statements

**Note to Teachers:**
If your learners require reinforcement of adjusting entries, you can require them to draw up the financial statements from the Pre-Adjustment Trial Balance and adjustments as per Task 2.4. Learners can then check their figures to the final accounts and Post-Closing Trial Balance which they have already prepared under Task 2.4.

If you are satisfied that this is not necessary, learners may simply prepare the financial statements from the final accounts and Post-Closing Trial Balance which they have already prepared.

**PALAMO (PTY) LTD**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME) FOR THE YEAR ENDED 31 AUGUST 20.4**

| | Note | |
|---|---|---|
| Sales | | 378 000 |
| Cost of sales | | (208 000) |
| **Gross profit** | | 170 000 |
| **Other operating income** | | 16 800 |
| Commission income | | 6 000 |
| Rent income | | 10 800 |
| **Gross operating income** | | 186 800 |
| **Operating expenses** | | (147 545) |
| Salaries and wages | | 90 000 |
| Directors fees | | 30 000 |
| Audit fees | | 7 300 |
| Bad debts | | 1 700 |
| Packing materials | | 1 940 |
| Insurance | | 320 |
| Sundry expenses | | 11 200 |
| Trading stock deficit | | 2 200 |
| Depreciation | | 2 400 |
| Provision for bad debts adjustment | | 485 |
| **Operating profit** | | 39 255 |
| Interest income | 1 | 700 |
| **Profit before interest expense** | | 39 955 |
| Interest expense / financing cost | 2 | (2 000) |
| **Net profit before tax** | | 37 955 |
| Income tax | | (7 252) |
| **Net profit after tax** | 8 | **30 703** |

**PALAMO (PTY) LTD**
**BALANCE SHEET (STATEMENT OF FINANCIAL POSITION) ON 31 AUGUST 20.4**

| **ASSETS** | **Note** | |
|---|---|---|
| **Non-current assets** | | 181 600 |
| Fixed/Tangible assets | 3 | 181 600 |
| **Current assets** | | 126 455 |
| Inventory | 4 | 80 460 |
| Trade and other receivables | 5 | 38 695 |
| Cash and cash equivalents | 6 | 7 300 |
| **Total assets** | | **308 055** |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | | 242 703 |
| Ordinary share capital | 7 | 210 000 |
| Retained income | 8 | 32 703 |
| **Non-current liabilities** | | 27 000 |
| Loan from East Bank | | 27 000 |
| **Current liabilities** | | 38 352 |
| Trade and other payables | 9 | 38 352 |
| **Total equity and liabilities** | | **308 055** |

**PALAMO (PTY) LTD**
**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 AUGUST 20.4**

| **1. INTEREST INCOME** | |
|---|---|
| From overdue debtors | 200 |
| From current account | 500 |
| | **700** |
| **2. INTEREST EXPENSE** | |
| On loan | 2 000 |
| | **2 000** |

| **3. FIXED/TANGIBLE ASSETS** | **Land & buildings** | **Equipment** | **Total** |
|---|---|---|---|
| Carrying value at beginning of year | 120 000 | 24 000 | 144 000 |
| Cost | 120 000 | 44 000 | 164 000 |
| Accumulated depreciation | - | (20 000) | (20 000) |
| **Movements** | 40 000 | (2 400) | 37 600 |
| Additions at cost | 40 000 | - | 40 000 |
| Disposals at carrying value | - | (2 400) | (2 400) |
| Depreciation | - | - | - |
| Carrying value at end of year | **160 000** | **21 600** | **181 600** |
| Cost | 160 000 | 44 000 | 204 000 |
| Accumulated depreciation | - | (22 400) | (22 400) |

| | |
|---|---|
| **4. INVENTORY** | |
| Trading inventory | 79 800 |
| Consumable stores on hand (including stationery) | 660 |
| | **80 460** |
| **5. TRADE AND OTHER RECEIVABLES** | |
| Net trade debtors | 37 715 |
| Trade debtors | 39 700 |
| Provision for bad debts | (1 985) |
| Accrued income/Income receivable | 900 |
| Prepaid expenses | 80 |
| | **38 695** |
| **6. CASH AND CASH EQUIVALENTS** | |
| Bank | 6 300 |
| Cash float | 750 |
| Petty cash | 250 |
| | **7 300** |
| **7. ORDINARY SHARE CAPITAL** | |
| **AUTHORISED** | |
| Number of authorised ordinary shares: 600 000 shares | |
| **ISSUED** | |
| 340 000 ordinary shares in issue at beginning of financial year | 172 800 |
| 60 000 shares of R0.62 each issued during the year | 37 200 |
| 400 000 ordinary shares in issue at end of financial year | **210 000** |
| **8. RETAINED INCOME** | |
| Retained income at beginning of year | 15 000 |
| Net profit after tax for the year | 30 703 |
| Dividends on ordinary shares | (13 000) |
| Paid | 5 000 |
| Recommended | 8 000 |
| Retained income at end of year | **32 703** |
| **9. TRADE AND OTHER PAYABLES** | |
| Trade creditors | 12 800 |
| SARS (Income tax) | 252 |
| Expenses payable / Accrued | 16 300 |
| Deferred income / Received in advance | 1 000 |
| Shareholders for dividends* | 8 000 |
| | **38 352** |

*Could be shown on the face of the Balance Sheet under Current Liabilities.

## TASK 3.10 ⌘ Essenzi (Pty) Ltd: Financial statements

**Note to Teachers:**
If your learners require reinforcement of adjusting entries, you can require them to draw up the financial statements from the Pre-Adjustment Trial Balance and adjustments as per Task 2.5. Learners can then check their figures to the final accounts and Post-Closing Trial Balance which they have already prepared under Task 2.5.

If you are satisfied that this is not necessary, learners may simply prepare the financial statements from the final accounts and Post-Closing Trial Balance which they have already prepared.

**ESSENZI (PTY) LTD**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME) FOR THE YEAR ENDED 30 JUNE 20.4**

| | **Note** | |
|---|---|---|
| Sales | | 911 000 |
| Cost of sales | | (510 000) |
| **Gross profit** | | 401 000 |
| **Other operating income** | | 64 630 |
| Commission income | | 63 800 |
| Bad debts recovered | | 400 |
| Provision for bad debts adjustment | | 430 |
| **Gross operating income** | | 465 630 |
| **Operating expenses** | | (284 060) |
| Rent expense | | 36 000 |
| Salaries and wages | | 126 000 |
| Directors fees | | 62 000 |
| Audit fees | | 9 300 |
| Advertising | | 3 900 |
| Bad debts | | 900 |
| Packing materials | | 3 000 |
| Insurance | | 3 790 |
| Sundry expenses | | 7 170 |
| Loss due to fire | | 3 000 |
| Depreciation | | 29 000 |
| **Operating profit** | | 181 570 |
| Interest income | 1 | 3 200 |
| **Profit before interest expense** | | 184 770 |
| Interest expense / financing cost | 2 | (4 200) |
| **Net profit before tax** | | 180 570 |
| Income tax | | (54 171) |
| **Net profit after tax** | 8 | **126 399** |

**ESSENZI (PTY) LTD**
**BALANCE SHEET (STATEMENT OF FINANCIAL POSITION) ON 30 JUNE 20.4**

| **ASSETS** | **Note** | |
|---|---|---|
| **Non-current assets** | | 459 000 |
| Fixed/Tangible assets | 3 | 419 000 |
| Financial assets: Fixed deposit | | 40 000 |
| **Current assets** | | 261 519 |
| Inventory | 4 | 135 600 |
| Trade and other receivables | 5 | 57 649 |
| Cash and cash equivalents | 6 | 68 270 |
| **Total assets** | | **720 519** |
| | | |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | | 569 399 |
| Ordinary share capital | 7 | 364 000 |
| Retained income | 8 | 205 399 |
| **Non-current liabilities** | | 60 000 |
| Loan from Southern Lenders | | 60 000 |
| **Current liabilities** | | 91 120 |
| Trade and other payables | 9 | 91 120 |
| **Total equity and liabilities** | | **720 519** |

**ESSENZI (PTY) LTD**
**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 20.4**

| **1. INTEREST INCOME** | |
|---|---|
| From investments | 2 200 |
| From current account | 1 000 |
| | **3 200** |
| | |
| **2. INTEREST EXPENSE** | |
| On mortgage loan | 4 200 |
| | **4 200** |

| **3. FIXED/TANGIBLE ASSETS** | **Vehicles** | **Equipment** | **Total** |
|---|---|---|---|
| Carrying value at beginning of year | 48 000 | 110 000 | 158 000 |
| Cost | 90 000 | 140 000 | 230 000 |
| Accumulated depreciation | (42 000) | (30 000) | (72 000) |
| **Movements** | 272 000 | (11 000) | 261 000 |
| Additions at cost | 290 000 | - | 290 000 |
| Disposals at carrying value | - | - | - |
| Depreciation | (18 000) | (11 000) | (29 000) |
| Carrying value at end of year | **320 000** | **99 000** | **419 000** |
| Cost | 380 000 | 140 000 | 520 000 |
| Accumulated depreciation | (60 000) | (41 000) | (101 000) |

| | |
|---|---|
| **4. INVENTORY** | |
| Trading inventory | 134 700 |
| Consumable stores on hand | 900 |
| | **135 600** |
| **5. TRADE AND OTHER RECEIVABLES** | |
| Net trade debtors | 31 730 |
| Trade debtors | 33 400 |
| Provision for bad debts | (1 670) |
| Accrued income/Income receivable | 13 400 |
| Prepaid expenses | 4 690 |
| SARS (Income tax) | 7 829 |
| | **57 649** |
| **6. CASH AND CASH EQUIVALENTS** | |
| Bank | 66 770 |
| Cash float | 1 000 |
| Petty cash | 500 |
| | **68 270** |
| **7. ORDINARY SHARE CAPITAL** | |
| **AUTHORISED** | |
| Number of authorised ordinary shares: 500 000 shares | |
| **ISSUED** | |
| 300 000 ordinary shares in issue at beginning of financial year | 420 000 |
| 40 000 shares repurchased during the year (average price R1.40) | (56 000) |
| 260 000 ordinary shares in issue at end of financial year | **364 000** |
| **8. RETAINED INCOME** | |
| Retained income at beginning of year | 159 000 |
| Net profit after tax for the year | 126 399 |
| Repurchase of 40 000 shares (at 65 cents above average price) | (26 000) |
| Dividends on ordinary shares | (54 000) |
| Paid | 30 000 |
| Recommended | 24 000 |
| Retained income at end of year | **205 399** |
| **9. TRADE AND OTHER PAYABLES** | |
| Trade creditors | 26 900 |
| Creditors for salaries | 10 200 |
| Pension fund | 840 |
| SARS (PAYE) | 1 680 |
| Accrued expenses | 27 500 |
| Shareholders for dividends* | 24 000 |
| | **91 120** |

*Could be shown on the face of the Balance Sheet under Current Liabilities.

## TASK 3.11 ⌘ Impilo (Pty) Ltd: Financial statements

**3.11.1 IMPILO (PTY) LTD**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME) FOR THE YEAR ENDED 31 AUGUST 20.4**

| | Note | |
|---|---|---|
| Sales [2 980 000 – 26 000] | | 2 954 000 |
| Cost of sales | | (1 701 000) |
| **Gross profit** | | 1253 000 |
| **Other operating income** | | 113 400 |
| Sundry income | | 5 400 |
| Rent income | | 108 000 |
| **Gross operating income** | | 1 366 400 |
| **Operating expenses** | | (822 730) |
| Advertising | | 12 000 |
| Audit fees | | 48 200 |
| Bad debts | | 8 600 |
| Depreciation | | 34 850 |
| Directors' fees | | 275 000 |
| Lease of vehicles | | 66 000 |
| Medical aid contributions | | 21 800 |
| Pension contributions | | 32 180 |
| Salaries and wages | | 305 000 |
| Sundry expenses | | 19 100 |
| **Operating profit** | | 543 670 |
| Interest income | 1 | 23 400 |
| **Profit before interest expense** | | 567 070 |
| Interest expense / financing cost | 2 | (49 070) |
| **Net profit before tax** | | 518 000 |
| Income tax [28% x 518 000] + [10% x 56 400] | | (150 680) |
| **Net profit after tax** | 8 | **367 320** |

### 3.11.2 IMPILO (PTY) LTD
### BALANCE SHEET (STATEMENT OF FINANCIAL POSITION) ON 31 AUGUST 20.4

| ASSETS | Note | |
|---|---|---|
| **Non-current assets** | | 863 360 |
| Fixed/Tangible assets | 3 | 723 360 |
| Financial assets: | | |
| Fixed deposit at East Bank | | 90 000 |
| Shares in PQR Limited | | 50 000 |
| **Current assets** | | 524 160 |
| Inventory | 4 | 468 750 |
| Trade and other receivables | 5 | 53 660 |
| Cash and cash equivalents | 6 | 1 750 |
| **Total assets** | | **1 387 520** |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | | 830 920 |
| Ordinary share capital | 7 | 402 000 |
| Retained income | 8 | 428 920 |
| **Non-current liabilities** | | 302 400 |
| Loan from Northern Lenders [388 800 – 86 400] | | 302 400 |
| **Current liabilities** | | 254 200 |
| Trade and other payables | 9 | 213 000 |
| Bank overdraft | | 41 200 |
| **Total equity and liabilities** | | **1 387 520** |

### IMPILO (PTY) LTD
### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 AUGUST 20.4

| | |
|---|---|
| **1. INTEREST INCOME** | |
| From fixed deposit | 5 400 |
| Dividends on shares in PQR Ltd | 18 000 |
| | **23 400** |
| **2. INTEREST EXPENSE** | |
| On loan from Northern Lenders | 41 800 |
| On overdraft | 7 270 |
| | **49 070** |

| **3. FIXED/TANGIBLE ASSETS** | **Land & buildings** | **Equipment** | **Total** |
|---|---|---|---|
| Carrying value at beginning of year | 325 710 | 348 500 | 674 210 |
| Cost | 325 710 | 410 000 | 735 710 |
| Accumulated depreciation | - | (61 500) | (61 500) |
| **Movements** | 84 000 | (34 850) | 49 150 |
| Additions at cost | 84 000 | - | 84 000 |
| Disposals at carrying value | - | - | - |
| Depreciation | - | (34 850) | (34 850) |
| Carrying value at end of year | **409 710** | **313 650** | **723 360** |
| Cost | 409 710 | 410 000 | 819 710 |
| Accumulated depreciation | - | (96 350) | (96 350) |

| | |
|---|---|
| **4. INVENTORY** | |
| Trading inventory | 465 000 |
| Consumable stores on hand | 3 750 |
| | **468 750** |
| **5. TRADE AND OTHER RECEIVABLES** | |
| Net trade debtors | 44 270 |
| Trade debtors | 46 600 |
| Provision for bad debts | (2 330) |
| Accrued income/Income receivable | 4 490 |
| Prepaid expenses | 4 900 |
| | **53 660** |
| **6. CASH AND CASH EQUIVALENTS** | |
| Cash float | 750 |
| Petty cash | 1 000 |
| | **1 750** |
| **7. ORDINARY SHARE CAPITAL** | |
| **AUTHORISED** | |
| Number of authorised ordinary shares: 100 000 shares | |
| **ISSUED** | |
| 60 000 ordinary shares in issue at beginning of financial year | 318 000 |
| 15 000 shares issued at 560 cents each during the year | 84 000 |
| 75 000 ordinary shares in issue at end of financial year | **402 000** |
| **8. RETAINED INCOME** | |
| Retained income at beginning of year | 118 000 |
| Net profit after tax for the year | 367 320 |
| Dividends on ordinary shares | (56 400) |
| Paid | 29 400 |
| Recommended | 27 000 |
| Retained income at end of year | **428 920** |
| **9. TRADE AND OTHER PAYABLES** | |
| Trade creditors | 38 900 |
| Creditors for salaries | 19 100 |
| Pension fund | 4 600 |
| Medical aid fund | 4 320 |
| SARS: Income tax (150 680 – 140 000) | 10 680 |
| SARS: PAYE | 4 460 |
| Deferred income | 13 500 |
| Expenses payable | 4 040 |
| Current portion of loan | 86 400 |
| Shareholders for dividends | 27 000 |
| | **213 000** |

| 3.11.3 | **In your opinion, should the directors be satisfied with their performance in managing the company?** |
|---|---|

Various answers possible.
The profit of R367 320 in relation to equity of R830 920 indicates a very good return (over 30%).
Only R56 400 was distributed in dividends which means that about 85% of profit earned is retained in the business, which will benefit performance in the future.
The current assets are more than double the current liabilities which means that liquidity should not be a problem.
The stock represents about ¼ of cost of sales which means stock of approximately 3 months is on hand, which should satisfy customers.
Profitability is generally good as operating profit is 18% of sales.
Learners could add their own comments – Teacher to assess validity of comments.

**Note to Teachers:**
Extend a bright class by asking them how much each shareholder would get per share if the company closed down and sold its assets at the values in the books (R11.07). They could then query why the directors issued shares to the new shareholders at only 560 cents per share when there is such a high retained income, which makes the value of each share more than 1 100 cents (they have paid about half of what the share is worth).

## TASK 3.12 ⌘ Uptoni Limited: Financial statements

**3.12.1 UPTONI LIMITED**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME) FOR THE YEAR ENDED 30 JUNE 20.2**

| | Note | |
|---|---|---|
| Sales [1 942 000 – 24 000] | | 1 918 000 |
| Cost of sales | | (1 080 000) |
| **Gross profit** | | 838 000 |
| **Other operating income** | | 160 650 |
| Commission income | | 82 400 |
| Bad debts recovered | | 5 200 |
| Rent income [78 400 – 11 200] | | 67 200 |
| Discount received | | 1 530 |
| Provision for bad debts adjustment | | 4 320 |
| **Gross operating income** | | 998 650 |
| **Operating expenses** | | (798 000) |
| Salaries & wages | | 406 000 |
| Directors fees | | 220 000 |
| Advertising | | 8 000 |
| Audit fees [36 000 + 8 000] | | 44 000 |
| Lease of vehicle [52 000 – 4 000] | | 48 000 |
| Bad debts [2 800 + 4 000] | | 6 800 |
| Insurance [29 040 – 4 840] | | 24 200 |
| Sundry expenses [9 200 – 2 400] | | 6 800 |
| Trading stock deficit | | 5 000 |
| Depreciation | | 7 200 |
| Repairs | | 22 000 |
| **Operating profit** | | 200 650 |
| Interest income | 1 | 10 600 |
| **Profit before interest expense** | | 211 250 |
| Interest expense / financing cost | 2 | (39 250) |
| **Net profit before tax** | | 172 000 |
| Income tax | | (51 600) |
| **Net profit after tax** | 8 | **120 400** |

### 3.12.2 UPTONI LIMITED
### BALANCE SHEET (STATEMENT OF FINANCIAL POSITION) ON 30 JUNE 20.2

| **ASSETS** | **Note** | |
|---|---|---|
| **Non-current assets** | | 2 218 800 |
| Fixed/Tangible assets | 3 | 2 118 800 |
| Financial assets: Fixed deposit | | 100 000 |
| **Current assets** | | 574 260 |
| Inventory | 4 | 428 600 |
| Trade and other receivables | 5 | 79 560 |
| Cash and cash equivalents | 6 | 66 100 |
| **Total assets** | | **2 793 060** |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | | 1 960 400 |
| Ordinary share capital | 7 | 1 870 000 |
| Retained income | 8 | 90 400 |
| **Non-current liabilities** | | 601 650 |
| Loan from South Bank [644 000 + 8 050 – 50 400] | | 601 650 |
| **Current liabilities** | | 231 010 |
| Trade and other payables | 9 | 231 010 |
| **Total equity and liabilities** | | **2 793 060** |

### UPTONI LIMITED
### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 20.2

| **1. INTEREST INCOME** | |
|---|---|
| From fixed deposit | 9 000 |
| From current account | 1 600 |
| | **10 600** |
| **2. INTEREST EXPENSE** | |
| On mortgage loan [31 200 + 8 050] | 39 250 |
| | **39 250** |

| **3. FIXED/TANGIBLE ASSETS** | **Land & buildings** | **Equipment** | **Total** |
|---|---|---|---|
| Carrying value at beginning of year | 1 890 000 | 72 000 | 1 962 000 |
| Cost | 1 890 000 | 256 000 | 2 146 000 |
| Accumulated depreciation | - | (184 000) | (184 000) |
| **Movements** | 164 000 | (7 200) | 156 800 |
| Additions at cost | 164 000 | - | 164 000 |
| Disposals at carrying value | - | - | - |
| Depreciation | - | (7 200) | (7 200) |
| Carrying value at end of year | **2 054 000** | **64 800** | **2 118 800** |
| Cost | 2 054 000 | 256 000 | 2 310 000 |
| Accumulated depreciation | - | (191 200) | (191 200) |

| | |
|---|---|
| **4. INVENTORY** | |
| Trading inventory [438 000 – 6 000 – 5 000] | 427 000 |
| Consumable stores on hand | 1 600 |
| | **428 600** |
| | |
| **5. TRADE AND OTHER RECEIVABLES** | |
| Net trade debtors | 69 920 |
| Trade debtors [80 000 – 4 000] | 76 000 |
| Provision for bad debts [10 400 – 4 320] | (6 080) |
| Prepaid expenses [4 000 + 800 + 4 840] | 9 640 |
| | **79 560** |
| | |
| **6. CASH AND CASH EQUIVALENTS** | |
| Bank | 63 100 |
| Cash float | 2 000 |
| Petty cash | 1 000 |
| | **66 100** |
| | |
| **7. ORDINARY SHARE CAPITAL** | |
| **AUTHORISED** | |
| 1 500 000 ordinary shares | |
| | |
| **ISSUED** | |
| 750 000 ordinary shares in issue at beginning of financial year | 1 540 000 |
| 150 000 shares at 220 cents issued during the year | 330 000 |
| 900 000 ordinary shares in issue at end of financial year | **1 870 000** |
| | |
| **8. RETAINED INCOME** | |
| Retained income at beginning of year | 120 000 |
| Net profit after tax for the year | 120 400 |
| Dividends on ordinary shares | (150 000) |
| Paid | 60 000 |
| Recommended | 90 000 |
| Retained income at end of year | **90 400** |
| | |
| **9. TRADE AND OTHER PAYABLES** | |
| Trade creditors [59 000 – 6 000] | 53 000 |
| SARS: PAYE | 6 210 |
| Pension fund | 7 600 |
| Deferred income | 11 200 |
| Expenses payable | 8 000 |
| Current portion of mortgage loan | 50 400 |
| Shareholders for dividends | 90 000 |
| South African Revenue Services - Income tax | 4 600 |
| | **231 010** |

| 3.12.3 | **The company aims to issue all its unissued shares in the near future. The price of the share on the JSE is currently 180 cents on 30 June 20.2. In your opinion, how much could they raise from this issue and what should they do with the proceeds?** |
|---|---|

Various answers possible.
Possible responses:
Could issue 600 000 shares at 180 cents = R1 080 000 assuming the share price remains the same as it is currently.
However, according to the books, each share is worth R1 960 400 ÷ 900 000 = 218 cents.
It appears to be under-valued on the JSE.
The directors should ascertain the reason for the low price on the JSE and try to rectify this, e.g. perceptions in the market that the company's prospects are not good.
If they can do this, they could raise at least 600 000 x 218c = R1 308 000.
They could use the proceeds to expand the business or reduce the loan (thereby reducing interest).

## TASK 3.13 Celia Jewellers Ltd: Financial statements

**3.13.1 CELIA JEWELLERS LTD**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME) FOR THE YEAR ENDED 28 FEBRUARY 20.6**

| | Note | |
|---|---|---|
| Sales (5 970 000 – 27 000) | | 5 943 000 |
| Cost of sales | | (3 120 000) |
| **Gross profit** | | 2 823 000 |
| **Other operating income** | | 164 700 |
| Fee income from services rendered | | 99 000 |
| Discount received | | 11 700 |
| Profit on sale of vehicle* | | 54 000 |
| **Gross operating income** | | 2 987 700 |
| **Operating expenses** | | (2 195 970) |
| Rent expense (165 000 + 15 000) | | 180 000 |
| Salaries and wages | | 744 000 |
| Directors fees (750 000 + 45 000) | | 795 000 |
| Employers contributions to pension & medical aid | | 112 500 |
| Audit fees | | 86 100 |
| Advertising (18 000 – 6 300) | | 11 700 |
| Bad debts (7 200 + 1 500) | | 8 700 |
| Insurance (50 700 – 3 900) | | 46 800 |
| Stationery & packing material (15 300 – 2 520) | | 12 780 |
| Motor vehicle expenses | | 51 000 |
| Bank charges (18 900 + 1 860) | | 20 760 |
| Sundry expenses | | 18 750 |
| Depreciation (33 750 + 49 200 + 9 900) | | 92 850 |
| Trading stock deficit | | 14 700 |
| Provision for bad debts adjustment | | 330 |
| **Operating profit** | | 791 730 |
| Interest income | 1 | 52 245 |
| **Profit before interest expense** | | 843 975 |
| Interest expense / financing cost | 2 | (23 945) |
| **Net profit before tax** | | 820 030 |
| Income tax | | (229 608) |
| **Net profit after tax** | 8 | **590 422** |

*See working below.

### 3.13.2 CELIA JEWELLERS LTD
### BALANCE SHEET (STATEMENT OF FINANCIAL POSITION) ON 28 FEBRUARY 20.6

| ASSETS | Note | |
|---|---|---|
| **Non-current assets** | | 1 707 300 |
| Fixed/Tangible assets | 3 | 1 359 900 |
| Financial assets: Fixed deposit | | |
| Fixed deposit (420 000 + 46 200 – 118 800) | | 347 400 |
| **Current assets** | | 1 320 965 |
| Inventory | 4 | 866 820 |
| Trade and other receivables | 5 | 119 910 |
| Cash and cash equivalents | 6 | 334 235 |
| **Total assets** | | **3 028 265** |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | | 2 212 922 |
| Ordinary share capital | 7 | 1 621 800 |
| Retained income | 8 | 591 122 |
| **Non-current liabilities** | | 112 745 |
| Loan from Wheels Finance Ltd (180 000 + 11 945 – 79 200) | | 112 745 |
| **Current liabilities** | | 702 598 |
| Trade and other payables | 9 | 623 398 |
| Short-term loans* | | 79 200 |
| **Total equity and liabilities** | | **3 028 265** |

***** Could be shown under Note for Trade & other payables

### CELIA JEWELLERS LTD
### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 20.6

| **1. INTEREST INCOME** | |
|---|---|
| From fixed deposit | 46 200 |
| From savings account | 3 600 |
| From current account (2 100 + 345) | 2 445 |
| | **17 415** |
| **2. INTEREST EXPENSE** | |
| Interest on loan: Wheels Finance Ltd (12 000 + 11 945) | 23 945 |
| | **23 945** |

| **3. FIXED/TANGIBLE ASSETS** | **Vehicles** | **Equipment** | **Total** |
|---|---|---|---|
| Carrying value at beginning of year | 900 750 | 66 000 | 966 750 |
| Cost | 1 458 000 | 324 000 | 1 782 000 |
| Accumulated depreciation | (557 250) | (258 000) | (815 250) |
| **Movements** | (256 950) | 650 100 | 393 150 |
| Additions at cost | 0 | 660 000 | 660 000 |
| Disposals at carrying value | (174 000) | 0 | (174 000) |
| Depreciation | (82 950) | (9 900) | (92 850) |
| Carrying value at end of year | **643 800** | **716 100** | **1 359 900** |
| Cost | 1 008 000 | 984 000 | 1 992 000 |
| Accumulated depreciation | (364 200) | (267 900) | (632 100) |

| | |
|---|---|
| **4. INVENTORY** | |
| Trading stock (879 000 – 14 700) | 864 300 |
| Consumable stores on hand | 2 520 |
| | **866 820** |
| | |
| **5. TRADE AND OTHER RECEIVABLES** | |
| Net trade debtors | 109 710 |
| Trade debtors (114 600 – 1 500) | 113 100 |
| Provision for bad debts (3 060 + 330) | (3 390) |
| Prepaid expenses (3 900 + 6 300) | 10 200 |
| | **119 910** |
| | |
| **6. CASH AND CASH EQUIVALENTS** | |
| Fixed deposit (maturing within 12 months) | 118 800 |
| Savings account | 160 000 |
| Bank (434 950 – 1 860 + 345 – 385 500) | 47 935 |
| Cash float | 6 000 |
| Petty cash | 1 500 |
| | **334 235** |
| | |
| **7. ORDINARY SHARE CAPITAL** | |
| **AUTHORISED** | |
| 200 000 ordinary shares | |
| | |
| **ISSUED** | |
| 200 000 ordinary shares in issue at beginning of financial year | 1 908 000 |
| 30 000 shares repurchased (average price R9.54) | (286 200) |
| 170 000 ordinary shares in issue at end of financial year | **1 621 800** |
| | |
| **8. RETAINED INCOME** | |
| Retained income at beginning of year | 478 000 |
| Net profit after tax for the year | 590 422 |
| Repurchase of 30 000 shares (at R3.31 above average price) | (99 300) |
| Dividends on ordinary shares | (378 000) |
| Paid | 108 000 |
| Recommended | 270 000 |
| Retained income at end of year | **591 122** |
| | |
| **9. TRADE AND OTHER PAYABLES** | |
| Trade creditors | 246 000 |
| Expenses accrued (payable) (45 000 + 15 000) | 60 000 |
| Pension fund | 6 510 |
| Medical Aid fund | 2 880 |
| Shareholders for dividends | 270 000 |
| SA Revenue Services (PAYE) | 17 400 |
| SA Revenue Services (Income Tax) (229 608 – 209 000) | 20 608 |
| | **623 398** |

**WORKINGS**:

**GENERAL LEDGER**

**Vehicles**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Balance | b/d | 1 458 000 | | | Asset disposal | | 450 000 |
| | | | | | | | Balance | c/d | 1 008 000 |
| | | | | **1 458 000** | | | | | **1 458 000** |
| | | Balance | b/d | 1 008 000 | | | | | |
| | | | | | | | | | |

**Accumulated depreciation on vehicles**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Asset disposal | | 276 000 | | | Balance | b/d | 557 250 |
| | | Balance | c/d | 364 200 | | | Depreciation | | 33 750 |
| | | | | | | | Depreciation | | 49 200 |
| | | | | **640 200** | | | | | **640 200** |
| | | | | | | | Balance | b/d | 364 200 |
| | | | | | | | | | |

**Asset disposal**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Vehicles | | 450 000 | | | Acc dep on vehicle | | 276 000 |
| | | Profit on disposal of asset | | 54 000 | | | Bank | | 228 000 |
| | | | | **504 000** | | | | | **504 000** |
| | | | | | | | | | |

| **3.13.3** | **Celia is considering selling her shares in the business as she is finding it too stressful to direct the business. What price would you be prepared to pay for her shares? What questions would you ask before deciding to buy the shares?** |
|---|---|

Value of the company is R2 212 922, and it will have existing goodwill which is not valued but could reasonably be R600 000.
This makes the 170 000 shares worth R2 812 922, which is R16.55 per share.
Her 75% would be valued at 127 500 x R16.55 = R2 110 125.
Questions to be asked:
What is a reasonable value for the goodwill? Will Celia be prepared to accept R16.55 per share?
What are the prospects for the future?
Learners may come up with their own opinions.
Valuing shares is very subjective.

## TASK 3.14 Eastville Supermarket (Pty) Ltd: Financial statements

**3.14.1 EASTVILLE SUPERMARKET (PTY) LTD**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME) FOR THE YEAR ENDED 28 FEBRUARY 20.4**

| | Note | |
|---|---|---|
| Sales (1 432 599 – 12 500 – 3 630) | | 1 416 370 |
| Cost of sales (832 000 – 2 420) | | (829 580) |
| **Gross profit** | | 586 790 |
| **Other operating income** | | 23 010 |
| Commission income [12 500 + 1 060] | | 13 560 |
| Bad debts recovered | | 640 |
| Discount received [3 840 – 30] | | 3 810 |
| Profit on disposal of fixed asset | | 5 000 |
| **Gross operating income** | | 609 800 |
| **Operating expenses** | | (521 158) |
| Advertising [8 000 – 480] | | 7 520 |
| Audit fees [23 600 + 1 600] | | 25 200 |
| Bad debts [2 060 + 300] | | 2 360 |
| Bank charges [8 990 + 860] | | 9 850 |
| Directors fees [135 000 + 15 000] | | 150 000 |
| Discount allowed | | 3 610 |
| Insurance | | 13 400 |
| Packing material [17 400 + 2 520 – 1 610] | | 18 310 |
| Rent expense [52 000 – 4 000] | | 48 000 |
| Salaries and wages | | 192 000 |
| Stationery | | 2 520 |
| Sundry expenses | | 5 060 |
| Trading stock deficit | | 4 000 |
| Vehicle expenses | | 18 700 |
| Provision for bade debts adjustment | | 428 |
| Depreciation [15 000 + 5 200] | | 20 200 |
| **Operating profit** | | 88 642 |
| Interest income | 1 | 12 150 |
| **Profit before interest expense** | | 100 792 |
| Interest expense / financing cost | 2 | (11 780) |
| **Net profit before tax** | | 89 012 |
| Income tax | | (26 704) |
| **Net profit after tax** | 8 | **62 308** |

### 3.14.2 EASTVILLE SUPERMARKET (PTY) LTD
### BALANCE SHEET (STATEMENT OF FINANCIAL POSITION) ON 28 FEBRUARY 20.4

| **ASSETS** | **Note** | |
|---|---|---|
| **Non-current assets** | | 292 875 |
| Fixed/Tangible assets | 3 | 196 800 |
| Financial assets [180 000 + 12 150 – 96 075] | | 96 075 |
| **Current assets** | | 442 393 |
| Inventory | 4 | 187 210 |
| Trade and other receivables | 5 | 59 978 |
| Cash and cash equivalents | 6 | 195 205 |
| **Total assets** | | **735 268** |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | | 545 508 |
| Ordinary share capital | 7 | 456 000 |
| Retained income | 8 | 89 508 |
| **Non-current liabilities** | | 60 000 |
| Loan from director | | 30 000 |
| Loan from IOU Bank [40 000 – 10 000] | | 30 000 |
| **Current liabilities** | | 129 760 |
| Trade and other payables | 9 | 119 760 |
| Current portion of loan* | | 10 000 |
| **Total equity and liabilities** | | **735 268** |

***** May be shown under note for Trade and other payables

### EASTVILLE SUPERMARKET (PTY) LTD
### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 20.4

| **1. INTEREST INCOME** | |
|---|---|
| On fixed deposit | 12 150 |
| | **12 150** |
| **2. INTEREST EXPENSE** | |
| On loans [9 400 + 750] | 10 150 |
| On overdraft [1 270 + 360] | 1 630 |
| | **11 780** |

| **3. FIXED/TANGIBLE ASSETS** | **Vehicles** | **Equipment** | **Total** |
|---|---|---|---|
| Carrying value at beginning of year | 30 000 | 52 000 | 82 000 |
| Cost | 75 000 | 162 000 | 237 000 |
| Accumulated depreciation | (45 000) | (110 000) | (155 000) |
| **Movements** | 52 000 | 62 800 | 114 800 |
| Additions at cost | 82 000 | 68 000 | 150 000 |
| Disposals at carrying value | (15 000) | - | (15 000) |
| Depreciation | (15 000) | (5 200) | (20 200) |
| Carrying value at end of year | **82 000** | **114 800** | **196 800** |
| Cost | 82 000 | 230 000 | 312 000 |
| Accumulated depreciation | - | (115 200) | (115 200) |

| | |
|---|---|
| **4. INVENTORY** | |
| Trading inventory [189 600 + 2 420 – 2 420 – 4 000] | 185 600 |
| Consumable stores [2 520 – 2 520 + 610] | 1610 |
| | **187 210** |
| **5. TRADE AND OTHER RECEIVABLES** | |
| Net trade debtors | 42 742 |
| Trade debtors [49 400 – 3 630 - 300] | 45 470 |
| Provision for bad debts [2 300 + 428] | (2 728) |
| Prepaid expenses [4 000 + 480] | 4 480 |
| Income receivable | 1 060 |
| SARS - Income tax [38 400 – 26 704] | 11 696 |
| | **59 978** |
| **6. CASH AND CASH EQUIVALENTS** | |
| Current portion of fixed deposit | 96 075 |
| Bank [-24 200 + 750 - 1 220 + 120 000] | 95 330 |
| Cash float | 3 000 |
| Petty cash | 800 |
| | **195 205** |
| **7. ORDINARY SHARE CAPITAL** | |
| **AUTHORISED** | |
| 200 000 Ordinary shares | |
| **ISSUED** | |
| 60 000 ordinary shares in issue at beginning of financial year | 336 000 |
| 20 000 shares of R6.00 each issued during the year | 120 000 |
| 80 000 ordinary shares in issue at end of financial year | **456 000** |
| **8. RETAINED INCOME** | |
| Retained income at beginning of year | 68 000 |
| Net profit after tax for the year | 62 308 |
| Dividends on ordinary shares | (40 800) |
| Paid | 24 000 |
| Declared (60 000 x 28c) | 16 800 |
| Retained income at end of year | **89 508** |
| **9. TRADE AND OTHER PAYABLES** | |
| Trade creditors [22 400 + 780 – 2 420 + 82 000 – 20 000] | 82 760 |
| SARS - PAYE | 2 850 |
| Expenses payable [15 000 + 1 600 + 750] | 17 350 |
| Shareholders for dividends | 16 800 |
| | **119 760** |

| 3.14.3 | **Has this business managed its working capital (current assets less current liabilities) well? Is this business likely to experience a liquidity problem in the near future?** |
|---|---|

The business is very liquid.
There is a lot of cash on hand.
Current assets are 3.4 times the Current liabilities.
Even if stock is not sold, debtors and cash exceed Current liabilities.
Stock will last approximately ¼ of the year.
Debtors appear to be fine.
Few bad debts.
Total owing by debtors is within reason, but there is a sizeable amount owing to creditors – as they have not been paid, it has improved the cash situation.
No liquidity problems expected.

## TASK 3.15 Star Shoes Ltd: Financial statements

**3.15.1 STAR SHOES LTD**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME) FOR THE YEAR ENDED 31 OCTOBER 20.4**

| | Note | |
|---|---|---|
| Sales [5 130 000 – 1 260] | | 5 128 740 |
| Cost of sales [3 020 000 – 840] | | (3 019 160) |
| **Gross profit** | | 2 109 580 |
| **Other operating income** | | 336 580 |
| Fee income [264 800 - 220] | | 264 580 |
| Rent income [84 000 – 12 000] | | 72 000 |
| **Gross operating income** | | 2 446 160 |
| **Operating expenses** | | (1 915 540) |
| Salaries and wages [641 600 + 52 200] | | 693 800 |
| Depreciation [2 400 – 600 + 29 000] | | 30 800 |
| Bank charges | | 14 400 |
| Directors' fees | | 950 000 |
| Consumable stores [25 200 – 2 100] | | 23 100 |
| Medical aid contributions [41 000 + 4 800] | | 45 800 |
| Pension fund contributions [60 480 + 5 480] | | 65 960 |
| Sundry expenses | | 14 640 |
| Audit fees | | 65 000 |
| Loss on disposal of asset [9 600 + 600 – 8 000] | | 2 200 |
| Trading stock deficit | | 9 840 |
| **Operating profit** | | 530 620 |
| Interest income | 1 | 10 890 |
| **Profit before interest expense** | | 541 510 |
| Interest expense / financing cost | 2 | (95 510) |
| **Net profit before tax** | | 446 000 |
| Income tax [28% x 446 000] + [10% x 252 000] | | (150 080) |
| **Net profit after tax** | 8 | **295 920** |

### 3.15.2 STAR SHOES LTD
### BALANCE SHEET (STATEMENT OF FINANCIAL POSITION) ON 31 OCTOBER 20.4

| **ASSETS** | **Note** | |
|---|---|---|
| **Non-current assets** | | 2 627 500 |
| Fixed/Tangible assets | 3 | 2 520 500 |
| Financial assets: Fixed deposit [100 000 + 7 000] | | 107 000 |
| **Current assets** | | 650 500 |
| Inventory | 4 | 492 600 |
| Trade and other receivables | 5 | 84 200 |
| Cash and cash equivalents | 6 | 73 700 |
| **Total assets** | | **3 278 000** |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | | 2 236 590 |
| Ordinary share capital | 7 | 1 767 900 |
| Retained income | 8 | 468 690 |
| **Non-current liabilities** | | 590 110 |
| Loan from Dusi Bank [646 000 + 6 510 – 62 400] | | 590 110 |
| Loan from J. Starr [44 000 – 44 000] | | - |
| **Current liabilities** | | 451 300 |
| Trade and other payables | 9 | 451 300 |
| **Total equity and liabilities** | | **3 278 000** |

### STAR SHOES LTD
### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 OCTOBER 20.4

| **1. INTEREST INCOME** | |
|---|---|
| On savings account | 1 750 |
| On current account | 2 140 |
| On fixed deposit | 7 000 |
| | **10 890** |
| **2. INTEREST EXPENSE** | |
| On loan [89 000 + 6 510] | 95 510 |
| | **95 510** |

| **3. FIXED/TANGIBLE ASSETS** | **Land & buildings** | **Equipment** | **Total** |
|---|---|---|---|
| Carrying value at beginning of year | 2 417 500 | 144 000 | 2 561 500 |
| Cost | 2 417 500 | 314 000 | 2 731 500 |
| Accumulated depreciation[1] | - | (170 000) | (170 000) |
| **Movements** | - | (41 000) | (41 000) |
| Additions at cost | - | - | - |
| Disposals at carrying value | - | (10 200) | (10 200) |
| Depreciation[2] | - | (30 800) | (30 800) |
| Carrying value at end of year | **2 417 500** | **103 000** | **2 520 500** |
| Cost | 2 417 500 | 290 000 | 2 707 500 |
| Accumulated depreciation[3] | - | (187 000) | (187 000) |

[1] 158 000 + 14 400 – 2 400
[2] 2 400 – 600 + 29 000
[3] 158 000 + 29 000

| | |
|---|---|
| **4. INVENTORY** | |
| Trading stock [499 500 + 840 – 9 840] | 490 500 |
| Consumable stores on hand | 2 100 |
| | **492 600** |
| **5. TRADE AND OTHER RECEIVABLES** | |
| Trade debtors [73 760 – 1 480] | 72 280 |
| SARS: Income tax [154 000 – 150 080] | 3 920 |
| Income receivable | 8 000 |
| | **84 200** |
| **6. CASH AND CASH EQUIVALENTS** | |
| Savings account [190 000 – 186 200] | 3 800 |
| Bank | 68 300 |
| Cash float | 1 600 |
| | **73 700** |
| **7. ORDINARY SHARE CAPITAL** | |
| **AUTHORISED** | |
| 200 000 Ordinary shares | |
| **ISSUED** | |
| 90 000 ordinary shares in issue at beginning of financial year | 1 917 000 |
| 7 000 shares repurchased (average price R21.30) | (149 100) |
| 83 000 ordinary shares in issue at end of financial year | **1 767 900** |
| **8. RETAINED INCOME** | |
| Retained income at beginning of year | 461 870 |
| Net profit after tax for the year | 295 920 |
| Repurchase of 7 000 shares (at R5.30 above average issue price) | (37 100) |
| Dividends on ordinary shares | (252 000) |
| Paid | 108 000 |
| Recommended | 144 000 |
| Retained income at end of year | **468 690** |
| **9. TRADE AND OTHER PAYABLES** | |
| Trade creditors | 59 340 |
| Medical aid fund [860 + 2 400 + 4 800] | 8 060 |
| Pension fund [420 + 3 920 + 5 480] | 9 820 |
| South African Revenue Services: PAYE [800 + 10 440] | 11 240 |
| Deferred income | 12 000 |
| Expenses payable | 65 000 |
| Creditors for salaries [52 200 – 10 440 – 2 400 – 3 920] | 35 440 |
| Shareholders for dividends | 144 000 |
| Current portion of loans [62 400 + 44 000] | 106 400 |
| | **451 300** |

| **3.15.3** | **Should the shareholders be satisfied with their dividends and the financial results?** |
|---|---|

**Various answers possible**.

The company has distributed 85% of its net profit after tax.

This means that they are not reinvesting much of their profit, which means that the company is not growing significantly.

The dividends per share are 280 cents per share, which is not bad in comparison to the value of the shares according to the average issue price (R21.30).

| 3.15.4 | **The six full-time employees are dissatisfied with the two directors, both of whom own many companies and do not play a full-time role at Star Shoes. One of these employees owns shares in this company. Is there any item she should query at the AGM? Explain.** |
|---|---|

**Various answers possible.**
On average, the six full-time employees are earning R8 700 p.m. (i.e. R52 200 ÷ 6) which is R104 400 p.a. This should be a reasonable salary for a shop assistant.
There might be a concern that the two directors are earning on average R475 500 each for a directorship position.
We cannot assess this level without information about how much time the directors are spending at the business.
Furthermore, the profit after tax of only R295 920 is not very good, based on sales of over R5m, so their decisions might not be as effective as they should be.

## TASK 3.16 Dunhill Ltd: Financial statements

**3.16.1 DUNHILL LTD**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME) FOR THE YEAR ENDED 28 FEBRUARY 20.4**

| | **Note** | |
|---|---|---|
| Sales (6 302 000 – 33 000 – 12 900) | | 6 256 100 |
| Cost of sales (3 278 000 – 7 800) | | (3 270 200) |
| **Gross profit** | | 2 985 900 |
| **Other operating income** | | 270 450 |
| Commission income (264 000 – 6 600) | | 257 400 |
| Profit on disposal of asset (27 000 + 137 250 – 153 000) | | 11 250 |
| Provision for bad debts adjustment | | 1 800 |
| **Gross operating income** | | 3 256 350 |
| **Operating expenses** | | (2 975 520) |
| Advertising | | 21 900 |
| Audit fees (75 000 + 30 000) | | 105 000 |
| Bad debts | | 15 900 |
| Directors' fees (965 000 + 240 000) | | 1 205 000 |
| Insurance (52 200 – 10 440) | | 41 760 |
| Packing materials (43 200 – 5 400) | | 37 800 |
| Rent expense (232 950 – 18 750) | | 214 200 |
| Salaries & wages (865 000 + 20 400 + 3 060 + 1 920) | | 890 380 |
| Vehicle expenses | | 104 400 |
| Sundry expenses (178 650 – 128 000) | | 50 650 |
| Depreciation (28 050 + 217 400 + 23 880*) | | 269 330 |
| Loss due to theft (42 000 – 33 000) | | 9 000 |
| Trading stock deficit | | 10 200 |
| **Operating profit** | | 280 830 |
| Interest income | 1 | 228 170 |
| **Profit before interest expense** | | 509 000 |
| Interest expense / financing cost | 2 | (57 000) |
| **Net profit before tax** | | 452 000 |
| Income tax | | (135 600) |
| **Net profit after tax** | 8 | **316 400** |

*Accept R23 999 if all fixed assets are valued at R1.00, however, it is more appropriate to value each item at R1.00.

### 3.16.2 DUNHILL LTD
### BALANCE SHEET (STATEMENT OF FINANCIAL POSITION) ON 28 FEBRUARY 20.4

| **ASSETS** | **Note** | |
|---|---|---|
| **Non-current assets** | | 2 255 920 |
| Fixed/Tangible assets | 3 | 570 920 |
| Financial assets: | | |
| Shares in Uptown Ltd | | 1 250 000 |
| Fixed deposit (660 000 – 225 000) | | 435 000 |
| **Current assets** | | 1 827 290 |
| Inventory | 4 | 1 240 200 |
| Trade and other receivables | 5 | 334 290 |
| Cash and cash equivalents | 6 | 252 800 |
| **Total assets** | | **4 083 210** |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | | 3 031 400 |
| Ordinary share capital | 7 | 2 563 200 |
| Retained income | 8 | 468 200 |
| **Non-current liabilities** | | 232 500 |
| Loan from Umgeni Lenders (253 500 + 57 000 – 78 000) | | 232 500 |
| **Current liabilities** | | 819 310 |
| Trade and other payables | 9 | 741 310 |
| Current portion of loan* | | 78 000 |
| **Total equity and liabilities** | | **4 083 210** |

*May be shown in Note for Trade & other payables.

### DUNHILL LTD
### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 20.4

| **1. INTEREST INCOME** | |
|---|---|
| Dividends from investments (115 200 + 61 200) | 176 400 |
| On fixed deposit | 49 200 |
| On current account | 2 570 |
| | **228 170** |
| **2. INTEREST EXPENSE** | |
| On loan from Umgeni Lenders | 57 000 |
| | **57 000** |

| **3. FIXED/TANGIBLE ASSETS** | **Vehicles** | **Equipment** | **Total** |
|---|---|---|---|
| Carrying value at beginning of year | 832 000 | 24 000 | 856 000 |
| Cost | 1240 000 | 570 000 | 1 810 000 |
| Accumulated depreciation | (408 000) | (546 000) | (954 000) |
| **Movements** | (261 200) | (23 880) | (285 080) |
| Additions at cost | 0 | 0 | 0 |
| Disposals at carrying value | (15 750) | 0 | (15 750) |
| Depreciation | (245 450)* | (23 880) | (269 330) |
| Carrying value at end of year | **570 800** | **120** | **570 920** |
| Cost | 1 087 000 | 570 000 | 1 657 000 |
| Accumulated depreciation | (516 200) | (569 880) | (1 086 080) |

*28 050 + 217 400

| | |
|---|---|
| **4. INVENTORY** | |
| Trading stock (1 287 000 – 42 000 – 10 200) | 1 234 800 |
| Consumable stores on hand | 5 400 |
| | **1 240 200** |
| | |
| **5. TRADE AND OTHER RECEIVABLES** | |
| Net trade debtors | 183 900 |
| Trade debtors (204 000 – 12 900) | 191 100 |
| Provision for bad debts (9 000 – 1 800) | (7 200) |
| Expenses prepaid (10 440 + 18 750) | 29 190 |
| Income accrued (receivable) (27 000 + 33 000 + 61 200) | 121 200 |
| | **334 290** |
| | |
| **6. CASH AND CASH EQUIVALENTS** | |
| Fixed deposit (maturing within 12 months) | 225 000 |
| Bank | 23 600 |
| Cash float | 3 000 |
| Petty cash | 1 200 |
| | **252 800** |
| | |
| **7. ORDINARY SHARE CAPITAL** | |
| **AUTHORISED** | |
| 600 000 ordinary shares | |
| | |
| **ISSUED** | |
| 450 000 shares in issue at beginning of year | 2 320 000 |
| 50 000 shares issued at R7.00 each during the year | 350 000 |
| 20 000 repurchased (average price R5.34 each) | (106 800) |
| 480 000 shares in issue at end of year | **2 563 200** |
| | |
| **8. RETAINED INCOME** | |
| Retained income at beginning of year | 519 000 |
| Net profit after tax for the year | 316 400 |
| Repurchase of 20 000 shares (R1.06 above average issue price) | (21 200) |
| Dividends on ordinary shares | (346 000) |
| Paid | 130 000 |
| Recommended | 216 000 |
| Retained income at end of year | **468 200** |
| | |
| **9. TRADE AND OTHER PAYABLES** | |
| Trade creditors (155 830 – 7 800) | 148 030 |
| Expenses accrued (payable) (30 000 + 240 000) | 270 000 |
| Income received in advance (Deferred) | 6 600 |
| Creditors for salaries (35 040 + 14 238) | 49 278 |
| Pension fund (13 260 + 1 530 + 3 060) | 17 850 |
| Medical Aid fund (5 250 + 960 + 1 920) | 8 130 |
| SA Revenue Services (PAYE) (13 950 + 3 672) | 17 622 |
| SA Revenue Services (Income tax) (135 600 – 127 800) | 7 800 |
| Shareholders for dividends | 216 000 |
| | **741 310** |

| 3.16.3 | **As a shareholder, what items would you query in the financial statements? Provide three items. Explain, quoting figures to support your answer.** |
|---|---|

Learners may provide a variety of opinions.
Advise them to focus on major items, e.g.:
Directors' fees of R1 205 000 are higher than total salaries.
Stock levels are very high at R1 234 800 – it might not be easy to sell all this stock quickly.
Vehicles are very high – cost price R1 087 000 – these vehicles might not be necessary and the depreciation is very high, affecting profits negatively by R245 450.

## TASK 3.17 Bogus Poolstuff (Pty) Ltd: Periodic inventory system

**3.17.1 Cost of sales**

| | |
|---|---|
| Opening stock | 64 800 |
| Purchases (430 000 – 3 200 – 740) | 426 060 |
| Carriage on purchases (15 700 + 170) | 15 870 |
| | 506 730 |
| Closing stock | (69 500) |
| Cost of sales | **437 230** |

**3.17.2 BOGUS POOLSTUFF (PTY) LTD**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME) FOR THE YEAR ENDED 28 FEBRUARY 20.5**

| | Note | |
|---|---|---|
| Sales [650 000 – 10 000] | | 640 000 |
| Cost of sales [see above] | | (437 230) |
| **Gross profit** | | 202 770 |
| **Other operating income** | | 153 680 |
| Fee income [153 900 - 220] | | 153 680 |
| **Gross operating income** | | 356 450 |
| **Operating expenses** | | (322 175) |
| Bad debts [2 245 + 400] | | 2 645 |
| Bank charges [767 + 77] | | 844 |
| Consumable stores [13 750 + 660 - 900] | | 13 510 |
| Delivery expenses [6 100 + 100] | | 6 200 |
| Directors' fees [38 000 + 12 000] | | 50 000 |
| Discount allowed [400 – 20] | | 380 |
| Medical aid contributions [4 020 + 60] | | 4 080 |
| Rent expense [17 600 + 1 600] | | 19 200 |
| Salaries and wages [190 000 + 2 800] | | 192 800 |
| Sundry expenses | | 9 800 |
| Provision for bad debts adjustment | | 7 |
| Audit fees | | 5 500 |
| Donation | | 740 |
| Depreciation [10 999 + 5 470] | | 16 469 |
| **Operating profit** | | 34 275 |
| Interest income | 1 | 4 600 |
| **Profit before interest expense** | | 38 875 |
| Interest expense / financing cost | 2 | (2 276) |
| **Net profit before tax** | | 36 599 |
| Income tax [28% x 36 599] + [12.5% x 17 600] | | (12 448) |
| **Net profit after tax** | 8 | **24 151** |

### 3.17.3 BOGUS POOLSTUFF (PTY) LTD
### BALANCE SHEET (STATEMENT OF FINANCIAL POSITION) ON 28 FEBRUARY 20.5

| **ASSETS** | **Note** | |
|---|---|---|
| **Non-current assets** | | 129 231 |
| Fixed/Tangible assets | 3 | 69 231 |
| Financial assets: Fixed deposit | | 60 000 |
| **Current assets** | | 187 360 |
| Inventory | 4 | 70 400 |
| Trade and other receivables | 5 | 69 560 |
| Cash and cash equivalents | 6 | 47 400 |
| **Total assets** | | **316 591** |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | | 247 551 |
| Ordinary share capital | 7 | 217 400 |
| Retained income | 8 | 30 151 |
| **Non-current liabilities** | | 10 000 |
| Loan from director (Q. Bogus) [15 000 - 5 000] | | 10 000 |
| **Current liabilities** | | 59 040 |
| Trade and other payables | 9 | 55 815 |
| Bank overdraft [2 582 + 77 + 86 + 480] | | 3 225 |
| **Total equity and liabilities** | | **316 591** |

### BOGUS POOLSTUFF (PTY) LTD
### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 20.5

| **1. INTEREST INCOME** | |
|---|---|
| from investments | 4 360 |
| from overdue debtors [200 + 40] | 240 |
| | **4 600** |
| **2. INTEREST EXPENSE** | |
| on mortgage loan | 2 000 |
| on overdraft [190 + 86] | 276 |
| | **2 276** |

| **3. FIXED/TANGIBLE ASSETS** | **Vehicles** | **Equipment** | **Total** |
|---|---|---|---|
| Carrying value at beginning of year | 11 000 | 29 700 | 40 700 |
| Cost | 55 000 | 54 700 | 109 700 |
| Accumulated depreciation | (44 000) | (25 000) | (69 000) |
| **Movements** | (10 999) | 39 530 | 28 531 |
| Additions at cost | - | 45 000 | 45 000 |
| Disposals at carrying value | - | - | - |
| Depreciation | (10 999) | (5 470) | (16 469) |
| Carrying value at end of year | **1** | **69 230** | **69 231** |
| Cost | 55 000 | 99 700 | 154 700 |
| Accumulated depreciation | (54 999) | (30 470) | (85 469) |

| | |
|---|---|
| **4. INVENTORY** | |
| Trading inventory [64 800 – 64 800 + 69 500] | 69 500 |
| Consumable stores [660 – 660 + 900] | 900 |
| | **70 400** |
| **5. TRADE AND OTHER RECEIVABLES** | |
| Net trade debtors | 50 008 |
| Trade debtors [52 500 + 480 + 20 + 40 – 400] | 52 640 |
| Provision for bad debts [2 625 + 7] | (2 632) |
| SARS (Income tax) [32 000 – 12 448] | 19 552 |
| | **69 560** |
| **6. CASH AND CASH EQUIVALENTS** | |
| Savings account | 46 400 |
| Cash float | 500 |
| Petty cash | 500 |
| | **47 400** |
| **7. ORDINARY SHARE CAPITAL** | |
| **AUTHORISED** | |
| 400 000 Ordinary shares | |
| **ISSUED** | |
| 160 000 ordinary shares in issue at beginning of financial year | 171 000 |
| 40 000 shares issued during the year at R1.16 each | 46 400 |
| 200 000 ordinary shares in issue at end of financial year | **217 400** |
| **8. RETAINED INCOME** | |
| Retained income at beginning of year | 23 600 |
| Net profit after tax for the year | 24 151 |
| Dividends on ordinary shares | (17 600) |
| Paid | 9 600 |
| Recommended | 8 000 |
| Retained income at end of year | **30 151** |
| **9. TRADE AND OTHER PAYABLES** | |
| Trade creditors [19 260 – 3 200] | 16 060 |
| South African Revenue Services: PAYE [3 970 + 700] | 4 670 |
| Medical aid fund [335 + 60 + 60] | 455 |
| Creditors for salaries [2 800 – 700 – 60] | 2 040 |
| Expenses payable [1 600 + 170 + 100 + 12 000 + 5 500] | 19 370 |
| Loan from director (Q. Bogus) | 5 000 |
| Deferred income | 220 |
| Shareholders for dividends | 8 000 |
| | **55 815** |

| **3.17.4** | **Should the directors and shareholders be happy with the net profit and dividends of this business? Explain.** |
|---|---|
| Dividends are very low (11 cents per share).<br>Profits appear to have dropped a lot as the provisional tax payments are based on the previous year's results – the provisional tax is a lot higher than the tax due for this year.<br>Operating profit is also a small fraction of sales (5%).<br>Must try to increase profits by being more efficient. | |

| 3.17.5 | **In your opinion, is it the right decision for this company to use the Periodic inventory system? Explain.** |
|---|---|

This is a small business.
They might not be able to afford the cost of implementing a perpetual inventory system.
However, this could lead to less internal control if the owner does not keep personal control.
Various opinions on this are possible.

## TASK 3.18 Impala (Pty) Ltd: Income Statement, Ethics and control

**Note to Teachers:**
This Task has been specifically designed to demonstrate unethical business practice and poor internal control. Although the first two parts in preparing the parts of the financial statements should be done independently by learners, it is advisable for them to collaborate in sharing ideas for the 3rd and 4th part of this Task. Be alert to other valid responses from learners.

**3.18.1 IMPALA (PTY) LTD**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME) FOR THE YEAR ENDED 28 FEBRUARY 20.5**

| | Note | |
|---|---|---|
| Sales (8 740 000 – 970 000 – 22 800) | | 7 747 200 |
| Cost of sales (3 850 000 – 12 000) | | (3 838 000) |
| **Gross profit** | | 3 909 200 |
| **Other operating income** | | 775 620 |
| Fee income (778 000 – 4 400) | | 773 600 |
| Provision for bad debts adjustment | | 2 020 |
| **Gross operating income** | | 4 684 820 |
| **Operating expenses** | | (4 364 470) |
| Directors fees (2 590 000 – 385 000) | | 2 205 000 |
| Audit fees (61 000 + 82 000) | | 143 000 |
| Salaries & wages (490 000 + 46 800) | | 536 800 |
| Employer's contribution to UIF (4 922 + 468) | | 5 390 |
| Vehicle expenses | | 151 200 |
| Consumable stores | | 64 500 |
| Telephone & electricity | | 33 900 |
| Staff training | | 1 000 |
| Bad debts (63 000 + 21 000) | | 84 000 |
| Overseas travel expenses (75 000 + 32 000) | | 107 000 |
| Sundry expenses (19 180 + 24 000) | | 43 180 |
| Depreciation (80 000 + 316 000 + 123 000 + 8 000) | | 527 000 |
| Loss on disposal of fixed asset | | 288 000 |
| Trading stock deficit (22 500 + 80 000 + 16 000) | | 118 500 |
| Repairs & maintenance | | 56 000 |
| **Operating profit** | | 320 350 |
| Interest income (3 000 + 2 250) | 1 | 5 250 |
| **Profit before interest expense** | | 325 600 |
| Interest expense / financing cost | 2 | (54 600) |
| **Net profit before tax** | | 271 000 |
| Income tax | | (75 880) |
| **Net profit after tax** | 8 | **195 120** |

**3.18.2 IMPALA (PTY) LTD**
**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 20.5**

| • **FIXED/TANGIBLE ASSETS** | **Land and buildings** | **Vehicles** | **Equipment** | **Total** |
|---|---|---|---|---|
| Carrying value at beginning of year | 760 000 | 1 510 000 | 80 000 | 2 350 000 |
| Cost | 760 000 | 2 060 000 | 420 000 | 3 240 000 |
| Accumulated depreciation | - | (550 000) | (340 000) | (890 000) |
| **Movements** | (190 000) | (27 000) | 192 000 | (25 000) |
| Additions at cost | - | 820 000 | 200 000 | 1 020 000 |
| Disposals at carrying value | (190 000) | (328 000) | - | (518 000) |
| Depreciation | - | (519 000) | (8 000) | (527 000) |
| Carrying value at end of year | **570 000** | **1 483 000** | **272 000** | **2 325 000** |
| Cost | 570 000 | 2 400 000 | 620 000 | 3 590 000 |
| Accumulated depreciation | - | (917 000) | (348 000) | (1 265 000) |

| • **RETAINED INCOME** | |
|---|---|
| Retained income at beginning of year | 318 000 |
| Net profit after tax for the year | 195 120 |
| Repurchase of ordinary shares (above average price) | (31 800) |
| Dividends on ordinary shares | (180 000) |
| Paid | 55 000 |
| Recommended | 125 000 |
| Retained income at end of year | **301 320** |

**Workings:**
**DEPRECIATION ON VEHICLES**

| | |
|---|---|
| 480 000 x 20% x $^{10}/_{12}$ | R80 000 |
| 1 580 000 x 20% | 316 000 |
| 820 000 x 20% x $^{9}/_{12}$ | 123 000 |
| Total | **R519 000** |

**DEPRECIATION ON EQUIPMENT**
80 000 x 10% = R8 000

**ASSET DISPOSAL: VEHICLES**

| | |
|---|---|
| Cost of asset | R480 000 |
| Accumulated depreciation (72 000 + 80 000) | 152 000 |
| Net book value | 328 000 |
| Scrap value | 40 000 |
| Loss | **R288 000** |

**DIRECTORS FEES PREPAID**

| | | |
|---|---|---|
| Let the original monthly fees | = | y |
| 6y + 8 (1y + 0.1y) | = | R2 590 000 |
| 6y + 8.8y | = | R2 590 000 |
| 14.8y | = | R2 590 000 |
| y | = | R175 000 |
| 1.1y | = | R192 500 per month |
| **2 months** | = | **R385 000** |

**INTEREST ON LOAN**

| | | |
|---|---|---|
| Balance of loan at beginning | = | R420 000 |
| Interest | = | x |
| Repayments | = | (R102 600) |
| Balance of loan at end | = | R372 000 |
| **X** | **=** | **R54 600** |

| **3.18.3** | **Refer to information 15 regarding the disgruntled shareholder, Ernie Grype. Make a list of the complaints that he would have had. Quote information from the question to support your opinions.** |
|---|---|

- The directors are not treating the customers well. The mark-up is too high, 90% in some cases. Installation fees are very high too, R2 200. Installation should be free. They cannot expect the customers to do it themselves. The company has a monopoly over air-conditioners in this area. They are likely to cause customers to secure their air-conditioners from another town, or a competitor is likely to open in the area.

- The stock they are buying is not good, and they are buying from a family member. This is not wise procurement policy. The returns are high (see Debtors allowances of R992 800) and it is unacceptable that they are buying obsolete stock from their relative and that this stock cannot even be sold for its cost price.

- They are not treating the employees well. Staff training is only R1 000. Also the increase granted was only 4% which is not good (below inflation) and they get no benefits other than UIF (no medical aid or pension fund). Salaries and wages for 12 employees are significantly below the directors' fees which are over R2.2m.

- The directors granted themselves a 10% increase in fees despite the fact that the company is earning only R271 000 before tax. This is a very small % of the total sales which indicates that control over expenses is poor. The company should have a remunerations committee to decide properly on the directors' fees. Also they are adding to the cash flow problems by paying fees to themselves in advance. They should be paid monthly for specific months.

- The internal control is poor as the auditors charged a considerable amount more to solve audit problems. The directors should ensure that internal control is good at all times.

- It is unacceptable that the stock records are so poor. Any stock leaving the storeroom must be recorded and accounted for at all times. Lack of control over deliveries into the business is a major problem too.

- The directors are abusing the assets of the company, particularly the vehicles. It is improper for a director to lend a company car to his son. The loss as a result of the crash should have been borne by the director himself, and not the company.

- It appears that the company has very expensive cars, which is not justified. This is an air-conditioning company, so they really need only the most practical vehicles that can be used in attending to customers' installation needs. These expensive vehicles have caused a R519 000 depreciation loss to the company.

- It is unacceptable for a director to buy the property at cost, especially as this is the cost from 12 years ago. The property should have been sold on the open market and would have attracted a considerably higher selling price. In any case, it is not good policy to sell off fixed assets to solve cash flow problems. If operating activities are improved, the cash flow will rectify itself.

- The director should not have been given a loan by the company. His interest rate of 3% p.a. is also unacceptable. This has added to the cash flow problems of the company, because the company itself has a loan which is bearing a significantly higher % interest rate.

- There may be a big query over whether the overseas travel expenses are justified or not. It appears that the director in question was simply on holiday, which cannot be at the company's expense. This is an air-conditioning company in the Cape. There appears to be no valid reason why an overseas trip by a director would benefit the company.

Additional valid comments are also acceptable.

| 3.18.4 | **Do you agree with Ernie Grype's strategy of withdrawing from the company by selling his shares back to the company? Explain. What other strategy could he have used?** |
|---|---|

If Ernie Grype is not happy, he must leave, but before doing so, he should have taken a stand on the poor corporate governance strategies being adopted by the directors.
The directors are the major shareholders and they are running the company poorly and not in terms of the King Code.
This is affecting the returns and the rights of the minority shareholders.
The auditors should also be querying many of these expenses and possibly refusing to offer an audit opinion.
The directors could be reported to the Commissioner of CIPRO (formerly Registrar) and they could face criminal charges if their actions are in contravention of the Companies Act.

## TASK 3.19 Scenarios: Corporate governance & Internal control

**Note to Teachers:**
Refer to the Modules on corporate governance and internal control for further scenarios. The purpose of placing this Task in this Module is to integrate ethical and internal control matters in the module involving preparation of financial statements to encourage learners to adopt a questioning and critically analysis approach at all times. .

| | |
|---|---|
| **3.19.1** | There is no problem with offering special discounts to encourage loyalty from customers. However, offering commission to specific individuals in the customers' organisations is equivalent to a bribe, which would be unethical and illegal. This will negatively affect the reputation of the company. |
| **3.19.2** | The directors should be concerned about this because of the nature of the stock that they sell. Even a very small % of the stock getting into the wrong hands can cause deaths for which the company and the directors will then have to be accountable. |
| **3.19.3** | The CEO is placing unfair pressure on the HR Director. The employment process must follow its due course, and the CEO must consider possibly advising his son not to apply for the job as this could affect inter-personal relationships in the company and lead to allegations of favouritism. |
| **3.19.4** | The internal auditor must request a response in writing by the director who submitted the claims. It appears that this is fraudulent. The company should have procedures set down for handling these matters. If fraud has occurred, the director in question will have to repay the amount and will probably have to face disciplinary sanction as well. |
| **3.19.5** | All companies must be aware of how their actions affect the environment. This proposal will be extremely damaging to the water systems. After a while the culprits will be detected and the company will then have to bear the negative consequences in terms of the law, e.g. fine or criminal charges being laid. RPL should not compromise on the best ways of destroying such stock. These processes are available. The cost will have to be paid. |

| | |
|---|---|
| **3.19.6** | The RPL directors must realise that they are sending a very negative message to the other stakeholders in the company. Directors' fees should be based on the results of the good work done by directors. If they have not been able to counter the risks faced by the company, they do not deserve an increase. The stance taken by the one director who does not want an increase is admirable. He must not bow down to the threats of the other directors. They are the ones who should be accountable. The establishment of a Remunerations Committee which reviews the earnings of the directors is a good idea to solve such problems, because it takes away the need for individual directors to take a certain stance on the matter. |
| **3.19.7** | This is an unethical, dangerous and criminal activity. The directors will be held liable should users suffer as a result of incorrect information on the labels. The company will probably suffer irreparable damage from which it cannot recover. |
| **3.19.8** | This is known as insider trading which is highly illegal as well as unethical. It is prohibited by the Companies Act. The director in question is in a privileged position due to his employment in the company. He cannot use information for his own benefit if it has not been made known to the other stakeholders and the general public. |
| **3.19.9** | This director has now placed himself in a difficult position. The computer company will now expect some sort of favour in awarding the tender to supply all the computers to RPL. The director should not have accepted the laptop. He must declare the problem to the board of directors and rectify the matter as soon as possible. |

## TASK 3.20 ⌘ General knowledge of Cash Flow Statements

| **3.20.1** | **What is the main purpose of this Cash Flow Statement?** |
|---|---|
| To give an indication of the quality of the cash flows into and out of the company.<br>To provide the users of financial statements with information of cash generated or utilised by operations, investing activities and financing activities during a particular year. | |
| **3.20.2** | **Briefly describe what is meant by Operating, Financing and Investing activities.** |
| **Operating**:<br>The running of the main purpose of the business.<br>Operating activities comprise the income-earning operations of a company.<br>These relate to the buying and selling of stock, payment to creditors, payment by debtors, payment of expenses and income earned, tax and dividends.<br>**Financing:**<br>The raising of funds to finance the infrastructure of the company.<br>Financing activities are those activities which are necessary to fund the infrastructure of a company, i.e. loans, issue of shares and payment of loans.<br>I**nvesting**:<br>The use of the funds in earning income.<br>Investing activities involve the actual establishment of the infrastructure of a company so that it is able to earn income, e.g. fixed assets, investments. | |
| **3.20.3** | **Make a list of transactions that could affect a company. For each transaction, indicate whether it will be classified as an operating, financing or investing activity, e.g. Goods sold for cash – Operating activity.** |
| Sell goods for cash = Operating | Buy goods on credit = Operating |
| Pay creditors = Operating | Pay salaries = Operating |
| Issue shares = Financing | Receive a loan = Financing |
| Repay a loan = Financing | Open up a fixed deposit = Investing |
| Fixed deposit matures = Investing | Buy fixed assets = Investing |
| Sell fixed assets = Investing | Goods sold for cash = Operating activity |

## TASK 3.21 ⌘ AB Ltd: Basic format of a Cash Flow Statement

**3.21.1 AB LIMITED:**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 20.4**

| | Note | |
|---|---|---|
| **Cash flows from operating activities** | | 820 000 |
| [2 200 000 – 1 380 000] | | |
| **Cash flows from investing activities** | | (740 000) |
| Purchase of non-current assets | | (490 000) |
| Investment in fixed deposit | | (250 000) |
| **Cash flows from financing activities** | | 1 050 000 |
| Proceeds from the issue of share capital | | 1 200 000 |
| Payment of capital portion of long-term borrowings | | (150 000) |
| **Net change in cash equivalents** | | 1 130 000 |
| Cash and cash equivalents – beginning of year | | 50 000 |
| Cash and cash equivalents – end of year | | **1 180 000** |

| 3.21.2 | **What is the bank balance at the end of the accounting period? Should the directors be satisfied with this?** |
|---|---|
| 50 000 + 4 100 000 – 2 970 000 = R1 180 000 | |

## TASK 3.22 ⌘ BC Ltd: Basic format of a Cash Flow Statement

**3.22.1 BC LIMITED**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 AUGUST 20.4**

| | Note | |
|---|---|---|
| **Cash flows from operating activities** | | 480 000 |
| [1 550 000 – 1 070 000] | | |
| **Cash flows from investing activities** | | (830 000) |
| Purchase of Fixed assets | | (710 000) |
| Investment in fixed deposit | | (120 000) |
| **Cash flows from financing activities** | | 840 000 |
| Proceeds from the issue of share capital | | 1000 000 |
| Payment of capital portion of long-term borrowings [1 660 000 – 1 500 000] | | (160 000) |
| **Net change in cash equivalents** | | 490 000 |
| Cash and cash equivalents – beginning of year | | (380 000) |
| Cash and cash equivalents – end of year | | **110 000** |

| 3.22.2 | **What is the bank balance at the end of the accounting period? Should the directors be satisfied with this?** |
|---|---|
| R110 000 [favourable]<br>Various answers possible, e.g. the quality of the cash flow is satisfactory because operating activities generate cash and the investing activities are balanced by cash raised from financing activities. | |

## TASK 3.23 ⌘ CD Ltd: Financing and investing activities

**3.23.1**

| | |
|---|---|
| **CASH FLOWS FROM FINANCING ACTIVITIES** | 960 000 |
| Proceeds from issue of share capital | 750 000 |
| Proceeds from long-term borrowings [1 050 000 – 840 000] | 210 000 |
| | |

**3.23.2**

| | |
|---|---|
| **CASH FLOWS FROM INVESTING ACTIVITIES** | (700 000) |
| Purchase of fixed assets | (630 000) |
| Increase in fixed deposit | (70 000) |
| | |

## TASK 3.24 ⌘ DE Ltd: Financing and investing activities

**3.24.1**

| | |
|---|---|
| **CASH FLOWS FROM FINANCING ACTIVITIES** | 800 000 |
| Proceeds from issue of share capital | 1 700 000 |
| Payment of capital portion of long-term borrowings [1 080 000 – 990 000] | (900 000) |
| | |

**3.24.2**

| | |
|---|---|
| **CASH FLOWS FROM INVESTING ACTIVITIES** | (2 700 000) |
| Purchase of non-current assets [14 400 000 – 12 100 000] | (2 300 000) |
| Financial assets [1 200 000 – 800 000] | (400 000) |
| | |

## TASK 3.25 ⌘⌘ EF Ltd: Repurchasing shares

**3.25.1**

**GENERAL LEDGER OF EF LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **Ordinary Share Capital** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.3 | | | | | |
| June | 30 | Bank | CPJ | 800 000 | May | 1 | Balance | b/d | 2 800 000 |
| 20.4 | | | | | | | | | | |
| April | 30 | Balance | c/d | 2 000 000 | | | | | | |
| | | | | **2 800 000** | | | | | **2 800 000** |
| | | | | | 20.4 | | | | | |
| | | | | | May | 1 | Balance | b/d | 2 000 000 |

| **3.25.2** | **Calculate the total amount that will be reflected in the Cash Flow Statement for the repurchase of shares. Also calculate the amount repaid per share.** |
|---|---|
| Amount paid for repurchase of shares = 800 000 + 180 000 = R980 000<br>Amount paid per share = R980 000 ÷ 100 000 shares = R9.80 per share | |

## TASK 3.26 ⌘ FG Ltd: Repurchasing shares

**3.26.1**

**GENERAL LEDGER OF FG LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **Ordinary Share Capital** **B** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.3 | | | | | |
| Nov | 30 | Bank | CPJ | 172 000 | Sept | 1 | Balance | b/d | 1 376 000 |
| 20.4 | | | | | | | | | | |
| Aug | 31 | Balance | c/d | 1 204 000 | | | | | | |
| | | | | **1 376 000** | | | | | **1 376 000** |
| | | | | | 20.4 | | | | | |
| | | | | | Sept | 1 | Balance | b/d | 1 204 000 |

| **3.26.2** | **Calculate the total amount that will be reflected in the Cash Flow Statement for the repurchase of shares. Also calculate the amount repaid per share.** |
|---|---|
| Amount paid for repurchase of shares = 172 000 + 36 000 = R208 000<br>Amount paid per share = R208 000 ÷ 40 000 shares = R5.20 per share | |

## TASK 3.27 ⌘⌘ GH Ltd: Issuing and repurchasing shares

**3.27.1**

**GENERAL LEDGER OF GH LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **Ordinary Share Capital** **B** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.3 | | | | | |
| Dec | 31 | Bank | CPJ | 168 000 | Mar | 1 | Balance | b/d | 1 520 000 |
| 20.4 | | | | | | | Bank | CRJ | 832 000 |
| Feb | 28 | Bank | CPJ | 2 184 000 | | | | | | |
| | | | | **2 352 000** | | | | | **2 352 000** |
| | | | | | 20.4 | | | | | |
| | | | | | Mar | 1 | Balance | b/d | 2 184 000 |

| **3.27.2** | **Calculate the total amount that will be reflected in the Cash Flow Statement for proceeds of shares issued. Also calculate the amount repaid per share.** |
|---|---|
| Proceeds of shares issued = R832 000<br>Amount paid for repurchase of shares = R52 000 + (20 000 shares x R8.40) = R220 000<br>Amount paid per share = R220 000 ÷ 20 000 shares = R11.00 per share | |

## TASK 3.28 ⌘⌘ HI Ltd: Issuing and repurchasing shares

**3.28.1**

**GENERAL LEDGER OF HI LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **Ordinary Share Capital** **B** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.3 | | | | | |
| Aug | 31 | Bank | CPJ | 195 000 | Mar | 1 | Balance | b/d | 2 000 000 |
| 20.4 | | | | | | | Bank | CRJ | 600 000 |
| Feb | 28 | Bank | CPJ | 2 405 000 | | | | | | |
| | | | | **2 600 000** | | | | | **2 600 000** |
| | | | | | 20.4 | | | | | |
| | | | | | Mar | 1 | Balance | b/d | 2 405 000 |

| 3.28.2 | **Calculate the total amount that will be reflected in the Cash Flow Statement for proceeds of shares issued. Also calculate the amount repaid per share.** |
|---|---|
| Proceeds of shares issued = 40 000 shares x R15.00 = R600 000<br>Amount paid for repurchase of shares = 15 000 x R17.20 = R258 000 | |

## TASK 3.29 ⌘ IJ Ltd: Cash generated by Operating activities

| **CASH GENERATED FROM OPERATIONS** | |
|---|---|
| Profit before tax | 150 000 |
| Adjustment in respect of: | |
| Depreciation | 80 000 |
| Interest paid | 30 000 |
| Operating profit before changes in working capital | **260 000** |

## TASK 3.30 ⌘ JK Ltd: Cash generated by Operating activities

| **CASH GENERATED FROM OPERATIONS** | |
|---|---|
| Profit before tax | 700 000 |
| Adjustment in respect of: | |
| Depreciation | 180 000 |
| Interest paid | 100 000 |
| Operating profit before changes in working capital | **980 000** |

## TASK 3.31 ⌘ KL Ltd: Cash effects of changes in Working capital

| **CHANGES IN WORKING CAPITAL** | |
|---|---|
| Increase in inventory | (90 000) |
| Increase in trade and other receivables | (20 000) |
| Decrease in trade and other payables | (30 000) |
| | **(140 000)** |

## TASK 3.32 ⌘ LM Ltd: Cash effects of changes in Working capital

| **CHANGES IN WORKING CAPITAL** | |
|---|---|
| Increase in inventory | 70 000 |
| Increase in trade and other receivables | (30 000) |
| Decrease in trade and other payables | 50 000 |
| | **90 000** |

## TASK 3.33 ⌘ Effect of changes in Working capital

| | | Effect on Working Capital | |
|---|---|---|---|
| | | **Positive** | **Negative** |
| **3.33.1** | Increase in inventories. | | X |
| **3.33.2** | Increase in trade and other receivables. | | X |
| **3.33.3** | Increase in trade and other payables. | X | |
| **3.33.4** | Decrease in inventories. | X | |
| **3.33.5** | Decrease in trade and other receivables. | X | |
| **3.33.6** | Decrease in trade and other payables. | | X |

## TASK 3.34 ⌘ MN Ltd: Tax, Dividends & Interest

**3.34.1**

**GENERAL LEDGER OF MN LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **SARS (Income tax)** **B** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.1 | | | | |
| Feb | 28 | Bank | CPJ | 309 000 | Mar | 1 | Balance | b/d | 31 000 |
| | | Balance | c/d | 27 000 | 20.2 | | | | |
| | | | | | Feb | 28 | Income tax | GJ | 305 000 |
| | | | | **336 000** | | | | | **336 000** |
| | | | | | Mar | 1 | Balance | b/d | 27 000 |

**Shareholders for dividends** **B**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.1 | | | | |
| Feb | 28 | Bank | CPJ | 114 000 | Mar | 1 | Balance | b/d | 114 000 |
| | | Balance | c/d | 180 000 | 20.2 | | | | |
| | | | | | Feb | 28 | Div. on ord. shares | GJ | 180 000 |
| | | | | **29 400** | | | | | **294 000** |
| | | | | | Mar | 1 | Balance | b/d | 180 000 |

**Expenses payable** **B**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.1 | | | | |
| Feb | 28 | Interest expense | GJ | 20 000 | Mar | 1 | Balance | b/d | 20 000 |
| | | Balance | c/d | 14 000 | 20.2 | | | | |
| | | | | | Feb | 28 | Interest expense | GJ | 14 000 |
| | | | | **34 000** | | | | | **34 000** |
| | | | | | Mar | 1 | Balance | b/d | 14 000 |

**NOMINAL ACCOUNTS SECTION**

**Income tax** **N**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | |
| Feb | 28 | SARS – Income tax | GJ | 305 000 | Feb | 28 | Appropriation | GJ | 305 000 |

**Dr** **Dividends on ordinary shares** **N** **Cr**

| 20.2 | | | | | 20.2 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Bank | CPJ | 120 000 | Feb | 28 | Appropriation | GJ | 300 000 |
| | | S/hldrs for dividends | GJ | 180 000 | | | | | |
| | | | | **300 000** | | | | | **300 000** |

**Interest expense** **N**

| 20.2 | | | | | 20.2 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Bank | CPJ | 106 000 | Feb | 28 | Expenses payable | GJ | 20 000 |
| | | Expenses payable | GJ | 14 000 | | | Profit and loss a/c | GJ | 100 000 |
| | | | | **120 000** | | | | | **120 000** |

**3.34.2 Logical calculations:**

| | **Tax** | **Dividends** | **Interest** |
|---|---|---|---|
| Amount due at beginning of year | 31 000 | 114 000 | 20 000 |
| Amount in Income State-ment/Retained income note | 305 000 | 300 000 | 100 000 |
| Amount due at end of year | (27 000) | (180 000) | (14 000) |
| **PAID** | **309 000** | **234 000** | **106 000** |

## TASK 3.35 ⌘ NO Ltd: Tax, Dividends & Interest

**Note to the Teacher:**
The following are the calculations as well as ledger accounts. Some learners may find it easier to do the ledger accounts in order to complete the calculations.

**GENERAL LEDGER OF NO LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **SARS (Income tax)** **B** **Cr**

| 20.3 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| July | 1 | Balance | b/d | 46 000 | June | 30 | Income tax | | 650 000 |
| 20.4 | | | | | | | | | |
| June | 30 | Bank | | 545 000 | | | | | |
| | | Balance | c/d | 59 000 | | | | | |
| | | | | **650 000** | | | | | **650 000** |
| | | | | | July | 1 | Balance | b/d | 59 000 |

**Shareholders for dividends** **B**

| 20.4 | | | | | 20.3 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Bank | | 98 000 | July | 1 | Balance | b/d | 98 000 |
| | | Balance | c/d | 140 000 | 20.4 | | | | |
| | | | | | June | 30 | Div. on ord. shares | | 140 000 |
| | | | | **238 000** | | | | | **238 000** |
| | | | | | July | 1 | Balance | b/d | 140 000 |

**Dr** **Expenses payable** **B** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.3 | | | | |
| Feb | 28 | Interest expense | | 13 000 | Mar | 1 | Balance | b/d | 13 000 |
| | | Balance | c/d | 10 000 | 20.4 | | | | |
| | | | | | Feb | 28 | Interest expense | | 10 000 |
| | | | | **23 000** | | | | | **23 000** |
| | | | | | Mar | 1 | Balance | b/d | 10 000 |

**NOMINAL ACCOUNTS SECTION**

**Income tax** **N**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.4 | | | | |
| June | 30 | SARS – Income tax | | 650 000 | June | 30 | Appropriation | | 650 000 |

**Dividends on ordinary shares** **N**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.4 | | | | |
| June | 30 | Bank | | 86 000 | June | 30 | Appropriation | | 226 000 |
| | | S/hldrs for dividends | | 140 000 | | | | | |
| | | | | **226 000** | | | | | **226 000** |

**Interest expense** **N**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.4 | | | | |
| Feb | 28 | Bank | | 123 000 | Feb | 28 | Expenses payable | | 13 000 |
| | | Expenses payable | | 10 000 | | | Profit and loss a/c | | 120 000 |
| | | | | **133 000** | | | | | **133 000** |

| **Logical calculations:** | **Tax** | **Dividends** | **Interest** |
|---|---|---|---|
| Amount due at beginning of year | (46 000) | 98 000 | 13 000 |
| Amount in Income State-ment/Retained income note | 650 000 | 226 000 | 120 000 |
| Amount due at end of year | (59 000) | (140 000) | (10 000) |
| **PAID** | **545 000** | **184 000** | **123 000** |

## TASK 3.36 ⌘ OP Ltd: Tax, Dividends & Interest

**Note to the Teacher:**
The following are the calculations as well as ledger accounts. Some learners may find it easier to do the ledger accounts in order to complete the calculations.

**GENERAL LEDGER OF OP LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **SARS (Income tax)** **B** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.2 | | | | |
| Apr | 30 | Bank | | 351 200 | May | 1 | Balance | b/d | 22 200 |
| | | | | | 20.3 | | | | |
| | | | | | Apr | 30 | Income tax | | 298 000 |
| | | | | | | | Balance | c/d | 31 000 |
| | | | | **351 200** | | | | | **351 200** |
| May | 1 | Balance | b/d | 31 000 | | | | | |

| Dr | | | | Shareholders for dividends | | | | | B | Cr |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.2 | | | | | |
| Apr | 30 | Bank | | 91 000 | May | 1 | Balance | | b/d | 91 000 |
| | | Balance | c/d | 74 000 | 20.3 | | | | | |
| | | | | | Apr | 30 | Div. on ord. shares | | | 74 000 |
| | | | | **165 000** | | | | | | **165 000** |
| | | | | | May | 1 | Balance | | b/d | 74 000 |

| | | | | Expenses payable | | | | | B | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.2 | | | | | |
| Feb | 28 | Interest expense | | 5 100 | Mar | 1 | Balance | | b/d | 5 100 |
| | | Balance | c/d | 6 600 | 20.3 | | | | | |
| | | | | | Feb | 28 | Interest expense | | | 6 600 |
| | | | | **11 700** | | | | | | **11 700** |
| | | | | | Mar | 1 | Balance | | b/d | 6 600 |

**NOMINAL ACCOUNTS SECTION**

| | | | | Income tax | | | | | N | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.3 | | | | | |
| Apr | 30 | SARS – Income tax | | 298 000 | Apr | 30 | Appropriation | | | 298 000 |

| | | | | Dividends on ordinary shares | | | | | N | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.3 | | | | | |
| Apr | 30 | Bank | | 83 000 | Apr | 30 | Appropriation | | | 157 000 |
| | | S/hldrs for dividends | | 74 000 | | | | | | |
| | | | | **157 000** | | | | | | **157 000** |

| | | | | Interest expense | | | | | N | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.3 | | | | | |
| Feb | 28 | Bank | | 54 500 | Feb | 28 | Expenses payable | | | 5 100 |
| | | Expenses payable | | 6 600 | | | Profit and loss a/c | | | 56 000 |
| | | | | **61 100** | | | | | | **61 100** |

**Logical calculations:**

| | Tax | Dividends | Interest |
|---|---|---|---|
| Amount due at beginning of year | 22 200 | 91 000 | 5 100 |
| Amount in Income Statement/ Retained income note | 298 000 | 157 000 | 56 000 |
| Amount due at end of year | 31 000 | (74 000) | (6 600) |
| **PAID** | **351 200** | **174 000** | **54 500** |

## TASK 3.37 ⌘ PQ Ltd: Capitalised interest

| | |
|---|---|
| Balance of loan at beginning | 640 000 |
| Add: Interest | **89 600** |
| Less: Repayments | (113 760) |
| Balance of loan at end | **615 840** |

**OR**

| | |
|---|---|
| Balance at of loan beginning | 640 000 |
| Repayments | (113 760) |
| Balance of loan at end | (615 840) |
| Interest paid for the year | **89 600** |

## TASK 3.38 ⌘ QR Ltd: Capitalised interest

**Logical calculations:**

| | Tax | Dividends |
|---|---|---|
| Amount due at beginning of year | 10 400 | (98 000) |
| Amount in Income Statement/ Retained income note | (445 700) | (236 000) |
| Amount due at end of year | 17 600 | 142 000 |
| **PAID** | (417 700) | (192 000) |

| | Interest |
|---|---|
| Balance at of loan beginning | 356 000 |
| Repayments | (77 220) |
| Balance of loan at end | (321 500) |
| Interest paid for the year | **42 720** |

## TASK 3.39 ⌘ RS Ltd: Investing activities

**3.39.1 Equipment purchased**

| | |
|---|---|
| Book value at beginning of year | 662 000 |
| Depreciation | (298 600) |
| Equipment purchased during the year | **356 600** |
| Book value at end of year | 720 000 |

**3.39.2 Fixed deposit: Calculation of increase**

| | |
|---|---|
| Value at beginning of year | 100 000 |
| Increase during the year | **40 000** |
| Value at end of year | 140 000 |

## TASK 3.40 ⌘ ST Ltd: Investing activities

**3.40.1 Vehicle purchased**

| | |
|---|---|
| Book value at beginning of year | 440 000 |
| Depreciation | (210 000) |
| Book value of vehicle sold | (860 000) |
| Vehicle purchased during the year | **1 325 000** |
| Book value at end of year | 695 000 |

**3.40.2 Fixed deposit: Calculation of increase**

| | |
|---|---|
| Value at beginning of year | 290 000 |
| Increase during the year | **70 000** |
| Value at end of year | 360 000 |

## TASK 3.41 ⌘ TU Ltd: Investing activities

**3.41.1**
**Equipment purchased**

| | |
|---|---|
| Book value at beginning of year | 390 000 |
| Depreciation | (41 000) |
| Book value of equipment sold | (15 000) |
| Equipment purchased during the year | **106 000** |
| Book value at end of year | 440 000 |

**Fixed/Tangible Assets Purchased:**

| | |
|---|---|
| Land and buildings<br>[2 100 000 – 1 500 000] | 600 000 |
| Equipment | 106 000 |
| | **706 000** |

**3.41.2 Fixed deposit: Calculation of increase**

| | |
|---|---|
| Value at beginning of year | 150 000 |
| Decrease during the year | **(45 000)** |
| Value at end of year | 105 000 |

**Note to Teachers:**

The following 10 Tasks involve the entire format of Cash Flow Statements. Teachers are strongly advised to select the Tasks appropriately for their classes. Learners do not need to do all 10 Tasks in order to understand Cash Flow Statements. A supply of 10 Tasks has been provided to enable learners to get additional practice should they experience difficulties in this area.

Seven of the Tasks cover capitalisation of interest on loans (i.e. Tasks 3.37, 3.38, 3.43, 3.46, 3.47, 3.49, 3.50).

Eight of the Tasks cover cases where interest is paid separately from the loan (i.e. interest is not capitalised – Tasks 3.34, 3.35, 3.36, 3.42, 3.44, 3.45, 3.48, 3.51).

Teachers should ensure that learners gain experience in both types of questions.

## REFINEMENTS IN RESPECT OF CASH RECEIVED FROM CUSTOMERS & CASH PAID TO SUPPLIERS AND EMPLOYEES

Teachers may decide whether or not to extend their learners by requiring these two extra lines in the Cash Flow Statement. CAPS does not, however, stipulate this as a requirement. Not required for exam purposes.

If Teachers want to enhance the Tasks, they may provide certain additional information to their classes as reflected in the table below.

- The figures in *BOLD ITALICS* will need to be provided by the Teacher.
- The figures in NORMAL FONT are obtainable from the information in the Task or note to the Cash Flow Statement.
- The figures in SHADED FORMAT are calculated by the learner.

**It was the intention of the authors not to include this information in the Tasks as this could unnecessarily complicate the Cash Flow Statement for the majority of learners. Teachers are advised to extend top learners through this exercise in some of the Tasks.**

| TASK | COMPANY | SALES | BAD DEBTS | DEBTORS AT BEGINNING | DEBTORS AT END | CASH RECEIVED FROM CUSTOMERS | CASH GENERATED BY OPERATIONS | CASH PAID TO SUPPLIERS & EMPLOYEES |
|---|---|---|---|---|---|---|---|---|
| 3.42 | PILLAY | 400 000 | 0 | 31 400 | 40 000 | 391 400 | 131 200 | 260 200 |
| 3.43 | GWALA | ***11 000 000*** | ***120 000*** | 115 000 | 150 000 | 10 845 000 | 1 451 500 | 9 393 500 |
| 3.44 | INDABA | 3 400 000 | 0 | 109 000 | 162 000 | 3 347 000 | 903 000 | 2 444 000 |
| 3.45 | KABELO | 8 000 000 | 70 000 | 1 194 000 | 598 000 | 8 526 000 | 1 886 000 | 6 640 000 |
| 3.46 | PABEX | 6 600 000 | 0 | 323 000 | 348 000 | 6 575 000 | 1 528 000 | 5 047 000 |
| 3.47 | WAVERLEY | ***18 400*** | ***240*** | 3 100 | 5 500 | 15 760 | 823 | 14 937 |
| 3.48 | MICRO | ***12 000 000*** | **30 000** | 290 000 | 270 000 | 11 990 000 | 884 000 | 11 106 000 |
| 3.49 | IMBIZO | ***660 000*** | **5 000** | 27 000 | 10 500 | 671 500 | 136 860 | 534640 |
| 3.50 | JASMINE | ***6 800*** | ***540*** | 3 100 | 1 572 | 7 788 | 1 003 | 6785 |
| | | Figures in bold italics will have to be provided to learners. Figures in normal font appear in the question. | Figures in bold italics will have to be provided to learners. Figures in normal font appear in the question. | All figures provided in the Tasks. | All figures provided in the Tasks. | Calculated as **Sales less Bad debts plus debtors at begin less Debtors at end** | Extracted from Cash Flow Statement prepared in the Task | Calculated as **Cash received from customers less Cash generated by operations** |

## TASK 3.42 ⌘ Pillay (Pty) Ltd: Complete Cash Flow Statement

**PILLAY (PTY) LTD**
**CASH FLOW STATEMENT FOR YEAR ENDED 28 FEBRUARY 20.3**

| | Note | |
|---|---|---|
| **Cash flows from operating activities** | | 39 000 |
| Cash generation from operations | 1 | 131 200 |
| Interest paid [2 500 + 14 000 – 3 000] | | (13 500) |
| Dividends paid | 3 | (35 000) |
| Tax paid | 4 | (43 700) |
| **Cash flows from investing activities** | | (159 000) |
| Purchase of non-current assets [65 000 + 94 000] | | (159 000) |
| Proceeds of sale of non-current assets | | - |
| **Cash flows from financing activities** | | 132 000 |
| Proceeds from issue of share capital | | 92 000 |
| Proceeds from long-term loan | | 40 000 |
| **Net change in cash equivalents** | 2 | 12 000 |
| Cash and cash equivalents – beginning of year | 2 | 27 000 |
| Cash and cash equivalents – end of year | 2 | **39 000** |

**Notes to the Cash Flow Statement for the year ended 28 February 20.3**

| | |
|---|---|
| **1. Reconciliation between profit before taxation and cash generated from operations** | |
| Profit before tax | 99 000 |
| Adjustments in respect of: | |
| Depreciation | 9 000 |
| Interest expense | 14 000 |
| Operating profit before changes in working capital | 122 000 |
| Changes in working capital: | 9 200 |
| Decrease in inventory | 5 600 |
| Increase in debtors | (8 600) |
| Increase in creditors | 12 200 |
| Cash generated from operations | **131 200** |

| **2. Cash and cash equivalents** | **Net change** | **20.3** | **20.2** |
|---|---|---|---|
| Bank | 11 500 | 37 000 | 25 500 |
| Cash float | - | 1 000 | 1 000 |
| Petty cash | 500 | 1 000 | 500 |
| | **12 000** | **39 000** | **27 000** |

| | |
|---|---|
| **3. Dividends paid** | |
| Amount owing at the end of the previous year | 19 000 |
| Dividends paid and recommended | 40 000 |
| Amount owing at the end of the current year | (24 000) |
| Amount paid | **35 000** |
| **4. Taxation paid** | |
| Amount owing at the end of the previous year | 1 700 |
| Income Statement amount | 45 600 |
| Amount owing at the end of the current year | (3 600) |
| Amount paid | **43 700** |

# TASK 3.43 Gwala Ltd: Complete Cash Flow Statement

**3.43.1 GWALA LTD**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.7**

| | Note | |
|---|---|---|
| **Cash flows from operating activities** | | 373 000 |
| Cash generation from operations | 1 | 1 451 500 |
| Interest paid | | (51 000) |
| Dividends paid | 3 | (432 500) |
| Tax paid | 4 | (595 000) |
| **Cash flows from investing activities** | | (258 000) |
| Purchase of non-current assets [28 000 + 178 000] | | (206 000) |
| Proceeds of sale of fixed assets | | 18 000 |
| Financial assets (Investment) | | (70 000) |
| **Cash flows from financing activities** | | 240 000 |
| Proceeds from issue of share capital | | 280 000 |
| Repayment of loans | | (40 000) |
| **Net change in cash equivalents** | 2 | 355 000 |
| Cash and cash equivalents – beginning of year | 2 | (105 000) |
| Cash and cash equivalents – end of year | 2 | **250 000** |

**NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.7**

| **1. Reconciliation between profit before taxation and cash generated from operations** | |
|---|---|
| Profit before tax | 1 100 000 |
| Adjustments in respect of: | |
| Depreciation | 80 000 |
| Interest expense | 51 000 |
| Operating profit before changes in working capital | 1 231 000 |
| Changes in working capital: | 220 500 |
| Decrease in inventory | 95 000 |
| Increase in debtors | (35 000) |
| Increase in creditors | 160 500 |
| Cash generated from operations | **1 451 500** |

| **2. Cash and cash equivalents** | **Net change** | **20.7** | **20.6** |
|---|---|---|---|
| Bank | 350 000 | 240 000 | (110 000) |
| Petty cash | 5 000 | 10 000 | 5 000 |
| | **355 000** | **250 000** | **(105 000)** |

| **3. Dividends paid** | |
|---|---|
| Amount owing at the end of the previous year | 192 500 |
| Dividends paid and recommended | 420 000 |
| Amount owing at the end of the current year | (180 000) |
| Amount paid | **432 500** |
| | |
| **4. Taxation paid** | |
| Amount owing to SARS at the end of the previous year | 60 000 |
| Dividends paid and recommended | 520 000 |
| Amount owing by SARS at the end of the current year | 15 000 |
| Amount paid | **595 000** |

| 3.43.2 | **During the year, Gwala Ltd was able to improve their cash situation and pay dividends. Explain how they were able to do this when the net income decreased.** |
|---|---|
| The company sold shares at a premium and bought more on credit. | |

## TASK 3.44 ⌘ Indaba Ltd: Complete Cash Flow Statement

**INDABA LTD**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.3**

| | Note | |
|---|---|---|
| **Cash flows from operating activities** | | 164 200 |
| Cash generation from operations | 1 | 743 000 |
| Interest paid [16 000 + 128 000 – 30 000] | | (114 000) |
| Dividends paid | 3 | (160 000) |
| Tax paid | 4 | (304 800) |
| **Cash flows from investing activities** | | 249 800 |
| Purchase of non-current assets | | (200 200) |
| Proceeds from disposal of non-current assets | | 450 000 |
| **Cash flows from financing activities** | | (500 000) |
| Repurchase of shares [160 000 + 40 000] | | (200 000) |
| Payment of capital portion of long-term borrowings | | (300 000) |
| **Net change in cash equivalents** | 2 | (86 000) |
| Cash and cash equivalents – beginning of year | 2 | 176 000 |
| Cash and cash equivalents – end of year | 2 | **90 000** |

**NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.3**

| **1. Reconciliation between profit before taxation and cash generated from operations** | |
|---|---|
| Profit before tax | 629 500 |
| Adjustments in respect of: | |
| Depreciation | 187 500 |
| Interest expense | 128 000 |
| Operating profit before changes in working capital | 945 000 |
| Changes in working capital: | (202 000) |
| Increase in inventory | (129 000) |
| Increase in debtors | (153 000) |
| Increase in creditors | 80 000 |
| Cash generated from operations | **743 000** |

| **2. Cash and cash equivalents** | **Net change** | **20.3** | **20.2** |
|---|---|---|---|
| Bank | (96 500) | 75 000 | 171 500 |
| Cash float | 3 000 | 5 000 | 2 000 |
| Petty cash | 7 500 | 10 000 | 2 500 |
| | **(86 000)** | **90 000** | **176 000** |

| **3. Dividends paid** | |
|---|---|
| Amount owing at the end of the previous year | 80 000 |
| Dividends paid and recommended | 200 000 |
| Amount owing at the end of the current year | (120 000) |
| Amount paid | **160 000** |

| | |
|---|---|
| **4. Taxation paid** | |
| Amount owing at the end of the previous year | 45 000 |
| Income Statement amount | 281 800 |
| Amount owing at the end of the current year | (22 000) |
| Amount paid | **304 800** |

## TASK 3.45 Kabelo Ltd: Complete Cash Flow Statement

### 3.45.1 NOTES TO THE FINANCIAL STATEMENTS

| 1. FIXED ASSETS | Land & buildings | Vehicles | Equipment | Total |
|---|---|---|---|---|
| Carrying value at beginning of year | 2 595 000 | 0 | **2 200 000** | 4 795 000 |
| Cost | **2 595 000** | 0 | **2 910 000** | **5 505 000** |
| Accumulated depreciation | 0 | 0 | 710 000 | **(710 000)** |
| Movements: | **(655 000)** | **2 208 000** | **72 000** | **1 625 000** |
| Additions | 0 | **2 208 000** | 302 000 | **2 510 000** |
| Disposals at carrying value | **(655 000)** | 0 | 0 | **(655 000)** |
| Depreciation | 0 | 0 | (230 000) | (230 000) |
| Carrying value at end of year | 1 940 000 | **2 208 000** | **2 272 000** | 6 420 000 |
| Cost | 1 940 000 | **2 208 000** | **3 212 000** | **7 360 000** |
| Accumulated depreciation | 0 | 0 | **(940 000)** | **(940 000)** |

### 3.45.2 KABELO LTD
### CASH FLOW STATEMENT FOR THE YEAR ENDED 31 AUGUST 20.2

| | Note | |
|---|---|---|
| **Cash flows from operating activities** | | 546 000 |
| Cash generation from operations | 1 | 1 886 000 |
| Interest paid [50 000 + 170 000 – 30 000] | | (190 000) |
| Dividends paid | 3 | (508 000) |
| Tax paid | 4 | (642 000) |
| **Cash flows from investing activities** | | (1 870 000) |
| Purchase of non-current assets* | | (2 510 000) |
| Investment in shares in Dicey Ltd | | (15 000) |
| Proceeds from disposal of non-current assets | | 655 000 |
| **Cash flows from financing activities** | | 1 240 000 |
| Proceeds from issue of share capital (5 750 000 – 4 700 000) | | 1 050 000 |
| Proceeds from long-term borrowings | | 190 000 |
| **Net change in cash equivalents** | 2 | (84 000) |
| Cash and cash equivalents – beginning of year | 2 | 96 000 |
| Cash and cash equivalents – end of year | 2 | **12 000** |

***Purchase of non-current assets**

| | |
|---|---|
| Book value at beginning | 4 795 000 |
| Additions | **2 510 000** |
| Disposals | (655 000) |
| Depreciation | (230 000) |
| Book value at end | 6 420 000 |

**NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 31 AUGUST 20.2**

| | |
|---|---|
| **1. Reconciliation between profit before taxation and cash generated from operations** | |
| Profit before tax | 1 300 000 |
| Adjustments in respect of: | |
| Depreciation | 230 000 |
| Interest expense | 170 000 |
| Operating profit before changes in working capital | 1 700 000 |
| Changes in working capital: | 186 000 |
| Increase in inventory | (230 000) |
| Decrease in debtors | 596 000 |
| Decrease in creditors | (180 000) |
| Cash generated from operations | **1 886 000** |

| **2. Cash and cash equivalents** | **Net change** | **20.2** | **20.1** |
|---|---|---|---|
| Bank | (86 000) | 10 000 | 96 000 |
| Petty cash | 2 000 | 2 000 | - |
| | **(84 000)** | **12 000** | **96 000** |

| | |
|---|---|
| **3. Dividends paid** | |
| Amount owing at the end of the previous year | 308 000 |
| Dividends paid and recommended | 600 000 |
| Amount owing at the end of the current year | (400 000) |
| Amount paid | **508 000** |
| | |
| **4. Taxation paid** | |
| Amount owing at the end of the previous year | 94 000 |
| Income Statement amount | 610 000 |
| Amount owing at the end of the current year | (62 000) |
| Amount paid | **642 000** |

| **3.45.3** | **The business bought a significant amount of new fixed assets. What did they buy and how did they pay for these fixed assets? Provide figures to support your answer.** |
|---|---|

**Fixed assets bought:**
They bought vehicles for R2 208 000.
They bought equipment for R302 000.
**Means of finance:**
They issued new 140 000 shares at a premium of R2.50 each = R1 050 000.
They raised a loan for R190 000.
They sold land and buildings for R655 000.
The rest (R615 000) was covered by operating activities and existing cash resources.

## TASK 3.46 Pabex Ltd: Complete Cash Flow Statement

**PABEX LTD**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.2**

| | Note | |
|---|---|---|
| **Cash flows from operating activities** | | 554 000 |
| Cash generation from operations | 1 | 1 228 000 |
| Interest paid | | (73 000) |
| Dividends paid | 3 | (415 000) |
| Tax paid | 4 | (186 000) |
| **Cash flows from investing activities** | | 91 000 |
| Purchase of equipment* | | (377 000) |
| Proceeds of sale of fixed assets [42 000 + 451 000] | | 493 000 |
| Increase in fixed deposit | | (25 000) |
| **Cash flows from financing activities** | | (550 000) |
| Repurchase of 15 000 shares [134 250 + 15 750] | | (150 000) |
| Payment of capital portion of long-term borrowings | | (400 000) |
| **Net change in cash equivalents** | 2 | 95 000 |
| Cash and cash equivalents – beginning of year | 2 | (83 000) |
| Cash and cash equivalents – end of year | 2 | **12 000** |

***Purchase of Equipment**

| | |
|---|---|
| Book value at beginning | 820 000 |
| Additions | **377 000** |
| Disposals | (42 000) |
| Depreciation | (115 000) |
| Book value at end | 1 040 000 |

**NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.2**

| | |
|---|---|
| **1. Reconciliation between profit before taxation and cash generated from operations** | |
| Profit before tax | 920 000 |
| Adjustments in respect of: | |
| Depreciation | 115 000 |
| Interest expense | 73 000 |
| Operating profit before changes in working capital | 1 108 000 |
| Changes in working capital: | 120 000 |
| Decrease in inventory | 186 000 |
| Increase in debtors | (25 000) |
| Decrease in creditors | (41 000) |
| Cash generated from operations | **1 228 000** |

| **2. Cash and cash equivalents** | **Net change** | **20.2** | **20.1** |
|---|---|---|---|
| Bank | 95 000 | 12 000 | (83 000) |
| | **95 000** | **12 000** | **(83 000)** |

| | |
|---|---|
| **3. Dividends paid** | |
| Amount owing at the end of the previous year | 195 000 |
| Total dividends for the year – interim and final | 360 000 |
| Amount owing at the end of the current year | (140 000) |
| Amount paid | **415 000** |
| | |
| **4. Taxation paid** | |
| Amount owing at the end of the previous year | (41 000) |
| Total tax for year | 276 000 |
| Amount owing at the end of the current year | (49 000) |
| Amount paid | **186 000** |

## TASK 3.47 Waverley Ltd: Complete Cash Flow Statement

**3.47.1 WAVERLEY LTD**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.4**

| | Note | *R'000* |
|---|---|---|
| **Cash flows from operating activities** | | (871) |
| Cash generation from operations | 1 | (41) |
| Interest paid | | (210) |
| Dividends paid | 3 | (150) |
| Tax paid | 4 | (470) |
| **Cash flows from investing activities** | | (1 690) |
| Purchase of non-current assets (800 + 874*) | | (1 674) |
| Sale of non-current assets | | 46 |
| Increase in investment | | (62) |
| **Cash flows from financing activities** | | 4 030 |
| Proceeds from issue of share capital | | 2 000 |
| Proceeds from long-term borrowings | | 2 300 |
| Repayment of long-term borrowings | | (270) |
| **Net change in cash equivalents** | 2 | 1 469 |
| Cash and cash equivalents – beginning of year | 2 | 31 |
| Cash and cash equivalents – end of year | 2 | **1 500** |

***Purchase of Fixed assets:**

| | *R'000* |
|---|---|
| Book value at beginning | 9 245 |
| Additions: Land & buildings | 800 |
| Equipment | **874** |
| Disposals | (46) |
| Depreciation | (140) |
| Book value at end | 10 733 |

**NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.4**

| **1. Reconciliation between profit before taxation and cash generated from operations** | ***R'000*** |
|---|---|
| Profit before taxation [700 + 410] | 1 110 |
| Adjustments in respect of: | |
| Depreciation | 140 |
| Interest expense | 210 |
| Operating profit before changes in working capital | 1 460 |
| Changes in working capital: | (1 501) |
| Increase in inventory | (3 381) |
| Increase in debtors | (2 400) |
| Increase in creditors | 4 280 |
| Cash generated from operations | **(41)** |

| **2. Cash and cash equivalents** | **Net change** | **20.4** | **20.3** |
|---|---|---|---|
| | ***R'000*** | ***R'000*** | ***R'000*** |
| Bank | 1 433 | 1 460 | 27 |
| Cash float | 17 | 20 | 3 |
| Petty cash | 19 | 20 | 1 |
| | **1 469** | **1 500** | **31** |

| **3. Dividends paid** | ***R'000*** |
|---|---|
| Amount owing at the end of the previous year | 60 |
| Total dividends for the year – interim and final | 230 |
| Amount owing at the end of the current year | (140) |
| Amount paid | **150** |

| **4. Taxation paid** | |
|---|---|
| Amount owing at the end of the previous year | 100 |
| Income Statement amount | 410 |
| Amount owing at the end of the current year | (40) |
| Amount paid | **470** |

| **3.47.2** | **Some of the shareholders feel that their cash flow is disappointing. What appears to be the reason for their concern? Why would they have this opinion if the cash assets increased significantly?** |
|---|---|

The cash generated by operations is poor.
The company should not be relying on loans and issue of shares to the extent it does.
Working capital also appears to be a problem, especially stock.
Net profit is R700 000, which means that sales at selling price could reasonably be R7m.
Stock however is valued at R9.6m.
Other valid explanations possible.

| **3.47.3** | **How much extra did the company borrow from North West Bank during the year? Provide a possible reason why the company might need the loan to increase by this amount.** |
|---|---|

They borrowed an extra R740 000 (i.e. 1 120 + 210 – 270 + 740 = 1 800).
They might need this for expansion of the business early in the next financial year.

# TASK 3.48 Micro (Pty) Ltd: Complete Cash Flow Statement

### 3.48.1 NOTES TO THE FINANCIAL STATEMENTS

| 1. FIXED ASSETS | Land & buildings | Equipment | Total |
|---|---|---|---|
| Carrying value at beginning of year | 1 050 000 | 1 100 000 | 2 150 000 |
| Cost | 1 050 000 | 1 420 000 | 2 470 000 |
| Accumulated depreciation | 0 | (320 000) | (320 000) |
| **Movements**: | **400 000** | **(80 000)** | **320 000** |
| Additions | **400 000** | **95 000** | **495 000** |
| Disposals at carrying value | 0 | **(25 000)** | **(25 000)** |
| Depreciation | 0 | **(150 000)** | **(150 000)** |
| Carrying value at end of year | 1 450 000 | **1 020 000** | **2 470 000** |
| Cost | 1 450 000 | 1 478 000 | 2 928 000 |
| Accumulated depreciation | 0 | **(458 000)** | **(458 000)** |

### 3.48.2 MICRO (PTY) LTD
### CASH FLOW STATEMENT FOR THE YEAR ENDED 30 APRIL 20.8

| | Note | 30 000 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash generation from operations | 1 | 884 000 |
| Interest paid [40 000 + 169 000 – 55 000] | | (154 000) |
| Dividends paid | 3 | (310 000) |
| Tax paid | 4 | (390 000) |
| **Cash flows from investing activities** | | (770 000) |
| Purchase of fixed assets (400 000 + 95 000*) | | (495 000) |
| Increase in investment | | (300 000) |
| Proceeds from disposal of non-current assets | | 25 000 |
| **Cash flows from financing activities** | | 820 000 |
| Proceeds from issue of share capital | | 950 000 |
| Payment of capital portion of long-term borrowings | | (130 000) |
| **Net change in cash equivalents** | 2 | 80 000 |
| Cash and cash equivalents – beginning of year | 2 | 170 000 |
| Cash and cash equivalents – end of year | 2 | **250 000** |

***Purchase of Fixed assets:**

| | |
|---|---|
| Book value at beginning | 2 150 000 |
| Additions: Land & buildings | 400 000 |
| Equipment | **95 000** |
| Disposals (37 000 – 12 000) | (25 000) |
| Depreciation | (150 000) |
| Book value at end | **2 470 000** |

**NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 30 APRIL 20.8**

| | |
|---|---|
| **1. Reconciliation between profit before taxation and cash generated from operations** | |
| Profit before taxation (520 000 + 550 000) | 1 070 000 |
| Adjustments in respect of: | |
| Depreciation | 150 000 |
| Interest expense | 169 000 |
| Operating profit before changes in working capital | 1 389 000 |
| Changes in working capital: | (505 000) |
| Decrease in inventory | 250 000 |
| Decrease in debtors | 20 000 |
| Decrease in creditors | (775 000) |
| Cash generated from operations | **884 000** |

| **2. Cash and cash equivalents** | **Net change** | **20.8** | **20.7** |
|---|---|---|---|
| Bank | 65 000 | 210 000 | 145 000 |
| Cash float | 10 000 | 20 000 | 10 000 |
| Petty cash | 5 000 | 20 000 | 15 000 |
| | **80 000** | **250 000** | **170 000** |

| | |
|---|---|
| **3. Dividends paid** | |
| Amount owing at the end of the previous year | 180 000 |
| Total dividends for the year – interim and final | 330 000 |
| Amount owing at the end of the current year | (200 000) |
| Amount paid | **310 000** |
| **4. Taxation paid** | |
| Amount owing at the end of the previous year | (50 000) |
| Income Statement amount | 550 000 |
| Amount owing at the end of the current year | (110 000) |
| Amount paid | **390 000** |

| **3.48.3** | **In your opinion, should the directors be satisfied with the cash flow situation? Explain.** |
|---|---|
| Any valid explanation.<br>It appears operating activities are not providing the cash inflow desired.<br>Lack of cash flow is being compensated for by financing activities, which is not ideal. | |

## TASK 3.49 Imbizo (Pty) Ltd: Complete Cash Flow Statement

**3.49.1 NOTES TO THE BALANCE SHEET ON 31 MARCH 20.4**

| | |
|---|---|
| **1. ORDINARY SHARE CAPITAL** | |
| Authorised: | |
| 400 000 ordinary shares | |
| Issued: | |
| 240 000 ordinary shares in issue at beginning of year | 120 000 |
| 12 000 ordinary shares repurchased on 31 May 20.3 | (6 000) |
| 122 000 ordinary shares issued on 1 September 20.3 | 97 600 |
| 350 000 ordinary shares in issue at end of year | **211 600** |

| | |
|---|---|
| **2. RETAINED INCOME** | |
| Retained income at beginning of year | 54 400 |
| Net profit after tax | 144 000 |
| Repurchase of 12 000 shares | (5 400) |
| Dividends paid and declared | (71 800) |
| Retained income at end of year | **121 200** |

**3.49.2 IMBIZO (PTY) LTD**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 20.4**

| | Note | |
|---|---|---|
| **Cash flows from operating activities** | | 102 200 |
| Cash generation from operations | 1 | 247 860 |
| Interest paid | | (14 360) |
| Dividends paid | 3 | (58 800) |
| Tax paid | 4 | (72 500) |
| **Cash flows from investing activities** | | (142 000) |
| Purchase of non-current assets[(1)] | | (119 000) |
| Proceeds from disposal of non-current assets [18 000 – 11 000] | | 7 000 |
| Financial assets (investment) | | (30 000) |
| **Cash flows from financing activities** | | 73 200 |
| Proceeds from issue of share capital | | 97 600 |
| Repurchase of shares [12 000 x 95c] or [6 000 + 5 400] | | (11 400) |
| Payment of capital portion of long-term borrowings | | (13 000) |
| **Net change in cash equivalents** | 2 | 33 400 |
| Cash and cash equivalents – beginning of year | 2 | 7 400 |
| Cash and cash equivalents – end of year | 2 | **40 800** |

***Purchase of Non-current assets:**

| | |
|---|---|
| Book value at beginning | 211 000 |
| Additions | **119 000** |
| Disposals | [7 000] |
| Depreciation | [27 000] |
| Book value at end | 296 000 |

**NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 20.4**

| | |
|---|---|
| **1. Reconciliation between profit before taxation and cash generated from operations** | |
| Profit before taxation [144 000 + 56 000] | 200 000 |
| Adjustments in respect of: | |
| Depreciation | 27 000 |
| Interest expense | 14 360 |
| Operating profit before changes in working capital | 241 360 |
| Changes in working capital: | 6 500 |
| Decrease in inventory | 24 800 |
| Decrease in debtors | 16 500 |
| Decrease in creditors | (34 800) |
| Cash generated from operations | **247 860** |

| 2. | Cash and cash equivalents | Net change | 20.4 | 20.3 |
|---|---|---|---|---|
| | Bank | 28 400 | 32 800 | 4 400 |
| | Cash float | 4 000 | 7 000 | 3 000 |
| | Petty cash | 1 000 | 1 000 | - |
| | | **33 400** | **40 800** | **7 400** |

| 3. | Dividends paid | |
|---|---|---|
| | Amount owing at the end of the previous year | 36 000 |
| | Total dividends for the year – interim and final | 71 800 |
| | Amount owing at the end of the current year | (49 000) |
| | Amount paid | **58 800** |
| | | |
| 4. | **Taxation paid** | |
| | Amount owing at the end of the previous year | 14 000 |
| | Income Statement amount | 56 000 |
| | Amount owing at the end of the current year | 2 500 |
| | Amount paid | **72 500** |

| 3.49.2 | **You own 75% of the shares in this small private company. Would you be satisfied with this Cash Flow Statement? Explain briefly.** |
|---|---|

Any valid answer.
Compare cash generated by operations with investing and financing activities.
There appears to be a good balance between the three.

## TASK 3.50 Jasmine Ltd: Complete Cash Flow Statement

**3.50.1 NOTES TO THE BALANCE SHEET ON 31 MARCH 20.5**

| 1. | ORDINARY SHARE CAPITAL | *R '000* |
|---|---|---|
| | Authorised: | |
| | 5 000 000 ordinary shares | |
| | Issued: | |
| | 2 000 000 ordinary shares in issue at beginning of year | 4 200 |
| | 500 000 ordinary shares issued on 1 April 20.4 | 1 500 |
| | 50 000 ordinary shares repurchased on 31 March 20.5 | (114) |
| | 2 450 000 ordinary shares in issue at end of year | **5 586** |
| | | |
| 2. | **RETAINED INCOME** | |
| | Balance at beginning of year | 370 |
| | Net profit after tax | 560 |
| | Repurchase of 12 000 shares | (46) |
| | Dividends for the year | (300) |
| | Balance at end of year | **584** |

**3.50.2 JASMINE LTD**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 20.5**

| | Note | *R '000* |
|---|---|---|
| **Cash flows from operating activities** | | (325) |
| Cash generation from operations | 1 | 380 |
| Interest paid | | (37) |
| Dividends paid | 3 | (360) |
| Tax paid | 4 | (308) |
| **Cash flows from investing activities** | | (1 773) |
| Purchase of non-current assets* | | (1 732) |
| Increase in investment | | (50) |
| Proceeds from disposal of non-current assets | | 9 |
| **Cash flows from financing activities** | | 1 593 |
| Proceeds from issue of share capital | | 1 500 |
| Repurchase of shares [50 000 x 3.20] or [114 + 46] | | (160) |
| Proceeds from long-term borrowings | | 253 |
| **Net change in cash equivalents** | 2 | (505) |
| Cash and cash equivalents – beginning of year | 2 | 310 |
| Cash and cash equivalents – end of year | 2 | **(195)** |

***Purchase of Equipment:**

| | *R '000* |
|---|---|
| Book value at beginning | 1 840 |
| Additions | **1 732** |
| Disposals | (9) |
| Depreciation | (53) |
| Book value at end | **3 510** |

**NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 20.5**

| **1. Reconciliation between profit before taxation and cash generated from operations** | *R '000* |
|---|---|
| Profit before tax | 777 |
| Adjustments in respect of: | |
| Depreciation | 53 |
| Interest expense | 37 |
| Operating profit before changes in working capital | 867 |
| Changes in working capital: | (487) |
| Increase in inventory | (1 005) |
| Decrease in debtors | 1 528 |
| Decrease in creditors | (1 010) |
| Cash generated from operations | **380** |

| **2. Cash and cash equivalents** | **Net change** *R '000* | **20.5** *R '000* | **20.4** *R '000* |
|---|---|---|---|
| Bank | (505) | (195) | 310 |
| | **(505)** | **(195)** | **310** |

| 3. **Dividends paid** | ***R '000*** |
|---|---|
| Amount owing at the end of the previous year | 60 |
| Total dividends for the year – interim and final | 300 |
| Amount owing at the end of the current year | - |
| Amount paid | **360** |
| | |
| **4. Taxation paid** | |
| Amount owing at the end of the previous year | 40 |
| Income Statement amount | 240 |
| Amount owing at the end of the current year | 28 |
| Amount paid | **308** |

| **3.50.3** | **At the AGM, some of the shareholders are demanding that a final dividend be declared. Would you support their opinion? Explain briefly.** |
|---|---|

The shareholders are not justified in asking for more dividends.
The interim dividends exceed the net profit significantly and there is a negative cash flow of R505 000.
The bank is now in overdraft.
They must wait until the operating activities generate sustainable inflows.

| **3.50.4** | **Explain the most significant points from the Cash Flow Statement. Quote figures to support your answer.** |
|---|---|

There is a cash deficit from operating activities of R302 000.
This is very poor as operations should generate cash, not cause a deficit.
A lot of non-current assets were bought (R1.732m).
Obviously the directors are trying to expand the business.
A significant number of new shares were issued (500 000) which generated R1.5m to assist in buying the new assets.
The stock levels have been reduced significantly by just more than R1m.
This is good as excess stock causes liquidity problems if it cannot be sold.

## TASK 3.51 Mega (Pty) Ltd: Identify missing figures

**MEGA (PTY) LTD**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.2**

| | Note | | |
|---|---|---|---|
| **Cash flows from operating activities** | | **65 730** | **a** |
| Cash generation from operations | 1 | **140 830** | **b** |
| Interest paid | | **(8 250)** | **c** |
| Dividends paid | | **(38 000)** | **d** |
| Income tax paid | | (28 850) | |
| **Cash flows from investing activities** | | **(243 730)** | **e** |
| Purchase of non-current assets | | **(268 930)** | **f** |
| Sale of non-current assets at carrying value | | 7 200 | |
| Cash effects of changes in financial assets | | **18 000** | **g** |
| **Cash flows from financing activities** | | **190 000** | **h** |
| Proceeds of shares issued | | **240 000** | **i** |
| Repayment of long-term loans | | (50 000) | |
| **Net change in cash equivalents** | | **(12 000)** | **j** |
| Cash and cash equivalents – beginning of year | | 58 000 | |
| Cash and cash equivalents – end of year | | 46 000 | |

**Notes to the Cash Flow Statement for the year ended 30 June 20.2**

| | | |
|---|---|---|
| **1. Reconciliation between profit before taxation and cash generated from operations** | | |
| Net profit before tax as per Income Statement | **92 500** | **k** |
| Adjustments in respect of: | | |
| Interest expense | **8 250** | **l** |
| Non-cash items: Depreciation | 24 080 | |
| Operating profit before changes in working capital | **124 830** | **m** |
| Changes in working capital: | **16 000** | **n** |
| Increase / decrease in inventories | (20 000) | |
| Increase / decrease in debtors | 17 000 | |
| Increase / decrease in creditors | 19 000 | |
| Cash generated from operations | **140 830** | **o** |

**Working:**
Income tax: 3 000+ 28 850 – 4 100 = 27 750
Net profit before tax: 27 750 x $^{100}/_{30}$ = 92 500
Dividends paid: (150 000 x 12c) + (250 000 x 8c) = 18 000 + 20 000 = 18 000
Fixed assets purchased: 1 150 650 + 7 200 + 24 080 – 913 000 = 268 930
Proceeds of shares issued: 100 000 x 240c = 240 000

## TASK 3.52 ⌘ Rajah (Pty) Ltd: Accounting Equation

| No. | Account debited | Account credited | Amount | A | O | L |
|---|---|---|---|---|---|---|
| 1. | Bank | Ordinary share capital | R1 000 000 | + | + | 0 |
| 2. | Preliminary expenses* | Bank | 38 000 | ± | 0 | 0 |
| 3. | SARS – Income tax | Bank | 120 000 | ± | 0 | 0 |
| 4. | Dividends on ord. shares | Bank | 50 000 | - | - | 0 |
| 5. | Audit fees | Bank | 67 000 | - | - | 0 |
| 6. | Bank | Ordinary share capital | 640 000 | + | + | 0 |
| 7. | Directors fees | Bank | 800 000 | - | - | 0 |
| 8. | Audit fees | Expenses payable | 13 000 | 0 | - | + |
| 9. | Directors fees | Expenses payable | 500 000 | 0 | - | + |
| 10. | SARS – Income tax | Bank | 132 000 | ± | 0 | 0 |
| 11. | Income tax | SARS – Income tax# | 249 000 | - | - | 0 |
| 12. | Dividends on ord. shares | Shareholders for dividends | 105 000 | 0 | - | + |
| 13. | Bank | Ordinary share capital | 300 000 | + | + | 0 |
| 14. | Ordinary share capital | Bank | 43 400 | - | - | 0 |
| | Retained income | Bank | 12 600 | - | - | 0 |

**Note**:

* Preliminary expenses are normally treated as an asset as they are payments to establish the company. These are normally written off over a number of years.

# In this case SARS remains an asset because the provisional tax payments exceed the amount of income tax for the year. If the income tax was, e.g. R260 000, SARS would convert to a liability.

## TASK 3.53 ⌘ Nipho (Pty) Ltd: Accounting Equation

| No. | Account debited | Account credited | Assets | Equity | Liabilities |
|---|---|---|---|---|---|
| **1.** | SARS (Income tax) | Bank | -12 000 | 0 | -12 000 |
| **2.** | Shareholders for dividends | Bank | -6 000 | 0 | -6 000 |
| **3.** | Bank | Ordinary share capital | +156 000 | +156 000 | 0 |
| **4.** | SARS (Income tax) | Bank | ±140 000 | 0 | 0 |
| **5.** | Dividends on ordinary shares | Bank | -180 000 | -180 000 | 0 |
| **6.** | Depreciation | Acc. dep. on equipment | -5 000 | -5 000 | **0** |
| | Asset disposal | Vehicle | -100 000 | -100 000 | 0 |
| | Acc. dep. on vehicle | Asset disposal | +65 000 | +65 000 | 0 |
| | Creditors control | Asset disposal | 0 | +42 000 | -42 000 |
| | Vehicle | Creditors control | +240 000 | 0 | +240 000 |
| | Asset disposal | Profit on disposal of asset | 0 | ±7 000 | 0 |
| | | | **+200 000** | **+2 000** | **+198 000** |
| **7.** | Bank | Loan from director | +100 000 | 0 | +100 000 |
| **8.** | SARS (Income tax)* | Bank | ±115 000 | 0 | 0 |
| **9.** | Dividends on ordinary shares | Shareholders for dividends | 0 | -90 000 | +90 000 |
| **10.** | Income tax | SARS (Income tax)* | -255 000 | - 270 000 | +15 000 |
| **11.** | Loan from director | Ordinary share capital | 0 | +100 000 | -100 000 |
| **12.** | Shares in Xaba Ltd | Bank | ±480 000 | 0 | 0 |
| **13.** | Ordinary share capital | Bank | -32 100 | -32 100 | 0 |
| | Retained income# | Bank | -12 900 | -12 900 | 0 |
| | | | **-45 000** | **-45 000** | **0** |

***Note:**
The provisional tax payments were shown as an asset (total of R255 000). As the income tax for the year is R270 000, the asset of is reduced by that amount, and a liability of R15 000 is created.

**#Note:**
Buy-back = 30 000 x 1.07
Average issue price = R32 100
Retained income portion = 45 000 – 32 100 = R12 900

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Explain the need for financial statements. | | | |
| List the people or organisations who may be interested in the financial statements of a company. | | | |
| Explain the function of an auditor. | | | |
| Explain the following GAAP principles and how they affect the Accounting procedures and entries: | | | |
| • Business entity | | | |
| • Historical cost concept | | | |
| • Going concern concept | | | |
| • Matching concept | | | |
| • Prudence concept | | | |
| • Concept of materiality | | | |
| Discuss the role of professional bodies. | | | |
| Discuss the Companies Act and how it affects the Accounting process. | | | |
| Draw up an Income Statement for a company. | | | |
| Draw up a Balance Sheet for a company. | | | |
| Draw up notes to the company Balance Sheet. | | | |
| Demonstrate two techniques to use when drawing up Income Statements. | | | |
| Explain the purpose of a Cash Flow Statement. | | | |
| Explain the difference between Operating, Investing and Financing activities. | | | |
| Identify information for a Cash Flow Statement. | | | |
| Calculate cash generated by Operating activities. | | | |
| Calculate Working capital. | | | |
| Calculate cash generated by Financing activities. | | | |
| Draw up a Cash Flow Statement. | | | |
| Reflect the repurchase (buy-back) of shares in a Cash Flow Statement. | | | |

# MODULE 4
# ANALYSIS AND INTERPRETATION OF COMPANY FINANCIAL STATEMENTS

## TASK 4.1 ⌘ Baseline assessment: Interested readers of financial statements

**Make a list of the individuals/institutions who would be interested in analysing a company's financial statements. Indicate which part of the financial statements would be of prime interest to each group.**

| No. | Individuals/Institutions | Which part of financial statements |
|---|---|---|
| **1.** | Shareholders | Net profit, dividends. |
| **2.** | Directors | Net profit, solvency, liquidity. |
| **3.** | Auditors | Overall fair presentation. |
| **4.** | CIPRO | Overall presentation, auditor's report. |
| **5.** | Financial institutions | Fixed/tangible assets, loans, net profit. |
| **6.** | Creditors | Current assets and current liabilities. |
| **7.** | Employees | Net profit, salaries and wages. |
| **8.** | SARS | Net profit. |
| **9.** | Competitors | Net profit, earnings, dividends. |

## TASK 4.2 ⌘ Baseline assessment: Financial indicators learnt in Grades 10 & 11

| No. | Description | Formula | Profitability | Operating efficiency | Liquidity | Solvency | Risk | Return |
|---|---|---|---|---|---|---|---|---|
| **1.** | % gross profit on sales | $\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$ | ✓ | ✓ | | | | |
| **2.** | % Gross profit on cost of sales | $\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$ | ✓ | ✓ | | | | |
| **3.** | % Operating profit on sales | $\frac{\text{Operating profit}}{\text{Sales}} \times \frac{100}{1}$ | ✓ | ✓ | | | | |
| **4.** | % Operating expenses on sales | $\frac{\text{Operating expenses}}{\text{Sales}} \times \frac{100}{1}$ | ✓ | ✓ | | | | |
| **5.** | % Net profit on sales | $\frac{\text{Net profit}}{\text{Sales}} \times \frac{100}{1}$ | ✓ | ✓ | | | | |
| **6.** | Net assets | Total assets – Total liabilities | | | | ✓ | | |
| **7.** | Solvency ratio | Total assets : Total liabilities | | | | ✓ | | |

| No. | Description | Formula | Profitability | Operating efficiency | Liquidity | Solvency | Risk | Return |
|---|---|---|---|---|---|---|---|---|
| **8.** | Net current assets | Current assets – Current liabilities | | | ✓ | | | |
| **9.** | Current ratio | Current assets : Current liabilities | | | ✓ | | | |
| **10.** | Acid-test ratio | CA - Inventory : Current liabilities | | | ✓ | | | |
| **11.** | Rate of stock turno-ver | Cost of sales ÷ Average stock | | | ✓ | | | |
| **12.** | Stock holding period | $\frac{\text{Average stock}}{\text{Cost of sales}} \times \frac{365}{1}$ | | ✓ | ✓ | | | |
| **13.** | Debtors' collection period | $\frac{\text{Average debtors}}{\text{Credit sales}} \times \frac{365}{1}$ | | ✓ | ✓ | | | |
| **14.** | Creditors' payment period | $\frac{\text{Average creditors}}{\text{Cost of sales (or Credit purchases)}} \times \frac{365}{1}$ | | ✓ | ✓ | | | |
| **15.** | % Return on equity | $\frac{\text{Net profit}}{\text{Average equity}} \times \frac{100}{1}$ | ✓ | | | | | ✓ |
| **16.** | Debt / Equity ratio | Non-current liabilities : Owner's equity | | | | | ✓ | |

## TASK 4.3 ⌘ Solly's Stationers (Pty) Ltd: Liquidity & control of Working capital

**4.3.1 Current ratio**

[26 000 + 20 000 + 12 000] : 38 000
58 000 : 38 000
**1.5 : 1**

**4.3.2 Acid-test ratio**

[20 000 + 12 000] : 38 000
32 000 : 38 000
**0.8 : 1**

**4.3.3 Rate of stock turnover**

$$\frac{850\,000}{\frac{1}{2}[44\,000 + 26\,000]}$$

$$\frac{850\,000}{35\,000}$$

**24.3 times**

| 4.3.4 | Period for which enough stock is on hand |
|---|---|

½[44 000 + 26 000] x 365
850 000 1
350 000 x 365
850 000 1
**15 days**

| 4.3.5 | Debtors average collection period |
|---|---|

½ [16 000 + 20 000] x 365
210 000 1
18 000 x 365
210 000 1
**31.3 days**

| 4.3.6 | Creditors average payment period |
|---|---|

½ [42 000 + 38 000] x 365
850 000 1
40 000 x 365
850 000 1
**17.2 days**

## TASK 4.4 ⌘ Gabba Furnishers Ltd: Liquidity & control of Working capital

| 4.4.1 | Current ratio |
|---|---|

[1 080 000 + 770 000 + 100 000] : 460 000
1 950 000 : 460 000
**4.2 : 1**

| 4.4.2 | Acid-test ratio |
|---|---|

[770 000 + 100 000] : 460 000
870 000 : 460 000
**1.9 : 1**

| 4.4.3 | Rate of stock turnover |
|---|---|

3 800 000
½[920 000 + 1 080 000]
3 800 000
1 000 000
**3.8 times**

| 4.4.4 | Period for which enough stock is on hand |
|---|---|

½[920 000 + 1 080 000] x 365
3 800 000 1
1 000 000 x 365
3 800 000 1
**96.1 days**

| 4.4.5 | Debtors average collection period |
|---|---|

½[530 000 + 770 000] x 365
4 200 000 1
650 000 x 365
4 200 000 1
**56.5 days**

| 4.4.6 | **Creditors average payment period** |
|---|---|

½[540 000 + 460 000] x 365
3 800 000 1
500 000 x 365
3 800 000 1
**48 days**

| **Comment:** |
|---|

Liquidity ratios are high – although the Acid-test ratio is better than the Current ratio.
Stock levels are satisfactory if it is considered that Gabba is a furniture business, which means they probably have to hold large volumes of stock in order to have a range plus it is not as fashionable as some other products.
Debtors' collection period is unacceptable – debtors are taking 56 days to pay.
Creditors are being paid too soon in comparison to the debtors and stock – negotiate for extension.
Negative cash flow because the period of stock on hand and the Debtors' collection period are greater than the Creditors' payments period.

## TASK 4.5 Tjekkers Supermarket Ltd: Liquidity & control of Working capital

| 4.5.1 | **Calculate the following for both years:** |
|---|---|
| | • **Current ratio** |

**20.2:** 263 000 : 110 000 = **2.4 : 1**
**20.1:** 160 000 : 105 000 = **1.5 : 1**

| | • **Acid-test ratio** |
|---|---|

**20.2:** [263 000 – 202 000] : 110 000 = **0.6 : 1**
**20.1:** [160 000 – 112 000] : 105 000 = **0.5 : 1**

| 4.5.2 | **Calculate the following for 20.2:** |
|---|---|
| | • **Rate of stock turnover** |

1 270 000
½[202 000 + 112 000]
1 270 000
157 000
**8.1 times**

| | • **Period for which enough stock is on hand** |
|---|---|

½[202 000 + 112 000] x 365
1 270 000 1
157 000 x 365
1 270 000 1
**45.1 days**

| | • **Debtors average collection period** |
|---|---|

½[44 000 + 36 000] x 365
191 000 1
40 000 x 365
191 000 1
**76.4 days**

| | • **Creditors' average payment period** |
|---|---|
| ½[78 000 + 63 000] x 365<br>1 270 000 1<br>70 500 x 365<br>1 270 000 1<br>**20.3 days** | |

| **4.5.2** | **Comment on your results and offer suggestions to the directors.** |
|---|---|
| Current ratio has improved but the acid test ratio is low – may have liquidity problems.<br>Stock levels of 45 days may be too high for a supermarket – they need to drop stock levels – offer discounts to clear out old stocks.<br>Debtors are taking too long to pay (76 days) while creditors are being paid too soon – negative cash flow. | |

## TASK 4.6 Madame's Dress Shop (Pty) Ltd: Liquidity & control of Working capital

| **4.6.1** | **Calculate the following for both years:** |
|---|---|
| | • **Current ratio** |
| **20.4:** 425 000 : 116 000 = **3.7 : 1**<br>**20.3:** 384 000 : 101 000 = **3.8 : 1** | |
| | • **Acid-test ratio** |
| **20.4:** [425 000 – 310 000] : 116 000 = **1.0 : 1**<br>**20.3:** [384 000 – 246 000] : 101 000 = **1.4 : 1** | |

| **4.6.2** | **Calculate the following for 20.4:** |
|---|---|
| | • **Rate of stock turnover** |
| 770 000<br>½[310 000 + 246 000]<br>770 000<br>278 000<br>**2.8 times** | |
| | • **Period for which enough stock is on hand** |
| ½[310 000 + 246 000] x 365<br>770 000 1<br>278 000 x 365<br>770 000 1<br>**132 days** | |
| | • **Debtors average collection period** |
| ½[110 000 + 130 000] x 365<br>1 450 000 1<br>120 000 x 365<br>1 450 000 1<br>**30.2 days** | |
| | • **Creditors' average payment period** |
| ½[45 000 + 41 000] x 365<br>770 000 1<br>43 000 x 365<br>770 000 1<br>**20.4 days** | |

| 4.6.2 | **Comment on your results and offer suggestions to the directors.** |
|---|---|

Current ratio is too high while the acid test ratio is satisfactory.
They have too much stock on hand, the turnover rate of 2.8 is too slow – could be carrying obsolete stock or stock that is out of fashion.
Debtors' payment period is satisfactory but there is a negative cash flow – creditors are being paid too soon – negotiate with suppliers for extended terms.

## TASK 4.7 ⌘ Hello Ltd: Debt-equity

**Calculate and comment briefly on the Debt-equity ratio.**

1 600 000 : 4 000 000 = **0.4 : 1**
**Comment:**
Lowly geared, low risk.
Equity is more than double non-current liabilities.

## TASK 4.8 ⌘ Buy-Buy Ltd: Debt-equity

**Calculate and comment briefly on the Debt/equity ratio.**

1 940 000 : 2 200 000 = **0.9 : 1**
**Comment:**
May be risky – almost equally funded by equity and loans.
Unlike equity capital loans and the interest thereon have to be repaid. Highly geared, high risk.

## TASK 4.9 ⌘ Uptown Ltd: Debt-equity

| 4.9.1 | **Calculate the debt-equity ratio for both years.** |
|---|---|

**20.3:** 1 100 000 : 2 400 000 = **0.5 : 1**
**20.2:** 1 600 000 : 1 500 000 = **1.1 : 1**

| 4.9.2 | **Comment on your results. What is your opinion on the degree of financial risk of Uptown Ltd?** |
|---|---|

Risk has decline significantly.
Borrowed capital was in excess of equity in 20.2; shares were probably issued in 20.3 and the funds used to repay the loans.
In 20.3 the situation has swung around – low risk and lowly geared.

## TASK 4.10 ⌘⌘ Daystar Ltd: Gearing & Return on total capital employed

| 4.10.1 | **Calculate the Debt/equity ratio both years.** |
|---|---|

**20.3:** 400 000 : 1 400 000 = **0.3 : 1**
**20.2:** 900 000 : 1 100 000 = **0.8 : 1**

| 4.10.2 | **Calculate the Return on total capital employed.** |
|---|---|

$$\frac{110\,000 + 104\,000}{\frac{1}{2}(1\,800\,000 + 2\,000\,000)} \times \frac{100}{1}$$

$$\frac{214\,000}{1\,900\,000} \times \frac{100}{1}$$

**11.3%**

| 4.10.3 | **Comment briefly on your results.** |
|---|---|
| Unfavourable gearing effect – interest rate on loans is higher than the return on capital employed.<br>Company should continue reducing loan debt.<br>Risk has decreased significantly in 20.3. | |

## TASK 4.11 ⌘ Downhill Ltd: Gearing & Return on total capital employed

| 4.11.1 | **Calculate the debt/equity ratio for both years.** |
|---|---|
| **20.3:** 3 000 000 : 2 800 000 = **1.1 : 1**<br>**20.2:** 1 800 000 : 2 400 000 = **0.8 : 1** | |

| 4.11.2 | **Calculate the return on total capital employed.** |
|---|---|
| $\frac{1\ 146\ 000 + 304\ 000}{\frac{1}{2}(5\ 800\ 000 + 4\ 200\ 000)} \times \frac{100}{1}$<br>$\frac{1\ 450\ 000}{5\ 000\ 000} \times \frac{100}{1}$<br>**29%** | |

| 4.11.3 | **The business embarked on an expansion program during 20.3, most of which was financed by loans. In your opinion, was this a wise decision or should the directors have opted for a further issue of shares? Explain.** |
|---|---|
| Yes – favourable gearing effect, the return on capital employed (29%) is higher than the interest rate on loans (16%).<br>The company is utilising equity and borrowed capital to generate higher income.<br>Risk has increased by 0.3 in 20.3. | |

## TASK 4.12 Woodlands Ltd: Gearing & Return on total capital employed

| 4.12.1 | **Calculate the interest on loans which would appear in the Income Statement for 20.5. Interest was not capitalised.** |
|---|---|
| 15% x 1 600 000 x $^{5}/_{12}$ = R100 000<br>15% x 1 000 000 x $^{7}/_{12}$ = R87 500<br>Interest on loan = 100 000 + 87 500 = **R187 500** | |

| 4.12.2 | **Calculate the Debt/equity ratio both years.** |
|---|---|
| **20.3:** 1 000 000 : 6 870 000 = **0.1 : 1**<br>**20.2:** 1 600 000 : 3 720 000 = **0.4 : 1** | |

| 4.12.3 | **Calculate the Return on total capital employed.** |
|---|---|
| $\frac{580\ 000 + 187\ 500}{\frac{1}{2}(7\ 870\ 000 + 5\ 320\ 000)} \times \frac{100}{1}$<br>$\frac{767\ 500}{6\ 595\ 000} \times \frac{100}{1}$<br>**11.6%** | |

| 4.12.4 | **In your opinion, were the directors wise in opting for the issue of new shares to finance the expansion or should they have opted for further loans? Explain.** |
|---|---|

Yes – the issue of shares was a better option.
Negative gearing effect as the return on capital employed (11.6%) is less than the interest rate on loans (15%).
If profitability can be increased the company has greater potential to raise further loans easily in the future in view of the low debt-equity ratio.

## TASK 4.13 ⌘ Highlands Ltd: Returns, Earnings & Dividends

| 4.13.1 | **Calculate the Return on shareholders' equity.** |
|---|---|

$$\frac{128\,000}{\frac{1}{2}[1\,200\,000 + 1\,660\,000]} \times \frac{100}{1}$$

$$\frac{128\,000}{1\,430\,000} \times \frac{100}{1}$$

**9%**

| 4.13.2 | **Calculate the Earnings per share.** |
|---|---|

$$\frac{128\,000}{1\,200\,000} \times 100c$$

**10.7 cents**

| 4.13.3 | **Calculate the Dividends per share.** |
|---|---|

$$\frac{96\,000}{1\,200\,000} \times 100c$$

**8 cents**

| 4.13.4 | **Comment briefly on your findings above.** |
|---|---|

Returns are low – does not compare favourable with alternative investments.
Low EPS – market value of share is not provided, but EPS is low even compared to the issue price of a share.
High DPS compared to EPS – very little retention of earnings.
Dividends might have been kept high to maintain the market price of the share.

## TASK 4.14 ⌘ Secam Ltd: Returns, Earnings & Dividends

| 4.14.1 | **Calculate the Return on shareholders' equity.** |
|---|---|

$$\frac{975\,000}{\frac{1}{2}[5\,600\,000 + 5\,880\,000]} \times \frac{100}{1}$$

$$\frac{975\,000}{5\,740\,000} \times \frac{100}{1}$$

**17%**

| 4.14.2 | **Calculate the Earnings per share.** |
|---|---|

$$\frac{975\,000}{800\,000} \times 100c$$

**121.9 cents**

| 4.14.3 | **Calculate the Dividends per share.** |
|---|---|

$$\frac{320\,000}{800\,000} \times 100c$$

**40 cents**

| 4.14.4 | **Comment briefly on your findings above.** |
|---|---|

Satisfactory after tax return.
Low dividend pay-out rate – company is retaining funds for further expansion.
Only 32.8% of total earnings have been paid to shareholders ($^{40}/_{121.9}$ x $^{100}/_{1}$).

## TASK 4.15 Lowveld Ltd: Returns, Earnings & Dividends

| 4.15.1 | **Calculate the Return on shareholders' equity for 20.2.** |
|---|---|

$$\frac{715\,500}{\frac{1}{2}[2\,330\,000 + 1\,474\,500]} \times \frac{100}{1}$$

$$\frac{715\,500}{1\,902\,250} \times \frac{100}{1}$$

**37.6%**

| 4.15.2 | **Calculate the Earnings per share.** |
|---|---|

$$\frac{715\,500}{2\,500\,000} \times 100c$$

**28.6 cents**

| 4.15.3 | **Calculate the Dividends per share.** |
|---|---|

$$\frac{350\,000}{2\,500\,000} \times 100c$$

**14 cents**

| 4.15.4 | **Comment briefly on your findings above.** |
|---|---|

Good after tax return if compared to alternate investments.
Shareholders should be pleased with the dividend of 14 cents per share.
The company is retaining half its income for growth/expansion.

## TASK 4.16 Wembley Ltd: Returns, Earnings & Dividends

| 4.16.1 | **Calculate the following:**<br>**(a) Return on shareholder's equity** |
|---|---|

$$\frac{150\,000}{\frac{1}{2}[4\,510\,000 + 3\,450\,000]} \times \frac{100}{1}$$

$$\frac{150\,000}{3\,980\,000} \times \frac{100}{1}$$

**3.8%**

| | **(b) Earnings per share** |
|---|---|

$$\frac{150\,000}{2\,000\,000} \times 100c = \textbf{7.5 cents}$$

| | **(c) Dividends per share** |
|---|---|

$$\frac{140\,000}{2\,000\,000} \times 100c = \textbf{7 cents}$$

| 4.16.2 | **Comment briefly on your findings above.** |
|---|---|

Poor returns – dropped from the previous year.
The EPS has decreased significantly – net income is too low, also the issue of share capital (R100 000) has not helped to increase earnings but rather led to a drastic decrease.
The company has paid out almost all its earnings – probably to maintain share price on stock exchange and maintain confidence in the company.

## TASK 4.17 A Ltd and B Ltd: Advanced Task on Gearing & Risk

| | |
|---|---|
| **4.17.1** | **Calculate the Debt/equity ratio for each company.** |
| **A. Ltd:** | 10 000 : 100 000 = **0.1 : 1** |
| **B. Ltd:** | 100 000 : 10 000 = **10 : 1** |
| **4.17.2** | **Complete the following table assuming different figures for net profit before interest (the first line has been done for you).** |

| Net profit before deducting interest | A Ltd | | B Ltd | |
|---|---|---|---|---|
| | Net profit after deducting interest | Earnings per share | Net profit after deducting interest | Earnings per share |
| R27 000 | R25 500 | 25.5 cents | R12 000 | 120 cents |
| R25 000 | R23 500 | 23.5 cents | R10 000 | 100 cents |
| R18 000 | R16 500 | 16.5 cents | R3 000 | 30 cents |
| R16 000 | R14 500 | 14.5 cents | R1 000 | 10 cents |
| R12 000 | R10 500 | 10.5 cents | [R3 000] Loss | -30 cents |
| R 6 000 | R4 500 | 4.5 cents | [R9 000] Loss | -90 cents |

| | |
|---|---|
| **4.17.3** | **Learner to complete the graph.** |
| **4.17.4** | **Study your results above and summarise your findings. Which company has the potential to earn the greater returns for the shareholders? Which company is the riskier investment?** |

B Ltd has a much higher degree of risk than A Ltd.
This can be seen from the debt-equity ratios.
B Ltd is producing better returns as can be seen from the EPS.
This is apparent from the table but you can also see the effect of the higher risk.
When profits are high enough to cover interest the returns become negative.
Therefore when times are good the risk is high but so are the returns.

## TASK 4.18 Tower Ltd: Net asset value

| | |
|---|---|
| **4.18.1** | **Calculate the number of new shares issued on 1 July 20.4 and the issue price of those shares.** |

1 200 000 ÷ 1 600 000 shares = **75 cents per share**

| | |
|---|---|
| **4.18.2** | **Calculate the Net asset value per share for both years.** |

**20.5:** 3 000 000 x 100c = **78.9 cents**
3 800 000

**20.4:** 1 400 000 x 100c = **63.6 cents**
2 200 000

| | |
|---|---|
| **4.18.3** | **Comment on your findings above.** |

NAV has increased by 15.3 cents but is lower than the market price of 85 cents.

| | |
|---|---|
| **4.18.4** | **Would you purchase shares in this company at 85 cents? Explain.** |

Any reasonable comment – e.g. potential earnings, undervalued assets, shares are overvalued on the stock exchange, etc.

## TASK 4.19 ⌘ Finsbury Ltd: Net asset value

| 4.19.1 | **Calculate the number of new shares issued on 1 September 20.1 and the issue price of those shares.** |
|---|---|
| 1 600 000 ÷ 500 000 shares = **320 cents** | |

| 4.19.2 | **Calculate the Net asset value per share for both years.** |
|---|---|
| **20.2:** | 6 070 000 / 2 200 000 x 100c = **275.9 cents** |
| **20.1:** | 4 310 000 / 1 700 000 x 100c = **253.5 cents** |

| 4.19.3 | **Comment on your findings above.** |
|---|---|
| NAV has increased by 22.4 cents – the new shares were issued at R3.20 per share. | |

| 4.19.4 | **A friend offers you 225 cents per share. Would you sell your shares at this price? Explain.** |
|---|---|
| No – according to the Balance Sheet the shares are worth more than R2.25.<br>Balance sheet figures are conservative – a company's share price should be higher than the NAV. | |

## TASK 4.20 Dodo Ltd: Net asset value, % return, EPS & DPS

| 4.20.1 | **Calculate the Return on shareholders equity for 20.3.** |
|---|---|
| 427 500 / ½[4 095 000 + 3 162 500] x 100/1<br>427 500 / 3 628 750 x 100/1<br>**11.8%** | |

| 4.20.2 | **Calculate the Earnings per share for 20.3.** |
|---|---|
| 427 500 / 680 000 x 100c = **62.9 cents** | |

| 4.20.3 | **Calculate the Dividends per share for 20.3.** |
|---|---|
| 340 000 / 680 000 x 100c = **50 cents** | |

| 4.20.4 | **Calculate the Net asset value per share for 20.3.** |
|---|---|
| 4 095 000 / 680 000 x 100c = **602.2 cents** | |

| 4.20.5 | **Comment on your findings above.** |
|---|---|
| ROSHE and EPS have decreased in 20.3 while DPS and NAV have increased.<br>In 20.2, 41.7% ($^{25}/_{60} \times {}^{100}/_{1}$) was paid out to shareholders as dividends.<br>In 20.3, 79.5% ($^{50}/_{62.9} \times {}^{100}/_{1}$) of earnings was paid out to shareholders - probably to maintain the share price on the securities exchange.<br>The value of the shares has increased by 102.2 cents – 20.4% ($^{102.2}/_{500} \times {}^{100}/_{1}$).<br>The market value of the share is not available. | |

## TASK 4.21 ⌘ Vuka Ltd: Repurchase of shares & Net asset value

| 4.21.1 | **Use the draft figures above to calculate the Net asset value and the Earnings per share based on the 700 000 shares issued to date.** |
|---|---|

**Net asset value:**

$\frac{9\ 560\ 000}{700\ 000} \times 100c = \underline{\mathbf{1\ 365.7\ cents}}$

**Earnings per share:**

$\frac{1\ 350\ 000}{700\ 000} \times 100c = \underline{\mathbf{192.9\ cents}}$

**4.21.2**

| **SHAREHOLDERS' EQUITY** | **8 250 000** |
|---|---|
| Ordinary share capital (600 000 shares x R12.50) | 7 500 000 |
| Retained income | 750 000 |
| | |
| **RETAINED INCOME** | |
| Balance at beginning of year | 440 000 |
| Net profit after tax | 1 350 000 |
| Repurchase of 100 000 shares | (60 000) |
| Dividends (140 cents per share) | (980 000) |
| Balance at end of year | **750 000** |

**Working:**

Average share price = 8 750 000 ÷ 700 000 shares = R12.50

Repurchase price = R13.10; Retained income portion = R0.60 per share or total R60 000

| 4.21.3 | **Calculate the Net asset value after the repurchase of the shares.** |
|---|---|

$\frac{8\ 250\ 000}{600\ 000} \times 100c = \underline{\mathbf{1\ 375\ cents}}$

| 4.21.4 | **In your opinion, should the directors proceed with the proposal to repurchase 100 000 shares? Explain, quoting evidence to support your opinion.** |
|---|---|

Yes.

- There are sufficient cash resources to pay R13.10 x 100 000 = R1.31
- The NAV will immediately increase by 9 cents which will have an effect on the price quoted on the JSE.
- If profits remain the same next year, the EPS will be 225 cents per share (an increase of 32 cents) which will also have a positive effect on the share price.
- If total dividends remain the same next year, the DPS will go up from 140 cents to 163 cents which will benefit the shareholders directly and will also have a positive effect on the share price on the JSE.

## TASK 4.22 ⌘ Wena Ltd: Repurchase of shares & Net asset value

| 4.22.1 | **Use the draft figures above to calculate the Net asset value and the Earnings per share based on the total of 500 000 shares in issue.** |
|---|---|

**Net asset value:**

$\frac{3\ 172\ 000}{500\ 000} \times 100c = \underline{\mathbf{634.4\ cents}}$

**Earnings per share:**

$\frac{502\ 000}{500\ 000} \times 100c = \underline{\mathbf{100.4\ cents}}$

**4.22.2**

| **SHAREHOLDERS' EQUITY** | **2 532 000** |
|---|---|
| Ordinary share capital (420 000 shares x R5.70) | 2 394 000 |
| Retained income | 138 000 |
| | |
| **RETAINED INCOME** | |
| Balance at beginning of year | 220 000 |
| Net profit after tax | 502 000 |
| Repurchase of 80 000 shares | (184 000) |
| Dividends (80 cents per share) | (400 000) |
| Balance at end of year | **138 000** |

| 4.22.3 | **Calculate the Net asset value after the repurchase of the shares.** |
|---|---|

$\frac{2\ 532\ 000}{420\ 000} \times 100c = \underline{\mathbf{602.8\ cents}}$

| 4.22.4 | **In your opinion, should the directors proceed with the proposal to repurchase 80 000 shares? Explain, quoting evidence to support your opinion.** |
|---|---|

No.

- The price that the shareholder is asking is much too high. The NAV is R6.34 and he is asking for R8,00. If they can bring the price down, then this might be an option.
- The NAV will immediately decrease by 31 cents which will have a significant effect on the price quoted on the JSE.
- The directors should assess why the shareholder disagrees with their decisions. This company is not doing extremely well (only R502 000 net profit after tax, retained income is relatively low). Maybe they could make a lot more if they listen to his suggestions.
- There are two points in favour of the proposal to repurchase the 80 000 shares: If profits remain the same next year, the EPS will be 120 cents per share (an increase of 20 cents) which will also have a positive effect on the share price. If total dividends remain the same next year, the DPS will go up from 80 cents to 95 cents which will benefit the shareholders directly and will also have a positive effect on the share price on the JSE.

## TASK 4.23 Green Ltd: Repurchase of shares & Net asset value

**4.23.1**

| | 20.5 | 20.4 |
|---|---|---|
| **SHAREHOLDERS' EQUITY** | **4 729 000** (a) | 3 630 000 |
| Ordinary share capital | **3 856 500** (b) | 2 800 000 |
| Retained income | **872 500** (c) | 830 000 |
| **ORDINARY SHARE CAPITAL** | | |
| ***Authorised***: | | |
| 600 000 ordinary shares | | |
| ***Issued***: | | |
| 350 000 shares in issue at beginning of year | 2 800 000 | 2 800 000 |
| 150 000 shares issued on 31 August 20.4 | 1 485 000 | 0 |
| 50 000 shares repurchased on 31 January 20.5 | **(428 500)** (d) | 0 |
| 450 000 shares in issue at end of year | **3 856 500** (e) | 2 800 000 |
| **RETAINED INCOME** | | |
| Balance at beginning of year | 830 000 | 520 000 |
| Net profit after tax | 1 270 000 | 1 060 000 |
| Repurchase of 50 000 shares (on 31 January 20.5) (x 0.95) | **(47 500)** (f) | 0 |
| Dividends for the year | **(1 180 000)** (g) | (750 000) |
| Interim (paid on 30 November 20.4) (500 000 x 1.10) | **(550 000)** (h) | 270 000 |
| Final (paid after year-end) (450 000 x 1.40) | **(630 000)** (i) | 480 000 |
| Balance at end of year | **872 500** (j) | 830 000 |

**Financial indicators:**

| | 20.5 | 20.4 |
|---|---|---|
| Net asset value per share | **1 050.9 cents** (k) | **1 037.1 cents** (l) |
| Interim dividends per share | 110 cents | 90 cents |
| Final dividends per share | 140 cents | 160 cents |
| % return on average equity | **30.4%** (m) | 30.7% |
| Earnings per share | ***284.9 cents** (n) | **302.9 cents** (o) |
| Current ratio | 3.2 : 1 | 3.4 : 1 |
| Acid-test ratio | 1.5 : 1 | 1.2 : 1 |

***Earnings per share:**
Accept any reasonable calculation, e.g. R1 270 000÷450 000 shares = 282.2 cents **OR** R1 270 000 ÷ 350 000 shares = 362.9 cents. The correct answer will lie between these two extremes.
However, Teachers may extend more capable learners by exposing them to the correct calculation which involves dividing by the weighted average number of shares, as follows:

**Workings for EPS of 20.5:**
Calculation Weighted average number of shares
= [(350 000 x 3 months) + (500 000 x 5 months) + (450 000 x 4 months)] ÷ 12 months
= [1 050 000 + 2 500 000 + 1 800 000] ÷ 12 months
= 445 833 shares
EPS for 20.5 = 1 270 000 ÷ 445 833 shares = **284.9 cents**

| 4.23.2 | **Calculate the price at which the company issued the new shares on 31 August 20.4.** |
|---|---|
| 1 485 000 ÷ 150 000 shares = **990 cents per share** | |

| 4.23.3 | **Was it advisable for the directors to repurchase 50 000 shares at 952 cents each? Explain, quoting evidence from the question.** |
|---|---|

Yes.

- The repurchase price of 952 cents is in line with the market price on the JSE.
- The NAV has improved by 13.8 cents which should have a positive effect on the share price on the JSE (this was also affected by the high price of 990 cents charged on the issue of the new shares in August 20.4). The total DPS remained the same.
- The liquidity ratios are both high (3.2 : 1 and 1.5 : 1) which means that the business could afford to repurchase the shares without negatively affecting the liquidity position (note that the Companies Act prevents directors from repurchasing shares if liquidity is negatively affected).
- They have issued more shares as well, so the company is still growing in size.

| 4.23.4 | **Should the shareholders be happy with the % return, EPS and DPS for 20.5? Explain, quoting evidence from the question.** |
|---|---|

% Return improved from 27.2% to 30.4% - apart from increased profits, the reduction in the number of shares affected this return positively.
EPS decreased from 302.9 cents to 284.9 cents, probably caused by the fact that profits did not increase in line with the increased number of shares from one year to the next (350 000 to 450 000 shares).
However the DPS remained the same for both years at 250 cents per share.
Overall the shareholders should be happy with this but they will expect that the EPS will improve in future.

| 4.23.5 | **The directors want to issue the remaining authorised shares that have not yet been issued. The CEO, Len Lwazi, who currently owns 40% of the shares of Green Ltd. wants to purchase 125 000 of these shares at R9,00 each and sell the remaining shares on the JSE to the public at the current market price of R9.40 each. Explain why the other directors and shareholders will not be happy with this arrangement.** |
|---|---|

Although Len Lwazi will have to pay R1 125 000 for these shares, the issue price he is suggesting is too low.
The public is prepared to pay up to 990 cents, not 900 cents.
Furthermore, the number of shares he will own will increase from 180 000 shares to 305 000 shares which means he will then be the majority shareholder with 50.8% of the shares.
As this is a public company, the proper process of issuing the shares will have to be followed as per the Memorandum of Incorporation, i.e. a prospectus must be published inviting the public to buy the shares.
It would be unethical and illegal for him to use his position as CEO to entrench himself as the majority shareholder.
Other shareholders should be given the opportunity to acquire the new shares as well according to a fair process.

## TASK 4.24 ⌘ Bay Ltd: % profit on sales

**Calculate net profit before tax on sales for both years and comment on the company's performance.**

**20.4**

$$\frac{340\,000}{1\,660\,000} \times \frac{100}{1} = \mathbf{20.5\%}$$

**20.3**

$$\frac{360\,000}{1\,200\,000} \times \frac{100}{1} = \mathbf{30\%}$$

**Comment:**
The company is now earning 20.5 cents in each R1.00 of sales compared to 30 cents the year before. This is a disappointing decline.

## TASK 4.25 ⌘ Lagoon Ltd: % profit on sales

**Calculate net profit before tax on sales for both years and comment on the company's performance.**

**20.4**

$\frac{720\,000}{4\,980\,000} \times \frac{100}{1} = \mathbf{14.5\%}$

**20.3**

$\frac{500\,000}{2\,950\,000} \times \frac{100}{1} = \mathbf{16.9\%}$

**Comment:**

Turnover has increased yet profitability has decreased by almost 2.4%.
This could be due to a decrease in mark-up, which has increased sales volume.

## TASK 4.26 Comparison: % profit on sales

**4.26.1 Calculate net profit before tax on sales for both companies.**

**Allan's Supermarket**

$\frac{730\,000}{8\,100\,000} \times \frac{100}{1} = \mathbf{9\%}$

**Barbie's Dress Shop (Pty) Ltd**

$\frac{540\,000}{3\,600\,000} \times \frac{100}{1} = \mathbf{15\%}$

**4.26.2 What do these results imply about the mark-up % and overhead expenses of the two companies?**

Barbie's mark-up is probably higher, causing less sales volume.
Allan's overhead expenses are probably higher than Barbie's, but as a percentage of sales his expenses are lower.

## TASK 4.27 ⌘ Completion of table

| | Alpha Ltd | Beta Ltd | Delta Ltd | Gamma Ltd |
|---|---|---|---|---|
| Number of shares issued | 100 000 | 40 000 | 50 000 | **60 000** |
| Current assets | 250 000 | 95 000 | **75 000** | **320 000** |
| Current liabilities | 112 000 | 70 000 | 25 000 | 160 000 |
| Inventories | 150 000 | 32 000 | **32 500** | **32 000** |
| Trading stock (beginning) | 125 000 | 36 000 | 25 060 | 26 600 |
| Trading stock (end) | 145 000 | 30 000 | 29 500 | **28 800** |
| Debtors (beginning) | 24 000 | 71 000 | 31 000 | 7 200 |
| Debtors (end) | 20 000 | 75 000 | 34 000 | 6 000 |
| Creditors (beginning) | 102 000 | 58 000 | 18 200 | 32 000 |
| Creditors (end) | 90 000 | 64 000 | 17 000 | 40 000 |
| Shareholders' equity (beginning) | 410 000 | 115 000 | 100 000 | 210 000 |
| Shareholders equity (end) | 440 000 | 135 000 | **135 000** | **240 000** |
| Non-current liabilities (beginning) | 165 000 | 100 000 | 66 000 | 100 000 |
| Non-current liabilities (end) | 115 000 | 110 000 | 54 000 | **120 000** |
| Sales (turnover) | 820 000 | 510 000 | **250 000** | **297 500** |
| Credit sales | 410 000 | 460 000 | 200 000 | 80 300 |
| Cost of sales | 550 000 | 408 000 | **160 600** | 72 000 |
| Interest on loans | 21 000 | 16 800 | 9 000 | 16 500 |
| Operating expenses | 164 000 | 59 200 | 40 400 | 62 250 |

| | Alpha Ltd | Beta Ltd | Delta Ltd | Gamma Ltd |
|---|---|---|---|---|
| Other operating income | 5 000 | 2 000 | 0 | 4 000 |
| Operating profit | 148 000 | 44 400 | **49 000** | **105 750** |
| Net profit before tax | 85 000 | 26 000 | 40 000 | **89 250** |
| Income tax (per Income Statement) | 38 800 | 11 840 | 17 875 | 39 750 |
| Net profit after tax | 46 200 | 14 160 | **22 125** | 49 500 |
| Dividends for the year | 36 000 | 400 | **12 500** | **27 000** |
| Current ratio | **2.2 : 1** | **1.4 : 1** | 3 : 1 | 2 : 1 |
| Acid test ratio | **0.9 : 1** | **0.9 : 1** | 1.7 : 1 | 1.8 : 1 |
| Debtors' average collection period | **19.6 days** | **57.9 days** | **59.3 days** | 30 days |
| Creditors' average payment period | **63.7 days** | **54.6 days** | 40 days | **182.5 days** |
| Rate of stock turnover | **4.1** | **12.4** | **5.9** | 2.5 |
| Stock holding period | **89.6 days** | **29.5 days** | 62 days | **146 days** |
| Debt/equity ratio | **0.3 : 1** | **0,8 : 1** | 0.4 : 1 | 0.5 : 1 |
| Return on capital employed | **18.8%** | **18.6%** | **27.6%** | **31.6%** |
| Return on shareholders' equity | **10.9%** | **11.3%** | **18.8%** | 22% |
| Earnings per share | **46.2c** | **35.4c** | **44.3c** | 82.5c |
| Dividends per share | **36c** | **1c** | 25c | 45c |
| Net asset value per share | **440c** | **337.5** | **270c** | **400c** |
| Profit before tax to turnover (sales) | **10.4%** | **5.1%** | 16% | 30% |

## TASK 4.28 ⌘ Composite Task: All financial indicators affecting companies

**4.28.1** **You are provided with figures relating to AB Ltd for the past two years.**

**(a) Calculate the mark-up % for both years.**

| 20.2 | 20.1 |
|---|---|
| $\frac{2\ 180\ 000}{4\ 020\ 000} \times \frac{100}{1} =$ **$\underline{54.2\%}$** | $\frac{1\ 520\ 000}{3\ 800\ 000} \times \frac{100}{1} =$ **$\underline{40\%}$** |

**(b) Calculate the % gross profit on sales for both years.**

| 20.2 | 20.1 |
|---|---|
| $\frac{2\ 180\ 000}{6\ 200\ 000} \times \frac{100}{1} =$ **$\underline{35.2\%}$** | $\frac{1\ 520\ 000}{5\ 320\ 000} \times \frac{100}{1} =$ **$\underline{28.6\%}$** |

**(c) Calculate the % operating expenses on sales for both years**

| 20.2 | 20.1 |
|---|---|
| $\frac{1\ 190\ 000}{6\ 200\ 000} \times \frac{100}{1} =$ **$\underline{19.2\%}$** | $\frac{500\ 000}{5\ 320\ 000} \times \frac{100}{1} =$ **$\underline{9.4\%}$** |

**(d) Calculate the % operating profit on sales for both years.**

| 20.2 | 20.1 |
|---|---|
| $\frac{2\ 180\ 000 - 1\ 190\ 000}{6\ 200\ 000} \times \frac{100}{1} =$ **$\underline{16\%}$** | $\frac{1\ 520\ 000 - 500\ 000}{5\ 320\ 000} \times \frac{100}{1} =$ **$\underline{19.2\%}$** |

**(e) Calculate the % net profit before tax sales for both years.**

| 20.2 | 20.1 |
|---|---|
| $\frac{920\ 000}{6\ 200\ 000} \times \frac{100}{1} =$ **$\underline{14.8\%}$** | $\frac{640\ 000}{5\ 320\ 000} \times \frac{100}{1} =$ **$\underline{12\%}$** |

**(f) Comment on your results.**

The company managed to increase sales despite the higher mark-up %. Customers continued to support the company.
A gross profit of 54 cents on every R1.00 worth of sales was made.
Operating expenses have more than doubled, but the increased expenses resulted in a higher net profit.
The company may have spent heavily on advertising, etc. to boost sales – an increase of R88 000.

| 4.28.2 | **You are provided with the following extract from the Balance Sheet of BB Bookshops Ltd:** |
|---|---|
| | **(a) Calculate the current ratio for both years.** |

| **20.2** | **20.1** |
|---|---|
| 1 840 000 : 1 100 000 = **1.7 : 1** | 2 910 000 : 1 160 000 = **2.5 : 1** |

**(b) Calculate the acid-test ratio for both years.**

| **20.2** | **20.1** |
|---|---|
| [1 840 000 – 1 010 000] : 1 100 000 = **0.8 : 1** | [2 910 000 – 1 800 000] : 1 160 000 = **1 : 1** |

**(c) Calculate the rate of stock turnover for 20.2.**

$$\frac{6\,000\,000}{\frac{1}{2}[1\,010\,000 + 1\,800\,000]}$$

$$\frac{6\,000\,000}{1\,405\,000}$$

**4.3 times**

**(d) Calculate the stock holding period at the end of 20.2.**

$$\frac{\frac{1}{2}[1\,010\,000 + 1\,800\,000]}{6\,000\,000} \times \frac{365}{1}$$

$$\frac{1\,405\,000}{6\,000\,000} \times \frac{365}{1}$$

**85.5 days**

**(e) Calculate the debtors average collection period for 20.2.**

$$\frac{\frac{1}{2}[720\,000 + 1\,080\,000]}{8\,760\,000} \times \frac{365}{1}$$

$$\frac{900\,000}{8\,760\,000} \times \frac{365}{1}$$

**37.5 days**

**(f) Calculate the creditors' average payment period for 20.2.**

$$\frac{\frac{1}{2}[600\,000 + 880\,000]}{6\,000\,000} \times \frac{365}{1}$$

$$\frac{740\,000}{6\,000\,000} \times \frac{365}{1} = \textbf{45 days}$$

**(g) Comment on your results.**

The current ratio decreased in 20.2 but is reasonable – almost two to one.
The acid test ratio has decreased – the company is holding less stock than in the previous year – favourable effect on working capital.
Inventory turnover rate is reasonable for a bookshop but they are carrying too much stock (almost 90 days).
Debtors must be encouraged to pay sooner (at least within 30 days).
Creditors' payment period appears favourable.

| 4.28.3 | **The following information appeared in the Balance Sheets of Mill Park Ltd:** |
|---|---|
| | **(a) Calculate the debt/equity ratio for both 20.2 and 20.1.** |

| **20.2** | **20.1** |
|---|---|
| 2 000 000 : 7 500 000 = **0.3 : 1** | 3 000 000 : 4 300 000 = **0.7 : 1** |

**(b) Calculate the return on total capital employed for both years.**

| **20.2** | **20.1** |
|---|---|
| $\frac{1\,389\,000 + 375\,000}{\frac{1}{2}[9\,500\,000 + 7\,300\,000]} \times \frac{100}{1}$ | $\frac{1\,305\,000 + 525\,000}{\frac{1}{2}[7\,300\,000 + 8\,350\,000]} \times \frac{100}{1}$ |
| $\frac{1\,764\,000}{8\,400\,000} \times \frac{100}{1}$ | $\frac{1\,830\,000}{7\,825\,000} \times \frac{100}{1}$ |
| **21%** | **23.4%** |

| | |
|---|---|
| | **(c) Comment on your results.** |
| Although the return on capital employed decreased, it is still higher than the interest rate on loans.<br>Gearing effect should be favourable, but loans have been reduced relative to equity.<br>The degree of financial risk has decreased as can be seen in the drop in the debt/equity ratio.<br>The company should assess whether this was a wise decision.<br>Returns to shareholders might well be geared up if loans are maintained. | |
| **4.28.4** | **The following information appeared in financial statements of Haig Ltd:**<br>**(a) Calculate the % Return on shareholders' equity for 20.2 and 20.1.** |

| **20.2** | **20.1** |
|---|---|
| 840 000 – 383 520 x 100<br>½[2 982 680 + 2 393 000] 1<br>456 480 x 100<br>2 687 840 1<br>**17%** | 530 000 – 249 800 x 100<br>½[2 393 000 + 1 840 000] 1<br>280 200 x 100<br>2 116 500 1<br>**13.2%** |

| | |
|---|---|
| | **(b) Calculate the Earnings per share for both years.** |
| **20.2** | **20.1** |
| 456 480 x 100c<br>480 000<br>**95.1 cents** | 280 200 x 100c<br>420 000<br>**66.7 cents** |
| | **(c) Calculate the Dividends per share for both years.** |
| **20.2** | **20.1** |
| 316 800 x 100c<br>480 000<br>**66 cents** | 277 200 x 100c<br>420 000<br>**66 cents** |
| | **(d) Calculate the Net asset value per share for both years.** |
| **20.2** | **20.1** |
| 2 982 680 x 100c<br>480 000<br>**621.4 cents** | 2 393 000 x 100c<br>420 000<br>**569.8 cents** |
| | **(e) Comment on your results.** |
| All the ratios have improved except dividends, which have remained constant.<br>The earnings per share in 20.2 have improved substantially but the directors have retained the additional earnings in the business rather than increase dividends.<br>The net asset value has improved – compare with the market value of the shares, the earnings and dividends per share. | |

## TASK 4.29 ⌘ Kasem (Pty) Ltd: All financial indicators

| **4.29.1** | **Calculate the following financial indicators for 20.4 (the 20.3 calculations are provided for you).** | |
|---|---|---|
| **(a)** | **Gross profit on cost of sales** | **50%** |
| 368 000 x 100 = **44.8%**<br>822 000 1 | | |
| **(b)** | **Gross profit on sales** | **33%** |
| 368 000 x 100 = **30.9%**<br>1 190 000 1 | | |

| (c) | **Operating expenses on sales** | **26%** |
|---|---|---|
| 233 000 / 1 190 000 x 100/1 = **19.6%** | | |
| **(d)** | **Operating profit on sales** | **11%** |
| 153 000 / 1 190 000 x 100/1 = **12.9%** | | |
| **(e)** | **Net profit after tax on sales** | **4%** |
| 64 440 / 1 190 000 x 100/1 = **5.4%** | | |
| **(f)** | **Current ratio** | **1.5 : 1** |
| 207 000 : 188 000 = **1.1 : 1** | | |
| **(g)** | **Acid-test ratio** | **0.5 : 1** |
| [207 000 – 135 000] : 188 000<br>72 000 : 188 000 = **0.4 : 1** | | |
| **(h)** | **Rate of stock turnover** | **6.0** |
| 822 000 / ½[135 000 + 116 000]<br>822 000 / 125 500 = **6.5 times** | | |
| **(i)** | **Stock holding period** | **61 days** |
| ½[135 000 + 116 000] / 822 000 x 365/1<br>125 500 / 822 000 x 365/1 = **55.7 days** | | |
| **(j)** | **Debtors average collection period** | **35 days** |
| ½[54 000 + 44 000] / 476 000 x 365/1<br>49 000 / 476 000 x 365/1 = **37.6 days** | | |
| **(k)** | **Creditors average payment period** | **42 days** |
| ½[134 000 + 84 000] / 822 000 x 365/1<br>109 000 / 822 000 x 365/1 = **48.4 days** | | |
| **(l)** | **Solvency ratio** | **1.7 : 1** |
| [464 000 + 207 000] : [180 000 + 188 000]<br>671 000 : 368 000 = **1.8 : 1** | | |
| **(m)** | **Debt/equity ratio** | **0.9 : 1** |
| 180 000 : 303 000 = **0.6 : 1** | | |
| **(n)** | **Return on total capital employed** | **25%** |
| 123 000 + 30 000 / ½[(303 000 + 180 000) + (228 960 + 220 000] x 100/1<br>153 000 / 465 980 x 100/1 = **32.8%** | | |

| (o) | **Return on shareholders' equity** | **18%** |
|---|---|---|
| $\frac{64\,440}{\frac{1}{2}[303\,000 + 228\,960]} \times \frac{100}{1}$<br>$\frac{64\,440}{265\,980} \times \frac{100}{1} =$ **24.2%** | | |
| **(p)** | **Earnings per share** | **43.7 cents** |
| $\frac{64\,400}{120\,000} \times 100c =$ **53.7 cents** | | |
| **(q)** | **Dividends per share** | **42 cents** |
| $\frac{62\,400}{120\,000} \times 100c =$ **52 cents** | | |
| **(r)** | **Net asset value per share** | **254.4 cents** |
| $\frac{303\,000}{120\,000} \times 100c =$ **252.5 cents** | | |
| **4.29.2** | **Comment on your results obtained above, taking into account any improvement or deterioration since 20.3. Quote the actual financial indicators calculated in order to support your answer. Comment under the following headings:** | |
| • **Results of operating activities reflected in the Income Statement** | | |
| The company did not achieve the targeted mark-up of 50% - probably due to trade discounts. This has, however, had a positive effect on sales and net income which have both shown an improvement. The decrease in expenses indicates that expenses have been well controlled. | | |
| • **Returns to the shareholders, and the company's dividend policy** | | |
| Net income after tax on sales has increased by 1.4%. The return on shareholders equity has increased significantly by 6.2%. The return of 24.2% is very satisfactory and is most likely higher than the interest rates payable on alternative types of investments. Both earnings and dividends per share have increased – shareholders should be pleased. The company retained only 1.7 cents (53.7c – 52c) of its total earnings. | | |
| • **Risk and financial leverage (gearing)** | | |
| Debt-equity ratio has decreased by 0.6 – R40 000 was paid towards the loan and a further issue of shares was made. The increase in equity capital has resulted in a slight decrease in the net asset value per share – this may have an effect on the market price of the shares. Assuming an interest rate of 16% p.a. on loans, the company is positively geared because it is earning almost twice the interest rate – 32.8%. | | |
| • **Solvency** | | |
| Solvency ratio has improved – company is solvent, as total assets are almost twice total liabilities. The company is not likely to experience solvency problems. | | |
| • **Liquidity** | | |
| Both the current and acid-test ratios have decreased. Although the ratios are low it seems that the company is coping with this as it been low for two years and is still trading. Debtors are taking longer to pay and the rate of inventory turnover needs to be improved. Stock levels are adequate for a hardware business. | | |
| **4.29.3** | **John Juma was the shareholder who bought the new shares that were issued on 1 April 20.4. Should be he satisfied with the price he has paid for his shares? Explain, quoting figures to support your answer.** | |
| John Juma paid 240 cents for his shares. The NAV is 252.5 cents. He should be very satisfied with the price he paid. However, he should be concerned that the share prices seem to be undervalued as this could affect the performance of the share in future. | | |

## TASK 4.30 Emerald Jewellers Ltd: All financial indicators

| 4.30.1 | Calculate the following financial indicators for 20.2 (the 20.1 calculations are provided for you). | |
|---|---|---|
| **(a)** | **Gross profit on cost of sales** | **56%** |
| 4 500 000 / 8 600 000 x 100/1 = **52.3%** | | |
| **(b)** | **Gross profit on sales** | **36%** |
| 4 500 000 / 13 100 000 x 100/1 = **34.4%** | | |
| **(c)** | **Operating expenses on sales** | **30%** |
| 4 078 750 / 13 100 000 x 100/1 = **31.1%** | | |
| **(d)** | **Operating profit on sales** | **6.1%** |
| 421 250 / 13 100 000 x 100/1 = **3.2%** | | |
| **(e)** | **Net profit after tax on sales** | **3.3%** |
| 180 750 / 13 100 000 x 100/1 = **1.4%** | | |
| **(f)** | **Current ratio** | **1.9 : 1** |
| 3 140 000 : 970 000 = **3.2 : 1** | | |
| **(g)** | **Acid-test ratio** | **0.14 : 1** |
| [3 140 000 – 2 910 000] : 970 000<br>230 000 : 970 000 = **0.2 : 1** | | |
| **(h)** | **Rate of stock turnover** | **4.1** |
| 8 600 000 / ½[2 910 000 + 1 440 000] = **4 times** | | |
| **(i)** | **Stock holding period** | **88 days** |
| ½ [2 910 000 + 1 440 000] / 8 600 000 x 365/1<br>2 175 000 / 8 600 000 x 365/1 = **92.3 days** | | |
| **(j)** | **Debtors average collection period** | **27 days** |
| ½ [146 000 + 110 000] / 1 310 000 x 365/1<br>128 000 / 1 310 000 x 365/1 = **35.7 days** | | |
| **(k)** | **Creditors average payment period** | **29 days** |
| ½ [699 000 + 716 000] / 8 600 000 x 365/1<br>707 500 / 8 600 000 x 365/1 = **30 days** | | |
| **(l)** | **Solvency ratio** | **2.4 : 1** |
| [875 000 + 3 140 000] : [970 000 + 850 000]<br>4 015 000 : 1 820 000 = **2.2 : 1** | | |

| (m) | **Debt/equity ratio** | **0.3 : 1** |
|---|---|---|
| 850 000 : 2 195 000 = **0.4 : 1** | | |
| **(n)** | **Return on total capital employed** | **37%** |
| $\frac{320\,000 + 101\,250}{\frac{1}{2}(2\,195\,000 + 850\,000) + (1\,858\,250 + 500\,000)} \times \frac{100}{1}$<br>$\frac{421\,250}{2\,701\,625} \times \frac{100}{1}$ = **15.6%** | | |
| **(o)** | **Return on shareholders' equity** | **26%** |
| $\frac{180\,750}{\frac{1}{2}[2\,195\,000 + 1\,858\,250]} \times \frac{100}{1}$<br>$\frac{180\,750}{2\,026\,625} \times \frac{100}{1}$ = **8.9%** | | |
| **(p)** | **Earnings per share** | **21.2 cents** |
| $\frac{180\,750}{2\,500\,000}$ x 100c = **7.2 cents** | | |
| **(q)** | **Dividends per share** | **4 cents** |
| $\frac{75\,000}{2\,500\,000}$ x 100c = **3 cents** | | |
| **(r)** | **Net asset value per share** | **84.4 cents** |
| $\frac{2\,195\,000}{2\,500\,000}$ x 100c = **87.8 cents** | | |
| **4.30.2** | **Answer the following questions with regard to the 20.2 results (take the 20.1 results into account in your answers. You must quote the financial indicators which you have calculated in order to support your answers.** | |
| | **(a) Should the directors of this company be satisfied with the net profit and control over expenses? Explain.** | |
| No – net income on sales has decreased.<br>Operating expenses have also increased.<br>Mark-up percentage has decreased and this had no effect on the sales – sales have in fact decreased. | | |
| | **(b) Comment on the company's mark-up percentage.** | |
| The company is not achieving its intended mark-up of 66% - 13% below.<br>Probable causes are trade discounts, too many price reductions, other factors such as theft, incorrect calculations, etc.<br>If the main cause is the granting of trade discounts, this has not worked in its favour as sales have decreased. | | |
| | **(c) As a shareholder, would you be satisfied with the return, earnings and dividends of the company?** | |
| No.<br>Return on shareholders equity decreased drastically by 17%.<br>A comparison should be made with alternative investments.<br>The DPS and EPS have also decreased.<br>Of the 7 cents earnings the company retained 4 cents – had they not done this, the NAV would have been lower and this could adversely affect the market price of the shares. | | |
| | **(d) Comment on the financial leverage (gearing) of the company.** | |
| The company is lowly geared – less risk.<br>The interest rate on loans is probably higher than the return on capital employed (this return decreased by 21.4%).<br>Conditions are not favourable to make use of further loans. | | |

| | |
|---|---|
| | **(e) If you had the option of buying further shares in this company, what price would you be prepared to pay? Was a fair price charged for the shares that were issued on 1 April 20.2? Explain, quoting figures to support your answer.** |
| Probably a lot less than 77 cents as the shares in this company are not a worthwhile investment – the returns are not high enough.<br>The profitability of the company needs improvement.<br>It was not a fair price as it is below the NAV.<br>Reasons for issue price being below NAV must be investigated.<br>Popular shares will have prices higher than NAV. | |
| | **(f) Comment on the degree of solvency of the company.** |
| Although the ratio has decreased the company should not have a solvency problem, as total assets are more than twice that of total liabilities. | |
| | **(g) Comment on the liquidity of the company. Has the working capital been well controlled?** |
| Both the acid test and current ratios have improved but the acid test ratio is too low.<br>The company may not be in a position to meet its short-term obligations.<br>Stock level is high (R2 910 000) – more than twice as much as the previous year.<br>The rate of inventory turnover seems to be reasonable, they have sufficient stock for 92 days – should not run out of stocks.<br>The company is making use of overdraft facilities to a large extent – probably due to emergency measures in the past with regard to liquidity.<br>Note also that fixed/tangible assets have decreased significantly – it is likely that the company has been selling off its Fixed/Tangible assets to solve liquidity problems. | |

## TASK 4.31 ⌘ Kirkwood Ladies Dress Shop (Pty) Ltd: All financial indicators

| **4.31.1** | **Comment on the liquidity of the company. Recommend ways in which the liquidity of this company can be improved.** |
|---|---|
| The current ratio is too high – four times higher than current liabilities.<br>Too much of stock is on hand – this is not generating any income for the company.<br>They can have sales, lower mark-up, offer incentives to increase sales, etc. The period of credit allowed to debtors is too long.<br>Regular statements/reminders should be sent to them, credit limits should be set, careful screening of prospective debtors is necessary.<br>The company needs to negotiate for extended credit terms – the company is paying creditors within 30 days while debtors are taking 90 days to pay the company. | |
| **4.31.2** | **As a shareholder of the company, would you be satisfied with the return, earnings and dividends over the past two years? Explain.** |
| The return on shareholders equity has dropped but is still fair compared to alternative investments.<br>Earnings per share have decreased by 4 cents but the dividends were increased by 2 cents.<br>In 20.7 the company paid out 16% ($^{5}/_{31}$ x $^{100}/_{1}$) of its earnings and retained 84%.<br>In 20.8, a higher 26% ($^{7}/_{27}$ x $^{100}/_{1}$) of earnings were paid to shareholders and 74% was retained in the business. | |
| **4.31.3** | **On which areas in the Income Statement should the directors concentrate in order to improve profitability? Explain.** |
| Mark-up percentage; operating expenses. | |

| 4.31.4 | **The directors are considering the expansion of the operations of the business. In order to do this, they are considering taking out a large long-term loan at an interest rate of 16% or issuing more ordinary shares. Which of these two methods of financing do you advise for this company? Explain.** |
|---|---|
| Return on capital employed is 28% while the interest on loan is 16%.<br>The company is positively geared.<br>Loans should be beneficial in gearing up returns to shareholders. | |
| **4.31.5** | **In your opinion, should the shareholders be satisfied with the market price of their shares in this company? Explain.** |
| The market price has increased by 5 cents but is still lower than the net asset value per share.<br>Directors should not be satisfied – investigate reasons. | |
| **4.31.6** | **The company is considering a change in their inventory system from the perpetual method to the periodic method. Do you feel this is a good idea? Give reasons for your answer, including reference to internal control.** |
| No – less control.<br>Although the periodic system is cheaper, one cannot timeously identify a deficit in order to take corrective action. | |

## TASK 4.32 Hyde Park Ltd: Cash flow & all financial indicators

**4.32.1 HYDE PARK LIMITED**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.2**

| | Note | |
|---|---|---|
| **Cash flows from operating activities** | | 80 000 |
| Cash generation from operations | 1 | 541 200 |
| Interest paid | | (234 000) |
| Dividends paid | 3 | (100 000) |
| Tax paid | 4 | (127 200) |
| **Cash flows from investing activities** | | (999 500) |
| Purchase of non-current assets[1] [337 500 + 660 000] | | (997 500) |
| Proceeds of sale of non-current assets | | 148 000 |
| Financial assets – increase in investments | | (150 000) |
| **Cash flows from financing activities** | | 940 000 |
| Proceeds from the issue of share capital | | 640 000 |
| Proceeds from long-term borrowings | | 300 000 |
| **Net change in cash equivalents** | 2 | 20 500 |
| Cash and cash equivalents – beginning of year | 2 | 582 250 |
| Cash and cash equivalents – end of year | 2 | **602 750** |

**[1]Calculation of Fixed/Tangible assets purchased**

| | |
|---|---|
| Carrying value at beginning of year | 1 970 000 |
| Premises purchased during the year (additions) | 337 500 |
| Vehicle purchased during the year (additions) | **660 000** |
| Proceeds from sale of vehicle [300 000 – 152 000] | [148 000] |
| Depreciation | [338 000] |
| Carrying value at end of year | 2 481 500 |

**NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.2**

| | |
|---|---|
| **1. Reconciliation between profit before taxation and cash generated from operations** | |
| Profit before tax | 424 200 |
| Adjustments in respect of: | |
| Depreciation | 338 000 |
| Interest expense | 234 000 |
| Operating profit before changes in working capital | 996 200 |
| Changes in working capital: | (455 000) |
| Increase in inventory | (190 000) |
| Increase in debtors | (340 000) |
| Increase in creditors | 75 000 |
| Cash generated from operations | **541 200** |

| **2. Cash and cash equivalents** | **Net change** | **20.2** | **20.1** |
|---|---|---|---|
| Savings account | 60 000 | 200 000 | 140 000 |
| Bank | [44 500] | 392 750 | 437 250 |
| Cash float | 5 000 | 10 000 | 5 000 |
| | **20 500** | **602 750** | **582 250** |

| | |
|---|---|
| **3. Dividends paid** | |
| Amount owing at the end of the previous year | 30 000 |
| Dividends paid and recommended | 80 000 |
| Amount owing at the end of the current year | (10 000) |
| Amount paid | **100 000** |
| **4. Taxation paid** | |
| Amount owing at the end of the previous year | (39 480) |
| Income Statement amount | 181 680 |
| Amount owing at the end of the current year | (15 000) |
| Amount paid | **127 200** |

| **4.32.2** | **Refer to the Cash Flow Statement:** |
|---|---|
| | • **What is the purpose of a Cash Flow Statement?** |
| To provide information of all financial resources during the period, in particular details of cash generated or utilised by operations, investing activities and financing activities. | |
| | • **Was Hyde Park Ltd a net user or net generator of cash during the year under review?** |
| Generator.<br>Cash flow from operations is positive. | |
| | • **Does the company have a good quality cash flow? Explain.** |
| Various answers possible, e.g.: Yes / No – the company generated R80 000 from operations but this is a very low figure for a company of this size. | |
| | • **What were the two main sources of their funds this year?** |
| Long-term borrowings (loans).<br>The issue of shares. | |
| | • **What were the two main applications of funds this year?** |
| Purchase of fixed/tangible assets.<br>Increase in working capital.<br>Increase in financial assets (investments). | |

| 4.32.4 | **The audit fees increased by 30% over the past year. What questions would you ask at the AGM in this regard?** |
|---|---|
| Learners must give their opinions and mention the questions. | |
| **4.32.5** | **The directors' fees increased by 50% over the past year. What questions would you ask at the AGM in this regard?** |
| Learners must give their opinions and mention the questions. | |
| **4.32.6** | **Calculate the price at which the new shares were issued on 1 July 20.1.** |
| 640 000 x 100c = **320 cents**<br>200 000 | |
| **4.32.7** | **Calculate the net asset value per share on 30 June 20.2.** |
| 2 832 000 x 100c = **354 cents**<br>800 000 | |
| **4.32.8** | **Hyde Park Ltd is lowly geared. Discuss briefly, quoting a ratio. What other information would you need before deciding to increase the gearing of the company?** |
| Debt/equity ratio = 1 200 000 : 2 832 000 = **0.42 : 1**<br>The company is funded more by own capital (equity) than borrowed capital.<br>Other information required: Return on capital employed, Interest rate on loans. | |

## TASK 4.33 Kobo Ltd: Cash flow, all financial indicators & share buy-back

**4.33.1 KOBO LIMITED**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 OCTOBER 20.6**

| | Note | |
|---|---|---|
| **Cash flows from operating activities** | | (252 800) |
| Cash generation from operations | 1 | 611 500 |
| Interest paid | | (396 000) |
| Dividends paid | 3 | (64 500) |
| Tax paid | 4 | (403 800) |
| **Cash flows from investing activities** | | (810 200) |
| Purchase of non-current assets (2 828 200 –1 998 000) | | (830 200) |
| Proceeds of sale of non-current assets[1] | | 70 000 |
| Investment in fixed deposit | | (50 000) |
| **Cash flows from financing activities** | | 1 700 000 |
| Proceeds from the issue of share capital (750 000 + 150 000) | | 900 000 |
| Proceeds from long-term borrowings | | 800 000 |
| **Net change in cash equivalents** | 2 | 637 000 |
| Cash and cash equivalents – beginning of year | 2 | 46 000 |
| Cash and cash equivalents – end of year | 2 | **683 000** |

**[1]Calculation of vehicles sold**

| | |
|---|---|
| Carrying value at beginning of year | 1 126 000 |
| Additions at cost | 0 |
| Proceeds from sale of vehicle | **(70 000)** |
| Depreciation | (255 000) |
| Carrying value at end of year | 801 000 |

**NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 31 OCTOBER 20.6**

| | |
|---|---|
| **1. Reconciliation between profit before taxation and cash generated from operations** | |
| Profit before tax | 636 000 |
| Adjustment in respect of: | |
| Depreciation (198 000 + 255 000) | 453 000 |
| Interest expense | 396 000 |
| Operating profit before changes in working capital | 1 485 000 |
| Changes in working capital: | [873 500] |
| Decrease in inventory | 18 000 |
| Increase in debtors | [822 000] |
| Decrease in creditors | [69 500] |
| Cash generated from operations | **611 500** |

| **2. Cash and cash equivalents** | **Net change** | **20.6** | **20.5** |
|---|---|---|---|
| Bank | 629 000 | 668 000 | 39 000 |
| Cash float | 5 000 | 10 000 | 5 000 |
| Petty cash | 3 000 | 5 000 | 2 000 |
| | **637 000** | **683 000** | **46 000** |

| | |
|---|---|
| **3. Dividends paid** | |
| Amount owing at the end of the previous year | 22 500 |
| Dividends paid and recommended | 56 000 |
| Amount owing at the end of the current year | (14 000) |
| Amount paid | **64 500** |
| | |
| **4. Taxation paid** | |
| Amount owing at the end of the previous year | 95 000 |
| Income Statement amount | 262 800 |
| Amount owing at the end of the current year | 46 000 |
| Amount paid | **403 800** |

| **4.33.2** | **Calculate the following financial indicators for 20.6.** |
|---|---|
| **(a)** | **Current ratio** |
| 2575 000 : 637 000 = **4 : 1** | |
| **(b)** | **Acid-test ratio** |
| [2 575 000 – 254 000] : 637 000<br>2 321 000 : 637 000 = **3.6 : 1** | |
| **(c)** | **Debt/equity ratio** |
| 1 800 000 : 2 869 200 = **0.6 : 1** | |
| **(d)** | **Return on shareholders' equity** |
| $\frac{373\ 200}{\frac{1}{2}[2\ 869\ 200 + 1\ 652\ 000]} \times \frac{100}{1}$<br>$\frac{373\ 200}{2\ 260\ 600} \times \frac{100}{1}$ = **16.5%** | |
| **(e)** | **Dividends per share** |
| $\frac{56\ 000}{700\ 000} \times 100c$ = **8 cents** | |

| (f) | **Earnings per share** |
|---|---|
| $\frac{373\,200}{700\,000} \times 100c = \mathbf{\underline{53.3\ cents}}$ | |

| (g) | **Return on total capital employed** |
|---|---|
| $\frac{636\,000 + 396\,000}{\frac{1}{2}(2\,869\,200 + 1\,800\,000) + (1\,652\,000 + 1\,000\,000)} \times \frac{100}{1}$ | |
| $\frac{1\,032\,000}{3\,660\,600} \times \frac{100}{1} = \mathbf{\underline{28.2\%}}$ | |

| (h) | **Solvency ratio** |
|---|---|
| 5 306 200 : 2437 000 = **2.2 : 1** | |

| (i) | **Net asset value per share** |
|---|---|
| $\frac{2\,869\,200}{700\,000} \times 100c = \mathbf{\underline{409.9\ cents}}$ | |

| (j) | **Period for which enough stock is on hand** |
|---|---|
| $\frac{\frac{1}{2}[254\,000 + 272\,000]}{5\,380\,000} \times \frac{365}{1}$ | |
| $\frac{263\,000}{5\,380\,000} \times \frac{365}{1} = \mathbf{\underline{17.8\ days}}$ | |

| (k) | **Debtors average collection period** |
|---|---|
| $\frac{\frac{1}{2}[1\,592\,000 + 770\,000]}{8\,070\,000} \times \frac{365}{1}$ | |
| $\frac{1\,181\,000}{8\,070\,000} \times \frac{365}{1} = \mathbf{\underline{53.4\ days}}$ | |

| (l) | **Creditors average payment period** |
|---|---|
| $\frac{\frac{1}{2}[572\,000 + 649\,500]}{5\,380\,000} \times \frac{365}{1}$ | |
| $\frac{610\,750}{5\,380\,000} \times \frac{365}{1} = \mathbf{\underline{41.4\ days}}$ | |

| (m) | **Net profit after tax on sales** |
|---|---|
| $\frac{373\,200}{8\,070\,000} \times \frac{100}{1} = \mathbf{\underline{4.6\%}}$ | |

| (n) | **Operating profit on sales** |
|---|---|
| $\frac{1\,032\,000}{8\,070\,000} \times \frac{100}{1} = \mathbf{\underline{12.79\%}}$ | |

| (o) | **Operating expenses on sales** |
|---|---|
| $\frac{1\,700\,300}{8\,070\,000} \times \frac{100}{1} = \mathbf{\underline{21.1\%}}$ | |

| 4.33.3 | **Refer to the information in the financial statements or your calculations above in order to answer the following questions. Quote specific figures or financial indicators to support your answer.** |
|---|---|
| | **(a) Net working capital has increased significantly from over the past year. Comment on whether or not this is satisfactory. What advice would you offer Kobo Ltd?** |

Unsatisfactory – liquidity ratios are too high, the problem lies with debtors and cash.
Debtors need to pay sooner – 53.4 days is too long.
Careful screening of debtors is essential, regular statements, charging interest on overdue accounts, legal action, etc.
The excess cash should be invested to earn income.

| | |
|---|---|
| | **(b) Do you feel that Kobo Ltd is likely to experience solvency problems in the near future? Explain.** |
| No – total assets are high enough to cover total liabilities. | |
| | **(c) As a shareholder of the company, would you be satisfied with the return, earnings and dividends over the past two years? Explain.** |
| No, equity has increased and profits have dropped.<br>Previous years' figures: ROSHE 23%; DPS – 11 cents; EPS – 84.6 cents.<br>No, all have decreased.<br>The shareholder is only getting 2.7% ($^{8}/_{300}$ x $^{100}/_{1}$).<br>The company is retaining a substantial portion of its earnings – 85% (53.3 – 8 = 45.3 cents; $^{45.3}/_{53.3}$ x $^{100}/_{1}$ = 85%).<br>This has had a positive effect on the net asset value per share which has increased from the last year's figure of 367 cents.<br>Note also that the company issued more shares during the year (R90 000) and a further loan of R80 000 was taken. | |
| | **(d) In your opinion, was it advisable for Kobo Ltd to raise the additional loan this year? Explain.** |
| Yes.<br>The return on capital employed is most probably higher than the interest rate on loan.<br>The company is therefore positively geared.<br>However, funds are not being utilised efficiently, e.g. debtors have increased – usage of the funds must be addressed. | |
| | **(e) The total number of directors has not changed since the company started. At the AGM, would you raise a query in connection with the directors' fees? Explain.** |
| Yes, directors' fees have increased by 37% ($^{350\,000}/_{950\,000}$ x $^{100}/_{1}$). | |
| | **(f) Explain the difference between the issue price of a share and the net asset value of a share.** |
| The issue price is the price at which a share is sold to a prospective shareholder.<br>This depends on the price that the company is prepared to accept for the share and the price that the shareholder is prepared to pay based on his circumstances.<br>The net asset value is the value of shares according to the books of the company, as reflected in the Balance Sheet, thus it is a guideline as to what the market price of a share should be (note that book values are often based on Historical cost and Prudence, so the NAV could be very conservative compared to issue price). | |
| | **(g) The readers of financial statements do not need to be informed of all the figures in the detailed financial statements. Do you agree with this statement? Explain.** |
| Yes.<br>The main readers are the existing shareholders and the future shareholders.<br>They are mainly interested in the bottom line (net profit, EPS, DPS and effect on share price.<br>They do not need to be encumbered with too much information.<br>They just need to be in a position to assess if the directors are doing a good job or not.<br>Confidential information need not be shown, e.g. cost of sales; concept of materiality; easy to understand. | |

| | | |
|---|---|---|
| | **(h)** | **The directors are considering an offer to repurchase 120 000 ordinary shares at the current JSE price of R4.00 per share from the estate of a shareholder who had died. How would this affect the net asset value of the remaining shares? Explain whether the directors should accept the offer or not, providing evidence from the question to support your answer. Also explain what other factors the directors might consider before making this decision.** |

Yes, the directors should accept the offer.
After the repurchase, the NAV would improve slightly.
Workings:
Average share issue price = R2 270 000 ÷ 700 000 shares = R3.24 per share
The retained income portion of the buy-back price is R4.00 – R3.24 = R0.76
OSC would = R2 270 000 – (120 000 x R3.24) = R1 881 200
RI would = R599 200 – (120 000 x R0.76) = R508 000
OSHE would = R1 881 200 + R508 000 = R2 389 200 ÷ 580 000 shares = 411.9 cents
The NAV will increase slightly from 409.9c to 411.9c so this should not negatively affect the price of the company's shares on the JSE.
Also, the liquidity ratios are extremely high and inefficient (current ratio 4 : 1 and acid-test ratio 3.6 : 1) so they can easily afford to pay R480 000 to repurchase the shares.
Also, if total profit and dividends remain the same next year, the remaining shareholders will benefit as profits and dividends would be divided over a smaller number of shares (580 000 shares instead of 700 000 shares).
EPS would rise from 53.3 cents to 64.3 cents, dividends would rise from 8 cents to 9.7 cents.
Although these returns have been moderate, with the reduced number of shareholders the company will be more efficient in utilising its funds.

## TASK 4.34 News Stand Ltd: Cash flow & financial indicators

**4.34.1**

| | | |
|---|---|---|
| • | **ORDINARY SHARE CAPITAL** | |
| | ***Authorised*** | |
| | 1 500 000 ordinary shares | |
| | ***Issued*** | |
| | 1 000 000 shares in issue at beginning of year | 2 000 000 |
| | 200 000 shares issued on 30 June 20.1 | 520 000 |
| | 280 000 shares repurchased on 31 December 20.1 [280 000 x R2.10] | (588 000) |
| | 920 000 shares in issue on 31 March 20.2 | **1 932 000** |
| • | **RETAINED INCOME** | |
| | Balance at beginning of year | 1 156 000 |
| | Net profit after tax | 861 000 |
| | Repurchase of 280 000 shares [280 000 x R0.95] | (266 000) |
| | Dividends | (337 200) |
| | Interim [1 200 000 x 12 cents] | 144 000 |
| | Final [920 000 x 21 cents] | 193 200 |
| | Balance at end of year | **1 413 800** |

### 4.34.2 CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 20.2

| | Note | |
|---|---|---|
| **Cash flows from operating activities** | | 1 191 900 |
| Cash generation from operations | 1 | 2 172 600 |
| Interest paid | | (135 000) |
| Dividends paid | 3 | (264 000) |
| Tax paid | 4 | (581 700) |
| **Cash flows from investing activities** | | (2 038 900) |
| Purchase of fixed assets | | (2 216 400) |
| Proceeds of sale of non-current assets | | 200 000 |
| Increase in investments | | (22 500) |
| **Cash flows from financing activities** | | 866 000 |
| Proceeds from the issue of share capital | | 520 000 |
| Repurchase of shares [588 000 + 266 000] OR [280 000 x R3.05] | | (854 000) |
| Proceeds from long-term borrowings | | 1 200 000 |
| **Net change in cash equivalents** | 2 | 19 000 |
| Cash and cash equivalents – beginning of year | 2 | 51 000 |
| Cash and cash equivalents – end of year | 2 | **70 000** |

### NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 20.2

| **1. Reconciliation between profit before taxation and cash generated from operations** | |
|---|---|
| Profit before tax | 1 230 000 |
| Adjustments in respect of: | |
| Loss on disposal of asset | 25 000 |
| Depreciation[1] | 675 000 |
| Interest expense [300 000 x 15% x $^{6}/_{12}$] + [1500 000 x 15% x $^{6}/_{12}$] | 135 000 |
| Operating profit before changes in working capital | 2 065 000 |
| Changes in working capital: | 107 600 |
| Decrease in inventory | 140 800 |
| Increase in debtors [(432 000 – 49 000) – 294 000] | (89 000) |
| Increase in creditors [889 000 – 193 200] – [923 700 – 163 700 – 120 000] | 55 800 |
| Cash generated from operations | **2 172 600** |

**[1]Calculation of depreciation amount**

| | |
|---|---|
| Carrying value at beginning of year | 2 300 000 |
| Depreciation | (675 000) |
| Proceeds from sale of fixed/tangible assets [20 000 + 2 500*] | (225 000) |
| Fixed assets purchased during the year | 2 216 400 |
| Carrying value at end of year | **3 616 400** |

*Profit on disposal of asset: 500 000 – [275 000 + 200 000]

| **2. Cash and cash equivalents** | **Net change** | **20.2** | **20.1** |
|---|---|---|---|
| Bank | **19 000** | **70 000** | **51 000** |

| | |
|---|---|
| **3. Dividends paid** | |
| Amount owing at the end of the previous year | 120 000 |
| Dividends paid and recommended | 337 200 |
| Amount owing at the end of the current year | (193 200) |
| Amount paid | **264 000** |
| | |
| **4. Taxation paid** | |
| Amount owing at the end of the previous year | 163 700 |
| Income Statement amount | 369 000 |
| Amount owing at the end of the current year | 49 000 |
| Amount paid | **581 700** |

**4.34.3 What is the purpose of a Cash Flow Statement?**

To provide information of all financial resources during the period, in particular details of cash generated or utilised by operations, investing activities and financing activities.

**4.34.4 Explain four major decisions taken by the directors, as evidenced by the Cash Flow Statement. Quote figures to support your answer and explain how these decisions should benefit the business in future.**

Bought fixed assets R2 216 400 – these could generate profits in future if they are well utilised and maintained.
Raised a large loan R1 200 000 – the gearing effect can benefit the company.
Repurchased shares R854 000 – this could increase the NAV, EPS & DPS because the number of shares is now lower.
Issued new shares R520 000 – this raised extra capital when the company might have needed it – not necessary to go into overdraft.

**4.34.5 Explain why the directors might want to be provided with a detailed set of financial statements, yet the shareholders might want a shortened (abridged) form of financial statements.**

The detailed financial statements show all assets, liabilities, income and expenditure – the directors are responsible for controlling all of these, therefore the need the information.
The shortened (abridged) form is simpler and easier to understand – shareholders want to know the final bottom line (net profit after tax) and the relevant important figures in the Balance Sheet to get an idea of liquidity, solvency, profitability, risk, etc.
They do not need to know every item to arrive at these conclusions.

**4.34.6 Refer to the table of financial indicators above. Calculate the missing indicators for 20.2.**

| | **20.2** | **20.1** |
|---|---|---|
| % Return on equity | **26.5%** | 16.3% |
| Earnings per share | **79.7 cents** | 56 cents |
| Dividends per share | 33 cents | 25 cents |
| % Return on total capital employed (before tax) | **32.9%** | 21.2% |
| Net asset value per share | **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 |

**Note to Teacher**:
You may wish to extend your capable learners by looking at the EPS calculation for 20.2 as well. Because the shares are issued and repurchased during the course of the year it is most appropriate to use the weighted average number of shares in this calculation.

**Workings for weighted number of shares:**

| | |
|---|---|
| 1 000 000 shares for 3 months | 3 000 000 |
| 1 200 000 shares for 6 months | 7 200 000 |
| 920 000 shares for 3 months | 2 760 000 |
| Total | **12 960 000** |
| Divided by | ÷12 |
| Weighted average number | 1 080 000 shares |

EPS = 861 000 ÷ 1080 000 shares = **79.7 cents**

| | |
|---|---|
| **4.34.7** | **Explain how the financial gearing and risk of the company has changed from 20.1 to 20.2. Was it wise for the directors to take this decision? Explain, quoting two financial indicators in your answer.** |

The company was in a very low risk situation in 20.1 with a debt/equity ratio of 0.1 : 1.
The interest rate on the loans of 15% was lower than the ROTCE of 21.2% which means it is advantageous to make use of loans.
This they did in 20.2.
The debt/equity ratio is now 0.5 : 1 and the ROTCE has improved to 32.9% which means the increased gearing has benefited the company.

| | |
|---|---|
| **4.34.8** | **Should the directors and shareholders be satisfied with the % return earned by the company? Explain, quoting figures to support your answer.** |

Yes.
The return improved from 16.3% to 26.5% which is a significant increase.
This exceeds the returns on most other safe investments.

| | |
|---|---|
| **4.34.9** | **Comment on the liquidity of the company. Make four suggestions how the company can improve its short-term cash position.** |

Both the current ratio and the acid-test ratio are relatively low, although they have been similar for the past two years which indicates that the company can exist with these low rations (Current ratio now 1.6 : 1 and acid-test ratio now 0.6 : 1).
To improve their short-term cash situation, the company could seek to convert their financial assets into cash when they mature (if they are fixed deposits), or they could sell them (if they consist of shares in other companies).
They could also increase their loans slightly as a debt/equity ratio of 0.5 : 1 is still regarded as quite safe.

| | |
|---|---|
| **4.34.10** | **Compare the EPS and DPS for both years. What does this comparison indicate? Quote figures to support your opinion.** |

The company is retaining most of its income.
Out of EPS of 79.7 cents the company pays out dividends of 33 cents (in the previous year they paid out 25 cents out of 56 cents).
The dividend pay out rate is about 40%.
Retaining funds helps the company to grow and make more profits in future.

| | |
|---|---|
| **4.34.11** | **The price of the share on the JSE on 31 March 20.2 is 280 cents. As a shareholder, what concerns would you raise at the AGM? How do you think the directors will respond to your concerns? Explain.** |

The JSE price of 280 cents is much lower than the NAV of 364.7 cents.
I would query why the public is not prepared to offer more for the shares.
There might be negative perceptions about the company or its products.
These must be rectified to restore the share price to its rightful value.

| 4.34.12 | **At the AGM the directors announce that they might want to issue all the unissued authorised shares as soon as possible. What questions will you raise at the AGM about this idea? Explain.** |
|---|---|

Why do they need the extra capital if they have recently bought back 280 000 shares?
What will they use the funds for?
Will this lead to bigger profits in future?
Will the EPS and DPS improve even though the number of shares will increase significantly?
As positive gearing still exists, why not raise more loans instead of issuing more shares?

| 4.34.13 | **On 31 March 20.2 Ben Shezi currently own 65% of the shares in issue on 31 March 20.2. How many shares would he have to buy to retain control of the company? As a minority shareholder, would you object to this? Explain.** |
|---|---|

He currently owns 65% of 920 000 shares = 598 000 shares
50% of 1 200 000 shares = 600 000 shares.
He needs to buy 12 001 of the new shares.
I would object if a fair process is not applied in the issuing of the shares and if the buyers of the shares are not paying a fair price.
I would object if the shares are offered at the JSE price of 280 cents as this will continue to depress the price of the shares, which will disadvantage all the shareholders.

| 4.34.14 | **One of the directors feels it will be a good idea to give 2 000 shares to each of the 50 employees instead of selling them to the public. What reasons would he have to suggest this? Explain.** |
|---|---|

It might be a good plan to do this. The employees will then become shareholders.
If the current price is R2.80 per share it will mean that each employee will benefit by R2 800.
This might be cheaper than paying bonuses.
Also the employees might work harder if they know they are part owners and the harder they work, the more profits will be made which will increase the value of their shares.
However, there should be restrictions on the employees – they must not be allowed to sell their shares in the next few years as this will defeat the major object of giving the shares to them.

| 4.34.15 | **Explain why it is important for this company to be audited.** |
|---|---|

This is a public company.
It is important to know that the figures in the financial statements are reliable.
The shareholders would want to see an unqualified audit report.

| 4.34.16 | **This company has provided sponsorship of certain welfare organisations and disadvantaged schools. Explain why and how the directors should highlight this when they prepare the financial statements.** |
|---|---|

This will create a good impression of the company amongst the general public.
Relates to expenditure by the company in the community and the environment.
It is essential that companies also put back into the economy, for the benefit of all, and do not just take in the form of profits.
The employees might also appreciate this if they are involved in the local community.
The goodwill create will lead to future benefits for the company, e.g. more customers.

## TASK 4.35 EFG Supplies (Pty) Ltd: Preparing financial statements using indicators

**EFG SUPPLIES (PTY) LTD**
**INCOME STATEMENT FOR THE YEAR ENDED 30 JUNE 20.4**

| | |
|---|---|
| Sales | **357 000** |
| Cost of sales | **(204 000)** |
| Gross profit | **153 000** |
| Operating expenses | **(87 000)** |
| Operating profit | **66 000** |
| Income from investments | 4 000 |
| Profit before interest expense | **70 000** |
| Interest expense | 13 000 |
| Net profit before tax | **57 000** |
| Income tax | **(22 800)** |
| Net profit after tax | **34 200** |

**EFG SUPPLIES (PTY) LTD**
**BALANCE SHEET ON 30 JUNE 20.4**

| | |
|---|---|
| **ASSETS** | |
| Non-current assets | **402 000** |
| Fixed assets | **352 000** |
| Financial assets | **50 000** |
| Current assets | **136 000** |
| Inventories | 51 000 |
| Trade & other receivables | **82 000** |
| Cash and cash equivalents | 3 000 |
| **TOTAL ASSETS** | **538 000** |
| **SHAREHOLDERS' EQUITY & LIABILITIES** | |
| Shareholders' equity | **420 000** |
| Ordinary share capital | **320 000** |
| Retained income | 100 000 |
| Non-current liabilities | **84 000** |
| Loan | **84 000** |
| Current liabilities | **34 000** |
| Trade and other payables | **34 000** |
| **TOTAL EQUITY AND LIABILITIES** | **538 000** |

**NOTE TO THE FINANCIAL STATEMENTS: RETAINED INCOME**

| | |
|---|---|
| Retained income at beginning of year | **80 800** |
| Net profit after tax | **34 200** |
| Dividends on ordinary shares | **(15 000)** |
| Paid | 5 000 |
| Declared | **10 000** |
| Retained income at end of year | **100 000** |

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Understanding of the users of financial statements and their information needs. | | | |
| Ability to calculate commonly used financial indicators. | | | |
| Ability to compare financial indicators for two consecutive years to identify trends. | | | |
| Ability to compare financial indicators of different companies to evaluate differences in financial performance. | | | |
| Understanding of the financial indicators which give an indication of profitability and operating efficiency. | | | |
| Understanding of the financial indicators which give an indication of returns to shareholders. | | | |
| Understanding of the financial indicators which give an indication of gearing and risk. | | | |
| Understanding of the financial indicators which give an indication of liquidity and solvency. | | | |
| Understanding of the role of the Cash Flow Statement in analysing the performance of a company. | | | |

# MODULE 5
# AUDIT REPORTS & PUBLISHED ANNUAL REPORTS OF COMPANIES

## TASK 5.1 ⌘ Basic knowledge of published financial statements

| | |
|---|---|
| **5.1.1** | An Income Statement is also known as a **Statement of Comprehensive Income.** |
| **5.1.2** | A Balance Sheet is also known as a **Statement of Financial Position.** |
| **5.1.3** | Financial statements of public companies must be prepared in accordance with IFRS. The letters IFRS stand for **International Financial Reporting Standards.** |
| **5.1.4** | The report which expresses an opinion on the fair presentation of the financial statements is the **Audit** Report. |
| **5.1.5** | The report issued by the board which explains important matters relating to the company is the **Directors'** Report. |
| **5.1.6** | The preparation of the published financial statements of a company are the responsibility of the **directors.** |
| **5.1.7** | If the independent auditor is satisfied with the financial statements, he/she will issue a/an **unqualified** audit report. |
| **5.1.8** | If the independent auditor is not satisfied with a certain aspect of the financial statements, he/she will issue a/an **qualified** audit report. |
| **5.1.9** | If the independent auditor is unhappy with the financial statements and does not wish to express an opinion, he will issue a **disclaimer** audit report. |
| **5.1.10** | The board committee which will make decisions about directors' fees is the **Remunerations** committee. |
| **5.1.11** | The board committee which will assess internal controls and make recommendations on the auditor to be appointed is the **Audit** committee. |
| **5.1.12** | The meeting to which the shareholders will be invited by the directors to consider the financial statements and elect directors is the **Annual General** meeting. |
| **5.1.13** | If a shareholder cannot attend this meeting he may appoint a **proxy** to vote on his behalf. |

## TASK 5.2 ⌘ Audit reports and published financial statements

| | |
|---|---|
| **5.2.1** | **What is the difference in the role of an internal auditor and an independent external auditor?** |
| The internal auditor is an employee of the company whose job it is to monitor internal controls and conduct on-going checks to ensure that the risks of loss or theft are minimised.<br>The independent auditor is appointed by the shareholders at an AGM, he/she is not an employee of the company, he/she must maintain independence from the directors and other employees, and must express an opinion on the financial statements after conducting an audit. | |
| **5.2.2** | **Why do you think that the Companies Act stipulates certain restrictive conditions for independent auditors, e.g. that the company's financial statements must be audited by an independent auditor, that the independent auditor must not be an employee of the company, and that he/she may not operate as the auditor of a company for more than five years?** |
| It is vitally important that the independent auditor must be totally independent.<br>He /she cannot be influenced by others, especially the directors who are responsible for preparing and approving the financial statements.<br>The restrictive conditions are intended to ensure that the independent auditor does not get too close to the company or its employees, and must maintain independence at all times. | |

| 5.2.3 | **Why must the independent auditor have a Chartered Accountant qualification?** |
|---|---|
| The independent auditor must be well qualified as many investors rely on his/her audit opinion.<br>Also, only accountants with a CA (SA) qualification fall under the Independent Regulatory Board for Auditors (IRBA) which entitles them to audit public companies. | |

| 5.2.4 | **What studies are necessary to become qualified as a Chartered Accountant, i.e. to have a CA (SA) qualification?** |
|---|---|
| A good Matric pass; a B.Com or B.Acc degree; a post-graduate diploma (e.g. Diploma of Accounting or Certificate in the Theory of Accounting); must also pass the SAICA Board examination. | |

| 5.2.5 | **External independent auditors can command high fees for their specialised work. What should the consequences be for the auditor if he is proved to be negligent in carrying out his responsibilities?** |
|---|---|
| Complaints against them may lead to disciplinary hearings under IRBA and/or SAICA; they can be struck off the membership roll of SAICA; they can be prevented from auditing companies in future; they can face criminal charges; civil charges may be brought against them by investors who have lost money as a result of relying on an erroneous audit opinion. | |

| 5.2.6 | **Explain why it is important for published financial statements to reflect figures for two consecutive years.** |
|---|---|
| Figures for two consecutive years allow readers to assess trends, i.e. whether the company is improving or not. | |

| 5.2.7 | **Explain why published financial statements do not reflect all the items contained in detailed financial statements and why they often contain figures rounded off to the nearest R1 000.** |
|---|---|
| The concept of Materiality applies.<br>Readers of financial statements are interested in the figures relevant to their decisions.<br>They do not need to be confused with numerous figures irrelevant to their decisions.<br>Also specific rands and cents will be irrelevant to the readers of the financial statements of big companies.<br>Rounding off to the nearest R1 000 will not affect their decisions, and will in fact make it easier for them to analyse the financial statements. | |

| 5.2.8 | **Explain why directors will add extra information into the annual report booklet about the company's contributions to social, community and environmental issues.** |
|---|---|
| The extra matters are included because they are in line with the recommendations of the King Code about integrated reporting and the 'triple bottom line'.<br>Companies will not be sustainable if they do not care about the community, the people who work for them, and the environment.<br>Good work in these areas will create goodwill for the company which could also improve demand for its shares, and hence could improve the share price on the JSE. | |

## TASK 5.3 ⌘ Details in independent auditor's reports

| 5.3.1 | **Explain why the independent auditor must stipulate page numbers in the audit report.** |
|---|---|
| The readers must be certain what parts of the annual report have been audited.<br>They must know that, whilst the other unaudited parts might be interesting, they cannot rely on those parts to make important financial decisions about investment in the shares of the company. | |

| 5.3.2 | **Explain why the independent auditor must stipulate the directors' responsibilities in the audit report.** |
|---|---|
| The directors are actually responsible for preparing the financial statements.<br>If readers are unhappy with any misstatement in the financial statements, the auditor will not be held responsible unless he has been negligent in his duties in conducting the audit. | |

| 5.3.3 | **Explain why the independent auditor must explain the auditor's duties in the audit report.** |
|---|---|

The readers must understand that auditors do not check every single transaction.
They do their checks on a random test basis, hence they do not attest to the financial statements being absolutely correct.
They express an opinion on 'fair presentation' only, i.e. that the financial statements are not biased to any one group of stakeholders.
As the directors prepare the financial statements, there is always the likelihood that they might be tempted to prepare financial statements that cast them in a good light.

| 5.3.4 | **Explain why the independent auditor must mention IFRS and the Companies Act in the audit report.** |
|---|---|

Public companies need to comply with IFRS as many investors move their investments around from one country to another.
The financial statements must be comparable to those prepared by companies in other countries.
Also, the directors and the auditor have to comply with the law, and the Companies Act is the most important law which controls companies in SA.

| 5.3.5 | **Explain the difference between a qualified and unqualified independent auditor's report.** |
|---|---|

An unqualified report is one in which the independent auditor does not add in any comment about any aspect that concerns him/her about the reliability of the financial statements.
A qualified audit report contains an explanation as to why a specific matter causes concern to the independent auditor and this will be mentioned in his/her opinion so that readers are fore-warned about the problem.

| 5.3.6 | **Explain what is meant by a disclaimer issued by an independent auditor.** |
|---|---|

In a disclaimer, the independent auditor will refuse to issue an opinion on the financial statements because there are too many significant items which make the figures possibly unreliable.
The independent auditor will also state the reasons why he/she does not want to issue an opinion.

## TASK 5.4 The SPAR Group Limited: Published financial statements

**This Task may be used as a class activity or as a project on Published Financial Statements.**

Before undertaking this Task, learners should know where to find certain important information. Depending on the confidence of their learners on this topic, Teachers may decide to identify these figures with their classes or use this pre-project activity as a formative class test, with one mark allocated to each figure or fact.

| **Refer to the Statement of Comprehensive Income (Income Statement)** | |
|---|---|
| Net Profit earned for 2012: **R1 058 900 000** (i.e. more than R1 billion) | |
| **Refer to the Statement of Financial Position (Balance Sheet)** | |
| Fixed assets: | **R1 588 000 000** |
| Stocks on hand: | **R1 415 600 000** |
| Debtors: | **R5 341 100 000** |
| Creditors: | **R6 772 600 000** |
| **Refer to the Notes to the financial statements.** | |
| Number of shares issued by the end of September 2012: **172 377 704 shares** | |
| **Refer to the other information:** | |
| Where the head office of SPAR is situated: | **Pinetown, KZN** |
| Name of the Chairman of the Board of Directors: | **Mr M. Hankinson** |
| Name of the Chief Executive Officer (CEO): | **Mr W. Hook** |
| Name of the independent auditors: | **Deloitte & Touche** |

**Requirements of project:**

| | | |
|---|---|---|
| **5.4.1** | **General information:** | |
| | **(a)** | **What is the difference between the work performed by the Chairman of the Board and the CEO?** |
| Mr M. Hankinson, the Chairman of the Board of Directors, does not work in the company, but oversees the decision-making by the directors.<br>Mr W. Hook, the Chief Executive Officer, works in the company as the managing director and is responsible for making sure the company is efficiently run.<br>✓ **for both** **(1)** | | |
| | **(b)** | **How many directors does SPAR have? How many of them are executive directors? How many of them are non-executive directors? Why is it necessary for a public company such as SPAR to have these two types of directors?** |
| Number of executive directors: 4 Number of non-executive directors: 6 ✓<br>Executive directors are responsible for day-to-day running of the company. Non-executive directors are not employed to actually run the company, but just to ensure that responsible and ethical decisions are taken. The King Code identified the value of non-executive directors in this regard because they are not too close to the making of day-to-day decisions. ✓<br>**(2)** | | |
| **5.4.2** | **Refer to the Review of Trading Results.** | |
| | **(a)** | **Who are the two people responsible for this review?** |
| The Chairman & the CEO. ✓<br>**(1)** | | |
| | **(b)** | **Do they have a good opinion of the trading results? Explain.** |
| They have a good opinion, saying they experienced a solid set of results despite the unsettled political and labour conditions. ✓<br>Sales increased by 12.2% and Headline earnings rose by 11%.✓<br>**(2)** | | |
| | **(c)** | **The SPAR Group Limited consists of three main divisions. Provide the name of each division, the product sold by each division, and explain how well each division did in the 2012 financial year.** |
| **SPAR:**<br>Products are Food; Did well with sales up by 11.5%; 23 new stores.✓<br>**TOPS:**<br>Products are Liquor (Alcohol); Had a great year; Sales up 21.2%; 47 new stores; won best liquor store awards.✓<br>**BUILDIT:**<br>Products are Building supplies; Excellent year; Sales up by 17%; 20 new stores.✓<br>**(3)** | | |
| | **(d)** | **What is meant by 'house brands', how well did they do in 2012, and why do the directors deliberately mention these brands?** |
| **'House brands' and how well did they did in 2012?**<br>These are products that use the "Spar", "Tops" or "BuildIt" name on them. SPAR (R6.2b) & BuildIt brands (R154m); they did very well. ✓<br><br>**Why do the directors deliberately mention these brands?**<br>Because they determine the specifications of these products and are likely to make a bigger profit on them.✓<br>**(2)** | | |
| | **(e)** | **What were the interim, final and total dividends per share during the year? Did they improve or not?** |
| **Interim**: 155 cents (increased from 142 cents)✓<br>**Final**: 275 cents (increased from 235 cents)✓<br>**Total**: 430 cents (increased from 377 cents)✓<br>**(3)** | | |
| | **(f)** | **What are the expectations of the directors for the future?** |
| They are being conservative by pointing out that economic conditions will be subdued or slow. ✓<br>However, they state that they are optimistic if they can keep increasing costs under control.✓<br>**(2)** | | |

| | | |
|---|---|---|
| **5.4.3** | **Refer to the two Notes to the financial statements that have been provided in this Task.** | |
| | **(a)** | **Why is there specific reference to IFRS and the Companies Act?** |

It is important for readers to know that they are complying with these standards and the law (the Act), which means that the figures should be reliable.✓

**(1)**

| | | |
|---|---|---|
| | **(b)** | **What is meant by 'weighted average' number of shares? Why is it correct to use this figure used in the calculation of financial indicators such as EPS?** |

This is the average number of shares which takes into account at what stage of the year the shares were issued, i.e. the beginning, end or middle of the year.✓✓

**(2)**

| | | |
|---|---|---|
| | **(c)** | **What caused the difference between 'Earnings' and 'Headline Earnings'?** |

It was not a significant difference.
The difference is caused by loss on sale of assets and a relatively small tax adjustment.
Headline earnings are earnings which exclude the non-recurring items.✓

**(1)**

| | | |
|---|---|---|
| **5.4.4** | **Refer to the Statement of Comprehensive Income, i.e. the Income Statement.** | |
| | **(a)** | **Explain why the figures are rounded off to the nearest million Rand, and why the Income Statement does not show all of the company's expenses.** |

The Concept of Materiality is applied. In a big company such as SPAR, the shareholders and other readers of the financial statements do not need to be confused by many irrelevant figures. ✓
Only the figures that are relevant to their decisions are required.✓
The Sales of this company amount to approximately R43 166 000 000 more than R43 billion, so small amounts will be irrelevant.

**(2)**

| | | |
|---|---|---|
| | **(b)** | **You are told that the following figures improved in 2012 compared to 2011. Provide workings to prove that these % increases are correct:** |
| | | • **Sales went up by 12.2%.** |

$\frac{4\,707.3}{38\,458.7} \times \frac{100}{1}$ = **12.2% ✓ for proof**

**(1)**

| | | |
|---|---|---|
| | | • **Operating profit went up by 7.5%.** |

$\frac{105.8}{1\,404.7} \times \frac{100}{1}$ = **7.5% ✓ for proof**

**(1)**

| | | |
|---|---|---|
| | | • **Net profit before tax went up by 8.1%.** |

$\frac{114.1}{1\,404.6} \times \frac{100}{1}$ = **8.1% ✓ for proof**

**(1)**

| | | |
|---|---|---|
| **5.4.5** | **Refer to the Statement of Financial Position, i.e. the Balance Sheet.** | |
| | **(a)** | **What is meant by 'Goodwill' and why is the figure so high?** |

This is a non-tangible asset.
It actually indicates the support that is gained from the company's customers which makes the company successful.✓
As there is a value of R391 000 000 000 attached to this in the SPAR Balance Sheet, SPAR must have bought an existing business and had paid this amount over and above the value of the business' net assets or the directors and auditors are of the opinion that the group has a lot of support from the public. ✓

**(2)**

| | | |
|---|---|---|
| | **(b)** | **Calculate the debt equity ratio for both years. Comment on this ratio.** |

2012 = 236.3 : 2 837.6 = **0.08 : 1**
2011 = 216.5 : 2 489.5 = **0.09 : 1 ✓ for both years**
SPAR is lowly geared.
The company is not making much use of loans.
There is very little financial risk attached to this company ✓✓ for comment.

**(3)**

| | | |
|---|---|---|
| | **(c)** | **Calculate the current ratio and acid-test ratio for both years. Comment on these ratios.** |

Current ratio (2012) = 7 672.8 : 6 821.4 = **1.12 : 1**
Current ratio (2011) = 6 177.8 : 5 595.6 = **1.10 : 1 ✓ for both years**
Acid-test ratio (2012) = 6 257.2 : 6 821.4 = **0.92 : 1**
Acid-test ratio (2011) = 5 042.8 : 5 595.6 = **0.90 : 1 ✓ for both years**

SPAR proves that it is possible to rely on very low liquidity ratios.
They are a successful company which has been using its working capital very effectively.
Stock makes up a small part of the current assets as most of the products they sell are perishable.✓ for comment.

**(3)**

| | | |
|---|---|---|
| **5.4.6** | | **Refer to the Cash Flow Statement.** |
| | **(a)** | **Provide workings from the Balance Sheet to prove that the cash balances at the beginning and end of the year are correct.** |

Cash at beginning = 96.4 – 114.9 = R18 500 000 Negative ✓
Cash at end = 752.4 + 89.2 = R841 600 000 Positive ✓

**(2)**

| | | |
|---|---|---|
| | **(b)** | **Briefly explain whether the directors should be satisfied with this Cash Flow Statement? Explain, quoting figures from the information provided.** |

Very satisfied.
They have paid off the overdraft of R18 500 000.
They now have R841 600 000 cash on hand.
The cash flows are good.
They generated R1 153 500 000 through operating activities which is excellent.
They spent only R222 000 000 on investing activities and R71 400 000 on financing activities.
**✓ for figures ✓✓ for comment** **(3)**

| | | |
|---|---|---|
| | **(c)** | **Explain the difference between 'expanding operations' and 'maintaining operations'.** |

Expanding operations: These are new fixed assets that are bought to grow the business.✓
Maintaining operations: These are the replacement of old fixed assets. This does not mean the business is growing in size.✓
It is merely to ensure that the fixed assets are kept at the same levels, although prices will have increased over the years.

**(2)**

| | | |
|---|---|---|
| | **(d)** | **Explain the significant change that occurred with regard to the financing activities, quoting figures to support your answer.** |

They bought back shares for R123 600 000. ✓
They also sold some new shares for R52 200 000.✓
Overall the share capital and number of shares issued was reduced.✓
This should serve to improve EPS.

**(3)**

| | | |
|---|---|---|
| **5.4.7** | | **Refer to the financial indicators that are provided under Salient Statistics.** |
| | **(a)** | **Provide workings to prove the following figures:** |
| | | • **Headline earnings per share of 616.3 cents** |

$\frac{1\,060\,000\,000}{171\,992\,577} \times \frac{100}{1}$ = **616.3 cents ✓ for proof**

| | |
|---|---|
| | • **Net asset value per share of 1 649.8 cents** |

$\frac{2\,837\,600\,000}{171\,992\,577} \times \frac{100}{1}$ = **1 649.8 cents ✓ for proof**

| | |
|---|---|
| | • **Operating profit margin of 3.5%** |

$\frac{1\,510\,200\,000}{43\,166\,000\,000} \times \frac{100}{1}$ = **3.5%✓ for proof**

| | | |
|---|---|---|
| | | • **Return on equity of 39.8%** |

1 060 000 000 x 100 = **40.5%** ✓ **for proof**
2 614 100 000 1

**Note**:
There is a slight difference here. SPAR might not have used headline earnings divided by simple average equity.

**(4)**

| | | |
|---|---|---|
| | **(b)** | **You are told that yesterday's price of SPAR shares on the JSE was R121.44 and that 312 000 shares were traded on the JSE yesterday. Would you buy shares in this company? Explain, quoting figures to support your opinion.** |

Yes/No with reasons.
The % return is excellent at 39.8% which exceeds returns on most other investments.
This did decrease slightly from 2011, but not significantly.
The NAV is R16.50 which is well below the JSE price of R121.44 which indicates there is a very big public demand for the share.
The high volume of shares traded also indicates its popularity with the public.
The dividends per share are R4.30 which is low in relation to the JSE price, so shareholders in this company are looking for capital growth of their investment rather than dividend income.
✓ **for figures** ✓✓ **for comments** **(3)**

**TOTAL MARKS: 50**

## TASK 5.5 Published financial statements: Company of your choice

**Note to Teacher:**

**This Task may be used as a class activity or as a project.**

This Task is comprehensive and you may find that some learners will find difficulty in completing this entire Task. However, it is a challenge for the brighter, more competent learners in your group. Learners must obtain a set of published financial statements for this Task. If they have problems in this regard you could obtain copies off the website of the company or you could get them to use the one supplied at the end of this guide.

**NOTE:**
**A COPY OF MR PRICE ANNUAL SUMMARY HAS BEEN INCLUDED IN THE BACK OF THIS BOOK. YOU ARE ALSO PROVIDED WITH DIGITAL COPIES OF ANNUAL REPORTS FOR MR PRICE.**
**YOU CAN MAKE COPIES OF ASPECTS OF THESE REPORTS FOR YOUR LEARNERS IF THEY CANNOT GET HOLD OF OTHER PUBLISHED FINANCIAL REPORTS.**

**See suggested rubric below.**

## RUBRIC FOR THE ASSESSMENT OF THE TASK OR PROJECT ON A PUBLISHED ANNUAL REPORT OF A PUBLIC COMPANY

| | | 0 marks | 1 mark | 2 marks | 3 marks | 4 marks | 5 marks | Weight | Score |
|---|---|---|---|---|---|---|---|---|---|
| 5.5.1 | Identifying **general points** about the company, e.g. group, subsidiary; product or service; head office address; executive and non-executive directors; shares issued. | Completely inaccurate. | Poor. Mostly inaccurate. | Satisfactory. Partially accurate. | Good. Partially accurate. | Very good. Mostly accurate. | Excellent. Completely accurate. | **X1** | **/5** |
| 5.5.2 | Identifying details of the **AGM,** e.g. time and place; items on agenda; special resolutions; proxy votes. | Completely inaccurate. | Poor. Mostly inaccurate. | Satisfactory. Partially accurate. | Good. Partially accurate. | Very good. Mostly accurate. | Excellent. Completely accurate. | **X1** | **/5** |
| 5.5.3 | Identifying **Rand amounts** of sales, net profit, income tax, directors' fees, audit fees, shareholders' equity, any other relevant item. | Completely inaccurate. | Poor. Mostly inaccurate. | Satisfactory. Partially accurate. | Good. Partially accurate. | Very good. Mostly accurate. | Excellent. Completely accurate. Other relevant item included. | **X1** | **/5** |
| 5.5.4 | Identifying or calculating **financial indicators**: EPS, DPS, NAV, debt/equity, current ratio, acid-test ratio, any other relevant or original indicator. | Completely inaccurate. | Poor. Mostly inaccurate. | Satisfactory. Partially accurate. | Good. Partially accurate. | Very good. Mostly accurate. Other relevant indicator identified. | Excellent. Completely accurate. Other relevant or original indicator identified. | **X1** | **/5** |
| 5.5.5 | Identifying **trends,** e.g. sales, net profit, equity, any other relevant or important item. | Completely inaccurate. | Poor. Mostly inaccurate. | Satisfactory. Partially accurate. | Good. Partially accurate. | Very good. Mostly accurate. Other relevant item included. | Excellent. Completely accurate. Other relevant item included. | **X1** | **/5** |
| 5.5.6 | Identifying **accounting policies**: Those that have been studied, as well as those that might not have been studied in Grade 12. | Completely inaccurate. | Poor. Mostly inaccurate. | Satisfactory. Partially accurate. | Good. Partially accurate. | Very good. Mostly accurate. Includes policy not studied. | Excellent. Completely accurate. Insightful. Includes policy not studied. | **X1** | **/5** |
| 5.5.7 | **Directors' Report** and **Auditors' Report**: Explain the difference in content, explain if directors are optimistic or not, explain if auditors are satisfied or not. | Completely inaccurate. | Poor. Mostly inaccurate. | Satisfactory. Partially accurate. | Good. Partially accurate. | Very good. Mostly accurate. Some insight evident. | Excellent. Completely accurate. Insightful. | **X1** | **/5** |
| 5.5.8 | **Corporate governance** and **corporate social investment**: Discussion of remuneration policy, quality of management, sustainability, additional reports on these topics, service to the wider community. | Completely inaccurate. | Poor. Mostly inaccurate. | Satisfactory. Partially accurate. | Good. Partially accurate. | Very good. Mostly accurate. Some insight into these issues. | Excellent. Completely accurate. Excellent insight into CSI, sustainability and management quality. | **X2** | **/10** |
| | **OVERALL IMPRESSION** | Not worthy of a mark. | Poor. | Satisfactory. | Good. | Very good. | Excellent. | **X1** | **/5** |
| | **TOTAL MARKS** **MAX 50** | | | | | | | | |

**CHECKLIST**:

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Understand and explain what is meant by published annual financial statements. | | | |
| Understand and explain the difference between published financial statements and detailed financial statements. | | | |
| Understand and explain the main components in a set of published financial statements: Independent Auditor's Report, Directors' Report, Statement of Comprehensive Income, Statement of Financial Position, Cash Flow Statement | | | |
| Understand other reports and information that can be presented with the published annual financial statements, e.g. Audit Committee Report, Remuneration Committee's Report. | | | |
| Understand and explain what is meant by Corporate Social Investment and why it is important to public companies. | | | |
| Understand and explain what is meant by an Annual General Meeting of shareholders and the matters that will be dealt with at that meeting. | | | |
| Understand and explain the three types of Independent Auditor's Report, i.e. Unqualified, Qualified and Disclaimer. | | | |
| Understand and explain the effect of IFRS on the annual financial statements. | | | |
| Understand how to read through the Annual Report booklet that is published by a company and where to locate relevant information in the booklet. | | | |
| Understand how to check the calculations of financial indicators that are reflected in the booklet. | | | |
| Understand, interpret and evaluate the financial indicators of a public company. | | | |

# MODULE 6
# BUSINESS ETHICS, CORPORATE GOVERNANCE & THE ROLE OF PROFESSIONAL BODIES

## TASK 6.1 ⌘ Baseline assessment: Unethical practices

**Possible answers:**

| |
|---|
| • **Theft** |
| Stealing assets of a business. |
| • **Fraud** |
| Covering up theft by altering or misrepresenting information. |
| • **Negligence** |
| Inattention or forgetfulness resulting in loss. |
| • **Bribery** |
| Offering an incentive to another person to commit an unethical act. |
| • **Kick-backs** |
| Offering a payment back to a person employed by a supplier or client. |
| • **Money-laundering** |
| Using illegally obtained money in a subsequent legitimate transaction in order to disguise the trail of the illegally obtained funds. |
| • **Discrimination** |
| Unfairness or prejudice against a person for a hidden reason. |
| • **Racism** |
| Racial prejudice against a person. |
| • **Poor working conditions** |
| Employer provides unreasonably poor environment for workers. |
| • **Employing illegal immigrants** |
| Employer offers jobs to people who have no right to live and work in the country. |
| • **Trading in illegal goods** |
| Making, buying or selling illegal goods such as drugs or pornography. |
| • **Discriminatory wage practices** |
| Unfair wage scales used – paying different people with the same qualifications different wages for the same job. |
| • **Misleading advertising** |
| Deceiving potential customers through distortion of facts in advertisements. |
| • **Abuse of the environment** |
| Destroying the air, plant life, animal life, natural geography, etc. in disposing of waste material or in conducting business (an unquantifiable cost is sometimes involved). |

| |
|---|
| • **Foreign exchange fraud** |
| Using exchanges of currencies for illegal gain. |
| • **Sexual harassment** |
| Using verbal or physical behaviour to influence or affect others in a sexual way. |
| • **Abuse of leave privileges** |
| Taking leave that should not be due to a person, e.g. a person taking sick leave when he is not sick. |
| • **Misrepresentation (e.g. qualifications fraud)** |
| Changing school or university qualifications on certificates in order to gain some benefit, e.g. to secure a job, or to secure a higher salary. |
| • **Over-charging** |
| Charging prices that are higher than the agreed or normal price. |
| • **Price-fixing** |
| Collusion between competitors to agree to maintain the same high prices. |
| • **Industrial espionage** |
| Using surreptitious means to gain confidential information on a competitor. |
| • **Insider trading** |
| Buying or selling shares in a company as a result of information which is not available to others. |
| • **Securities (share) fraud** |
| Committing fraud through dealing in shares of companies or distorting such dealings, e.g. converting a loan into shares when this has not been properly approved, or deliberately spreading positive or negative rumours of a company in order to influence the market price of a share. Teachers are referred to the movie, wall street starring Michael Douglas and Charlie Sheen, which covers this type of fraud. |

## TASK 6.2 ⌘ Reflection time: Ethical business practice

**Note to Teacher:**
Set time limits on each reflection. Allow groups or pairs to brainstorm ideas and list them on a flip-chart. At appropriate moments, allow groups to report back using the flip charts they have prepared. Individual learners should take notes on A4 paper to be placed in their files for future reference.

**Note:** Various opinions possible in each case. Allow a wide variety of responses from learners.

| |
|---|
| **Reflection time 1:** |
| There might be a feeling that criminal elements might take over. |
| **Reflection time 2:** |
| Quality service to customers, fair treatment of employees, good reputation in the business community (i.e. goodwill). |
| **Reflection time 3:** |
| Poor image as CEO as you should have the ability to influence practices positively; poor image as major shareholder because you are responsible for appointing the directors at the AGM. You should make it your priority to ensure that the company and its employees are conducting themselves properly. Failure to do so is not only negligent, but could affect the share price. |

**Reflection time 4:**

Certain countries do not value the position of women, certain countries do not value high productivity (compare South Africa to Japan), certain countries do not have control of crime and this would affect business dealings. A global company would have to establish a definite code of conduct or code of ethical practices and put key people in place in the various countries to ensure that the code is obeyed.

**Reflection time 5:**

Customers will support well managed and ethical companies, good quality employees would be attracted to the company – the company would be able to choose from a good pool of potential employees, an atmosphere of ethical conduct throughout will cause employees to respect the company and deter them from being involved in fraud or other disreputable conduct. The company would benefit through bigger profits ultimately.

**Reflection time 6:**

The nature of their jobs entails integrity and ensuring that the assets of a business are safeguarded. Membership of their professional bodies may be terminated if the accountants and auditors do not conduct themselves ethically. They must set the right example as they fill important fiduciary roles in a company, i.e. they look after the assets belonging to other people.

**Reflection time 7:**

Learners should identify the 'right' option, i.e. be objective and do not allow the friendship to interfere with the making of the decision to expose and report the culprit.

**Reflection time 8:**

Various opinions possible.

- The overall mission and objectives of the organisation, e.g. quality products and competitive prices
- Compliance with the laws of the land, e.g. absolute compliance.
- Use of the assets of the organisation, e.g. respect for property, no unauthorised use.
- Communication within the organisation, e.g. in a respectful way, transparency, not hiding information.
- Dealing with conflicts of interest, e.g. in a mutually respectful way, process to lodge complaints, hearings.
- Relationships with shareholders, e.g. profit maximising, awareness of share price, involved in decisions at AGM.
- Relationships with investors and lenders, e.g. respect, loyalty.
- Relationships with external public stakeholders, e.g. Government, environmental organisations, the local community, e.g. awareness of their requirements and regulations, co-operation.
- Treatment of customers, e.g. respect, quality service, quality product, loyalty rewards, good advertising.
- Conduct of and treatment of employees, e.g. fairness, mutual respect, good working conditions, discipline, fair wages.
- Relationships with suppliers, e.g. loyalty, reliability, quality of product required.
- Relationships with competitors, e.g. mutual respect, no sabotage, no disreputable advertising.
- Human rights, e.g. respect for the constitution of the land, attitude of mutual respect.

## TASK 6.3 Martha Stewart: Insider trading

**6.3.1 What crime was Martha Stewart convicted for?**

She sold her shares at a good price knowing that when certain privileged information was released, the price of the shares would likely drop.

**6.3.2 What moral or ethical dilemma did she face? In your opinion, how can she be accused of lack of transparency or lack of accountability?**

Sell the shares prior to the release of the information OR Watch helplessly as the price of the share drops due to the information released.

| 6.3.3 | In your opinion, is her punishment fair? |
|---|---|
| Wide variety of possible opinions.<br>The sentence reflects the intolerance of this sort of fraud in modern times. | |
| **6.3.4** | **Why was her stockbroker also subjected to a fine?** |
| He colluded with her and helped her sell the shares.<br>In his position as a stock broker, he should have known that her act could be construed as insider trading which is illegal. | |
| **6.3.5** | **What would you have expected the independent auditor of Imclone Systems Inc to do about this incident? Explain.** |
| If it was likely that he knew about the privileged information, he should have advised Martha Stewart not to sell the shares.<br>If she did not heed his advice he should have alerted another director in the company to dissuade her from this course of action.<br>Assuming all his advice is not heeded, he would then be a material witness to the case. | |

## TASK 6.4 Worldcom: Accountability

| 6.4.1 | What is Ebbers accountable for? |
|---|---|
| He altered the financial records by hiding liabilities and over-exaggerating the income.<br>As the chairman of the company, he was in a position of trust and abused this. | |
| **6.4.2** | **How would his actions have affected the stakeholders of WorldCom?** |
| When the fraud was exposed, the share price plummeted.<br>Many shareholders would have relied on the good performance of the share in providing for their retirement. | |
| **6.4.3** | **In your opinion, is the sentence imposed by the judge appropriate? Share your opinions with the rest of the class.** |
| Variety of opinions possible.<br>The stiff sentence reflects the intolerance of this type of fraud today. | |
| **6.4.4** | **What would you have expected the independent auditor of Worldcom to do about this incident? Explain.** |
| He should have refused to put the fraudulent entries through in the books.<br>If this caused an argument with Ebbers he could have given the information to the SEC before the other investors were affected. | |

## TASK 6.5 Scenarios

| Case 1 |
|---|
| This is insider trading in shares, which is illegal.<br>Ben should face charges in court.<br>Anybody that learns of this should expose him.<br>Ben could be imprisoned or fined if found guilty.<br>He could be disbarred from operating as a director. |
| **Case 2** |
| Any person responsible for processing this transaction could be held accountable.<br>The perception is that Ben has favoured his wife's business which means that he gains indirectly.<br>The directors must put a stop to this practice.<br>They must convene a disciplinary hearing which could mean that Ben loses his job.<br>This should also be reported to shareholders. |

**Case 3**

This could be regarded as an attempt by Ben to distort the figures in the financial statements.
Ben could face legal charges if any person loses out as result of relying on this information.
The accountant could also face disciplinary action in the company or, if a complaint is laid, through his professional body for processing the transaction.

**Case 4**

This will definitely be regarded as an attempt by Ben to distort the figures in the financial statements – it inflates the profit figure and decreases liabilities.
Ben will face legal charges and could face disqualification as a director.
The accountant could also face legal and disciplinary action in the company or, if a complaint is laid, through his professional body for processing the transaction.

**Case 5**

This may be regarded as unethical conduct by the directors.
They are obviously trying to protect their position by converting a net loss into a net profit by selling fixed assets.
If the assets are not used, this could be justified, but it must be fully disclosed in the annual report to shareholders.

**Case 6**

This is price-fixing, which is unethical.
It could also be against laws which have been passed in the country.
Customers should lay complaints with the competitions board (refer to the Nationwide vs SA Airways case).
The company can be severely fined.

**Case 7**

This is unethical. Abuse of the environment should not be tolerated.
Members of the community should institute a formal complaint.
The company can be severely fined.

**Case 8**

This is unethical and illegal. Bribery should not be tolerated.
The parties to this scheme can be charged in court and can face imprisonment, fines and forfeiture of their personal assets.

**Case 9**

This is unethical and illegal.
Ben Badd has disadvantaged the company because the builders will have inflated the cost of the construction paid for by the company, so that Ben Badd would have got free extensions to his property.
This amounts to a bribe as well, which is also illegal and unethical.
Criminal charges could be laid by the company or the shareholders to recover the excess amount paid by the company.

## TASK 6.6 ⌘ Scenarios relating to professional bodies

**6.6.1**

I would be worried. I would not know if he was properly qualified or if he was 'of good standing' with no complaints laid against him.

**6.6.2**

I would be worried because I would expect lawyers to be moral and ethical people especially if they are looking after my funds in a Trust account.
The fact that he is committing a crime (drunk driving) is very inappropriate for a lawyer who should be upholding the law at all times.

**6.6.3**

I would be worried as the persons signing the financial statements would not be bound by the code of professional practice if they are not members of a professional body.
I would not know if I could rely on the figures ort not.
I would have to insist on a proper audit of the figures.

**6.6.4**

SAICA and SAIPA give the public in SA an assurance that their members have certain qualifications and expertise in doing their jobs, and that disciplinary action is taken if they transgress.
This engenders confidence in the work that they do and consequently it encourages investment in businesses if the figures in financial statements can be relied upon.

## TASK 6.7 ⌘ Professional Bodies

**6.7.1 What do the terms SAICA and SAIPA mean?**

SAICA: South African Institute of Chartered Accountants
SAIPA: South African Institute of Professional Accountants

**6.7.2 How does it help the business community for accountants to be members of such organisations?**

The professional bodies ensure that:

- Their members keep up to date with the latest developments.
- Their members comply with a code of good practice and ethics.
- Complaints against members are investigated.
- Disciplinary action is taken against errant members.

**6.7.3 What actions can these bodies take if their members do not comply with their standards or requirements? What are the consequences for members who do not maintain the standards and ethics of the professional bodies to which they belong? Share your opinions with the rest of the class.**

Possible actions:

- Investigation of complaints
- Disciplinary hearings
- Possible de-registration as a member of the professional body, i.e. de-registered member cannot use the term CA(SA), SIACA or SAIPA in connection with his / her name, which will affect their ability to earn income as an accountant or auditor.

**6.7.4 Explain three offences that could result in expulsion from SAICA or SAIPA.**

Possible responses:
Failure to do their job diligently.
Over-charging for their services.
Divulging confidential information.
Pretending to have a proper qualification.

## TASK 6.8 Auditors

| 6.8.1 | What do the terms IRBA and RA mean? |
|---|---|

IRBA: Independent Regulatory Board for Auditors
RA: Registered Auditor

| 6.8.2 | How does it help the business community for auditors to be regulated by IRBA? |
|---|---|

- The Public Practice Examination ensures that auditors have high knowledge in the field of auditing.
- The auditors have had practical training.
- They adhere to generally accepted auditing standards – all auditors should have the same professional approach.
- Disciplinary investigations and hearings may be facilitated by IRBA against RA's.

| 6.8.3 | What actions can this body take if auditors do not comply with the professional standards expected of them? What are the consequences for auditors who do not maintain the standards and ethics expected by IRBA? Share your opinions with the rest of the class. |
|---|---|

De-registration as an auditor.
The auditor will have to change his / her career.

## TASK 6.9 Baseline assessment: GAAP

| 6.9.1 | What is meant by GAAP and why do accountants and auditors have to be fully knowledgeable of GAAP in order to comply with their professional duties? |
|---|---|

GAAP is the general body of knowledge that has evolved over the centuries. GAAP guides accountants and auditors with regard to accepted ways of making entries in the books and of preparing financial statements. Accountants and auditors need to understand these so that the users of financial statements will be able to understand the financial statements they are reading, make comparisons between financial statements of different companies, and have confidence in the reliability of the information provided in the financial statements.

| 6.9.2 | Consider the term 'International Accounting Standards'. What does this term imply to you, and how important are they to professional accountants and auditors? |
|---|---|

IAS is a general term to cover guidelines or decisions that are taken on accounting treatment which will apply across international boundaries Due to the rise of global companies, it would be confusing if accounting treatment varied from county to country. Shareholders and other stakeholders need information that is consistently prepared and valued, hence IAS forms an important part of GAAP.

## TASK 6.10 Baseline assessment: Characteristics required

| 6.10.1 | **Financial statements must have the following characteristics: Faithful representation, Relevance, Comparability, Verifiability, Timeliness and Understandability. Explain what is meant be each of these characteristics and why they are so important. Share your opinions with the rest of the class.** |
|---|---|

**Faithful representation:**
Financial statements must be complete (i.e. show the whole financial picture of the company), the must be free from error, and they must be neutral (i.e. they must not be prepared in such a way as to protect or favour any set of stakeholders)

**Relevance:**
The readers must find the information relevant and material (i.e. important) to the decisions that they expect to make.

**Comparability**:
It must be possible to compare the financial statements of different businesses; it must be possible to compare the financial information of one year to another year.

**Verifiability:**
It must be possible for the information in the financial statements to be verified (checked) so that it is reliable.

**Timeliness:**
Financial statements must be timely – they must be produced in good time to enable stakeholders to make prompt decisions.

**Understandability:**
Financial statements must not be confusing to the reader.

These characteristics are important because they enhance the usefulness and reliability of the financial statements. Financial statements are always prepared for a purpose of providing useful information for decisions that have to be made by the readers.

| 6.10.2 | **Accountants and auditors need to personally possess the following characteristics: Integrity, Objectivity, Independence. Explain what is meant be each of these characteristics and why they are so important. Share your opinions with the rest of the class.** |
|---|---|

**Integrity:** Honesty
**Objectivity:** Unbiased
**Independence**: Not influenced by the motives of others.
Without these characteristics, accountants will lose the confidence of the general public who will not be able to rely on the work produced by accountants and auditors. The reputation and long-term prospects of the Accounting profession will be negatively affected.

## TASK 6.11 ⌘ International standards

| 6.11.1 | **What is meant by the term IFRS?** |
|---|---|
| International Financial Reporting Standards | |
| **6.11.2** | **Interview an accountant or search the website for information on IFRS. Choose one accounting aspect covered by IFRS and report to the rest of your group and/or the class.** |
| IFRS comprises guidelines or decisions that are taken on accounting treatment which will apply across international boundaries.<br>Due to the rise of global companies, it would be confusing if accounting treatment varied from country to country. Shareholders and other stakeholders need information that is consistently prepared and valued. | |
| **6.11.3** | **Why is it so important that international standards be set for auditors and accountants to follow? What would be the consequences for the international business community if these standards did not exist? Share your opinions with the rest of the class.** |
| If these standards did not exist, it would not be possible to consolidate (combine) the operations of global companies in different countries, and it will not be possible to compare the financial statements of a company in one country with a company in another country.<br>This would impair the decisions of international investors, it could affect the on-going viability of big companies requiring capital, and it would affect the flow of funds from one country to another. | |

## TASK 6.12 Case Study: Enron

| 6.12.1 | **Explain the role played by Enron's Chairman of the Board of Directors, its CEO and CFO in this scandal. In your opinion, do they deserve to receive prison sentences?** |
|---|---|
| They applied creative Accounting methods which were not in accordance with GAAP and IFRS.<br>As a result the figures were completely incorrect.<br>They do deserve prison sentences they benefited from the fraud while a number of investors lost their life savings. | |
| **6.12.2** | **Explain the role played by the auditing firm, Arthur Andersen. Why was it necessary for them to close down? What consequences could there have been for the qualified accountants and auditors who work on Enron's audit, and the partner who signed the independent auditor's report?** |
| The auditors should have detected this fraud at the outset.<br>They should not have allowed the directors to present financial statements in this way.<br>They had a duty to ensure that IFRS was applied.<br>They destroyed evidence which would have incriminated them.<br>It is correct that the firm has closed down.<br>The auditors responsible would have been struck off the membership roll of the professional body in the USA and prevented from operating as an auditor again. | |
| **6.12.3** | **The whistle-blower, Sherron Watkins, was named by Time magazine as one of the Persons of the Year in 2002. Why did Time magazine award her this honour? Explain.** |
| She had to have a lot of courage to stand up to the directors on this matter, knowing that they she could have been victimised by them by unfairly dismissing her from her job.<br>She took the right action when she became aware of the problem to prevent such misconduct problems from spreading to other companies and affecting other investors.<br>Her actions ultimately benefited IFRS for the better. | |

## TASK 6.13 Auditing standards

| 6.13.1 | Why are the auditors unhappy with All Joy? |
|---|---|
| There was a 'material irregularity' in the financial statements.<br>All Joy had overstated the receivables. | |

| 6.13.2 | Why is All Joy unhappy with their auditors? |
|---|---|
| All Joy's directors felt that this was an error and they should have been given an opportunity to correct the error.<br>They are probably worried that a negative report from the auditors will reflect negatively on the company. | |

| 6.13.3 | What is the PAAB and why are they involved in this case? |
|---|---|
| PAAB= Public Accountants and Auditors Board.<br>They are the body which regulates auditing of companies.<br>They have the right to investigate complaints against auditors, but in this case the complaint is by the auditors against a company.<br>The PAAB therefore has a duty to refer this to the appropriate body according to the Companies Act. | |

| 6.13.4 | What is the JSE and why are they involved in this case? Why does the article refer to the share price in the last paragraph? |
|---|---|
| JSE: Johannesburg Securities Exchange.<br>People rely on the financial statements to make decisions about companies.<br>If there is an over-statement, this will tend to inflate the share price.<br>The board of the JSE has a duty to ensure that the prices quoted for any share is not manipulated through inappropriate measures like fraudulent entries. | |

| 6.13.5 | In your opinion, are the auditors correct in the action which they took? Explain your reasons. |
|---|---|
| Variety of opinions possible, e.g.:<br>They have acted professionally and will not allow their credibility to be negatively affected, even if it means losing their job as the auditor. | |

## TASK 6.14 Reflection on the King Code

**Note to Teacher:**
Set time limits on each reflection. Allow groups or pairs to brainstorm ideas and list them on a flip-chart. At appropriate moments, allow groups to report back using the flip charts they have prepared. Individual learners should take notes on foolscap paper to be placed in their files for future reference.
**Note**: Various opinions possible. Allow a wide variety of responses from the learners.

| ➲ Directors and their responsibilities |
|---|
| Learners should realise that directors are in positions of trust, i.e. using the assets of other people. Independent directors from outside the business will tend to be intolerant of bad practices in the company as they are not directly involved in the running of the company. They could be expected to be more objective than the executive directors. |

| ➲ Risk management |
|---|
| Types of risks, e.g. downturn in the economy, loss of customers to competitors, poor perceptions of quality of service, changes to the law which could affect the company, poor conduct by employees, internal fraud, theft and unethical practices. Learners should realise that the stakeholders, especially shareholders, have invested large amounts of money in the company. They need to know the risks that they face so that they can make decisions as to where to put their money. |

| ➲ **Internal audit** |
|---|
| Internal audits serve to monitor risks in the business – internal auditors do checks to monitor whether internal controls are in place. The external auditors must be independent of this process. They must be independent and objective, and must be seen to be independent and objective, otherwise their opinion on the financial statements might be questioned and regarded as unreliable. They can take the work of the internal auditors into account, but they cannot rely on it without further corroboration. |
| ➲ **Integrated sustainability reporting** |
| Most shareholders do not want to make a 'quick buck'. They tend to look for long-term benefits from their investments. Also directors and employees do not want their jobs to be at risk. A company becomes sustainable in the long-run when it develops a good reputation and minimises the risks that it faces. |
| ➲ **Accounting and independent auditing** |
| External auditors have a heavy responsibility. Their opinion on the financial statements can affect the lives of many stakeholders. If people rely on that opinion and then suffer a loss, the external auditor will be accountable. Due to the technical nature of their tasks, and the importance of those tasks, it is essential that they be very well qualified. Independence is important so as to enhance the reliability of their opinion. An auditor who is not independent will not be objective and his opinion cannot be relied upon. |
| ➲ **Compliance to and enforcement of good management practice** |
| The shareholders and the press are the 'watchdogs'. The shareholders have a direct interest in the company, and they need information which investigative reporting by the press might provide. |

## TASK 6.15 Examples of Corporate Social Investment

| **6.15.1** | **In your own words, briefly explain the role each company plays in contributing to the greater community.** |
|---|---|
| The articles are self-explanatory.<br>Pick 'n Pay supports conservation, Sasol supports cultural heritage, and SAB supports entrepreneurship. | |
| **6.15.2** | **Why did these companies get involved in this form of activity?** |
| It is ethically correct to do so.<br>The companies benefit in various ways from the communities they serve.<br>It is right that they put something back into the community.<br>The goodwill which results from this will serve to enhance the sustainability of the companies. | |
| **6.15.3** | **How does this form of activity affect their financial statements?** |
| Triple bottom line.<br>The net profit will be reduced by this 'corporate social investment'.<br>However, in the long run, the companies' profits are likely to increase due to the support from the communities in the future. | |

## TASK 6.16 Examples of Corporate Social Investment

**Advice to Teachers:**
Responses from learners will depend on the articles chosen by them. Learners might need assistance in locating and identifying articles. The Business Report in the morning newspapers is a convenient way of doing this.

If learners have access to the Internet, they may use a search engine such as Google or the Independent Online website (www.iol.co.za) and click on 'business reports'. Key words can be entered to search for articles, e.g. enter 'corporate social investment'.

In cases where learners do not have easy access to such reports, further features are provided below.

## ABSA Educating our children

*Education does not occur haphazardly. Quality education will empower us as a nation and will allow South Africa to compete in a global economy.*

ABSA's ECD Awards recognise that the hard work and excellence of individual practitioners like Romalie Adams, and of centres and organisations, make a significant contribution to the future of our children.

The awards are open to all persons in the ECD sector and participants can enter in one of four categories. ECD Resource and Training Organisation of the Year, ECD Home-based Centre or Playgroup of the Year, ECD Practitioner of the Year, and ECD Community-based Centre of the Year.

It is awards such as these that build awareness of ECD and encourage other companies to support the crucial research and development needed in this field. Research into ECD has shown that children who participate in ECD programmes tend to be more successful in school and later in life. Not only are they better equipped with social skills and greater intellectual capacity, but they are also more economically productive. Ensuring healthy childhood development is therefore an investment in the future society and economy of our country.

## METROPOLITAN

BRIGHT SPARKS WITH BRIGH FUTURES

*Nurturing skills and knowledge through education and training ultimately ensures the long-term sustainability for corporate South Africa.*

To date, there are only four black actuaries in South Africa, but, with the support provided by Metropolitan, this number is set to increase dramatically. Some of the learners who have benefitted from the Actuaries-on-the-Move project will be offered employment at Metropolitan, while others will be free to pursue their careers with other institutions. By empowering these individuals, Metropolitan has demonstrated its commitment to strengthening South Africa's economy and to increasing the country's skills base.

"The Actuaries-on-the-Move project fits in well with Metropolitan's overall focus on sustainability and capacity building. The project also allows us to leverage the skills and resources that are important to our business while addressing specific community needs. We are very enthusiastic about the progress that the learners concerned have made and wish them every success in the future," says Nkosinathi Chonco, Metropolitan's Group Empowerment and Corporate Affairs Executive.

## FNB
## THE POWER OF MASS MEDIA

*The commercial mass media is often blamed for the spread of violence and perversion and for generating greed and consumer additions, but it is also a powerful tool that can initiate and stimulate social change.*

Socially responsible companies, such as First National Bank, understand the positive influence that the mass media can have on the hearts and minds of South African communities. They also realise that the mass media provides a platform that can be used to encourage a debate on a variety of issues that may otherwise be overlooked.

By making the project relevant to the South African audience, HEARTLINES was able to stimulate debate and challenge the moral fibre of our society. Since the eight values were communicated from combined media platforms, it was possible to reinforce the messages continually.

"We hoped that HEARTLINES would lead to a national conversation involving community leaders, teachers, students and South Africans from all walks of life. We were positive that it would influence the way South Africans talk and think about issues in our society. Through HEARTLINES we began to achieve one of our goals as a bank, and that is to be a great company, helping to create a better South African," says Michael Jordaan, the CEO of FNB.

## TELKOM FOUNDATION
## POSTIIVE BENEFITS FOR ALL

*Volunteer programmes like this encourage a culture of corporate caring that filters down through the entire organisation in South Africa, forward-thinking companies like Telkom are actively embracing volunteerism as an integral part of their corporate social responsibility programmes.*

Initiatives like the Adopt-a-Project programme enhance the welfare of the community as some of its key needs are directly addressed. Assistance from skilled volunteers means that a transfer of skills and knowledge takes place. However, it is not only the communities that benefit from volunteer projects. In Telkom's Adopt-a-Project programme, management dramatically increased their own awareness and understanding of the issues affecting South African communities by getting actively involved. In volunteer projects like this, employees often report that personal growth and development are also key benefits of getting involved. It forges a deep connection between the company and the community and instils a sense of pride in all the participants.

The CEO of Telkom, Papi Moloisane, sums it up: "Community involvement is a key component in Telkom's ability to generate creative ideas, develop and hone our professional skills and improve team spirit while at the same time helping to rejuvenate and develop our local areas."

## ACSA
## MOVING PEOPLE, CHANGING LIVES

*When companies such as ACSA align their corporate social investment focus with their core business, a powerful brand is created that moves people and changes lives.*

The aim of ACSA is to play a leading role in financing projects that allow for the greater mobility of all people throughout the country. It is for this reason that the company sponsors wheelchair tennis in South Africa and supports initiatives for providing specialised wheelchairs for disabled children and bicycles for rural schoolchildren.

To date, the company has donated 398 wheelchairs for children of various ages, with a further 250 wheelchairs to be distribute to various institutions during 2006. By doing so, it has given these children access to education and social facilities that they would not normally enjoy. It has also donated 224 bicycles for high-school learners in remote rural area, with a further 250 bicycles to be donated to schools at the beginning of the new school year in 2007. ACSA moreover invests in other sectors, such as community development, education and the environment, with the focus of such investment being primarily on those communities and areas close to its airports.

"As a company, we are deeply committed to the communities in the vicinity of our airports. Our aim is to grow and operate our business in partnership with local communities and to invest in local community initiatives. We are also beginning to engage our staff in volunteer work and, in this manner, encourage them to contribute towards the development of sustainable and empowered communities," says Charmaine Lodewyk, ACSA's Group Executive Brand and Communications Manager.

## PETRO SA
## POSTIVE ACTION

PetroSA's corporate social investment philosophy is to invest in community projects that are sustainable and empowering.

In the past three, the company has invested over R50 million by way of the three pillars of its corporate social investment programme, namely donations, sponsorship and investment.

PetroSA also strongly believes in education and training. Accordingly it provides schools with equipment designed to facilitate the teaching of mathematics and science, thereby ensuring that future engineering and science graduates have the opportunity to be educated in the most appropriate environment. The company also focuses on health related issues, particularly HIV/Aids; hence its investment in St Mary's.

"We ensure that, when we make any kind of investment – whether in the form of money, buildings or equipment – sustainability is the key," says Shedreck Ramosa, the Vice-President of PetroSa Corporate Services. "We are therefore particularly interested in projects that empower communities by involving them in self-sustainability.

## OLD MUTUAL
## NEW FRONTIERS FOR SUSTAINABLE LIVING

*Teaching environmental values is what ultimately builds a sustainable society.*

In 1999, a Foundation was established to take sole responsibility for this portfolio and, since then, a number of successful projects involving rural development, education, support for children affected by HIV/Aids and staff volunteerism have been undertaken.

When the Old Mutual Foundation first became aware of the Stonehouse Project, it was immediately drawn to the synergy of environmental and social values that was being created and which was similar to that of its Out-of-the Box Environmental Education Project.

The Out-of-the-Box Environment Education Project relies on local perspective to teach children about global issues such as climate change, water conservation and organic agriculture. "We realised that what Vernon Colliss was trying to achieve by way of the Stonehouse Project was to confront these issues by relating them to everyday life," explains Old Mutual Foundation Manager, Kate Miszewski.

Complex issues such as climate change have been related to the everyday life of the community by encouraging the efficient use of energy, and the need to conserve water as a resource has been emphasised though the collection of rainwater.

As the Stonehouse Project expands from eight pilot homes to an eventual 250 homes, community members will be able to build the houses themselves owing to the guidance and mentorship that will be available as a result of Old Mutual's assistance. A mainly pictorial construction manual is also being developed to reinforce the skills that have been acquired by members of the community.

"We were impressed with the idea of teaching sustainable living at the same time as teaching practical skills such as building," says Miszewski. "The Stonehouse Project is an excellent example of an eco-friendly village and will, in our view, create the kind of caring, sharing community that we wish to see thriving throughout the country.

## TASK 6.17 Further ethical and legal scenarios affecting companies

**6.17.1**

The director has not been attending to his responsibilities as he has not been attending the meetings to make strategy decisions for the company.
He is also guilty of qualifications fraud for which he can be dismissed immediately.
Alternatively, the shareholders can choose not to elect him at the next AGM.

**6.17.2**

It would be my duty to alert the board to the deficiencies in the internal control systems.
This could also reflect on the effectiveness of the internal auditor.
He must be addressed on the matter by the board.
It is his responsibility to detect these problems in advance.

**6.17.3**

This is unethical.
The Remunerations Committee must be left to deal with the matter of setting the directors' fees.
There should be no undue influence placed on them.
His remuneration should be performance-related, not simply a % increase irrespective of results.

**6.17.4**

There is a reasonable expectation that this company can be successfully rescued.
The board of directors should make a decision to apply business rescue proceedings.
A Business Rescue Practitioner should be appointed.
Meetings would be held with affected stakeholders who should co-operate and compromise as it will be in their interests to wait for full payment.

**6.17.5**

This amounts to a conflict of interests.
The CEO should have declared his indirect personal interest in this transaction.
He would be guilty of an offence as he will have known of his wife's involvement.
The board must cancel the transaction, and the CEO should be held accountable and could face a criminal charge.

**6.17.6**

It might be difficult for the minority shareholder to argue against a majority decision like this as it is a valid decision not to pay dividends that could benefit the company.
If the shareholder feels aggrieved he could approach the Companies and Intellectual Properties Commission for assistance or he could offer to sell his shares back to the company so that he can invest in another company which pays dividends regularly.

**6.17.7**

This is a case of insider trading which is illegal.
The privileged information would naturally affect the share price if it was commonly known.
The director is guilty of a criminal offence by using this information before it is released to the public.
He will have to face the consequences and could face a considerable fine or imprisonment and will be disqualified from being a director in future.

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Identify and explain different types of unethical conduct in the context of companies. | | | |
| Understand and explain the need and importance for ethical conduct in the business environment, with special reference to companies. | | | |
| Understand and explain the concepts of transparency and accountability. | | | |
| Understand the role played by professional bodies such as SAICA and SAIPA, and regulatory bodies such as IRBA. | | | |
| Understand and explain the basic principles of GAAP. | | | |
| Understand and explain the need for accountants and auditors to comply with GAAP and IFRS. | | | |
| Understand the effect on Accounting standards by high profile cases such as Enron and Worldcom. | | | |
| Understand and explain the basic principles of the King Code and its effect on the companies and the Companies Act. | | | |
| Understand and explain the concepts of sustainability reporting and corporate social investment. | | | |
| Understand and explain responsibilities of directors. | | | |
| Understand and explain the need for board committees. | | | |
| Understand and explain remuneration of directors and evaluation of their performance. | | | |
| Understand and explain the idea of business rescue. | | | |
| Understand and explain the need for directors to disclose financial interests. | | | |
| Understand and explain alternative ways of solving disputes relating to companies. | | | |
| Understand and explain the crime of insider trading. | | | |

**ADDITIONAL RESOURCES:**

Teachers are advised to monitor the press for topical reports of incidents concerning business ethics, and to develop tasks around these. Here are two reports on a recent case in South Africa.

## You let society down very badly – judge
## LEISURENET PAIR GET JAIL

***Business Report April 24, 2007 By Ben Maclennan and Mirah Langer***

Former LeisureNet bosses Peter Gardener and Rod Mitchell have been sentenced to serve eight and seven years in prison. "You let society down very, very badly," Acting Justice Dirk Uijs said as he handed down the sentences in the Cape High Court. He granted the pair leave to go to the Supreme Court of Appeal to challenge their convictions and sentences and extended their bail of R500 000 each. Acting Judge Uijs took just over an hour to sentence Gardener to 12 years in jail, four of them suspended, and Mitchell to 12 years, five of them suspended.

The men, former joint chief executives of the company, were convicted last month of fraud involving R12 million relating to their failure to disclose their interest in a German gym operation that LeisureNet bought out in 1999. Acting Judge Uijs told the pair that their paying the R12m and an additional R4.5m to LeisureNet's liquidators was "the best thing you did". It also meant that they had, to an extent, been punished.

Acting Judge Uijs found that this was a "substantial and compelling" reason not to impose the 15-year minimum sentence laid down in the Criminal Procedure Act for fraud involving more than R500 000. He said the two men were, to all intents, first offenders. Although Gardener had a previous conviction for VAT fraud, this was also related to LeisureNet.

An application by the Asset Forfeiture Unit against Gardener and Mitchell is to be heard in September. The pair were acquitted on counts under the Prevention of Organised Crime Act, the Income Tax Act and a Companies Act charge of reckless trading related to LeisureNet's collapse. LeisureNet, which ran the Health and Racquet Club chain, was provisionally liquidated in 2000. It had liabilities of R1.2 billion and assets of only R302m.

That they had clean records indicated they were not criminals by nature, the acting judge told the pair. The bottom line, however, was that they unlawfully took R12m from the coffers of a public company. "Business, economic enterprise, economic intercourse, is based on trust," Acting Judge Uijs said. "Therefore, I find it to be indubitably so that it is in the interests of society that people be told by way of the sentences … imposed by the republic's courts, that crime will not be tolerated.

"Mr Gardener, Mr Mitchell, that relates to your kind of crime. It relates to white-collar crime." Their sentencing was the most difficult task yet put on his shoulders and he had had "sleepless nights" about it. The millions involved might not be a huge amount of money to Gardener and Mitchell, but it was to him and presumably also to members of the public, wealthy and poor, Acting Judge Uijs said.

Their fraud did not cause LeisureNet a loss equivalent to their gain, and he could not find that what they did had led directly to the demise of the company. "Nevertheless, to walk away from a deception with R6m in each of your pockets is a very, very serious offence - that, despite the fact that you paid it all back."

He was not impressed by the defence's call for fines and suspended sentences, Acting Judge Uijs said. Applying such penalties would convey a message to the public that the rich could pay for their misdeeds, like paying for groceries. Addressing Gardener, the acting judge said: "The question that has sat in my head ever since the day I found you guilty is, why? "What did you need to do this for, or for what did you need to do this? You were independently wealthy."

Exactly the same went for Mitchell, the acting judge said. He said the state had asked for sentences of 10 years for Gardener and eight for Mitchell, who had not stooped quite as low as Gardener. It was not often that a court agreed with counsel's submissions, he said. "I believe, Mr Gardener, that you deserve 10 years in jail. I believe, Mr Mitchell, that 10 years is not inappropriate to your case either."

In arriving at the lesser sentences, he had tried to the best of his limited ability to blend mercy with the needs of society, Acting Judge Uijs said. The suspension of part of the sentences is conditional on the two men's not being found guilty of a crime involving dishonesty. Neither Mitchell nor a grim-faced Gardener, who had accused the media of destroying his life, would speak to journalists after their sentencing. Their attorney, Jeremy Tyfield, said in a brief comment that it was difficult to comment on the judgment without being disrespectful to the court. He said it was "a relief" that leave to appeal had been granted.

## LEISURENET BOSSES GO TO JAIL AS JUDGE SLAMS WHITE COLLAR CRIME

***April 24, 2007 By Ronnie Morris***

Cape Town - Peter Gardener and Rod Mitchell, the former joint chief executives of liquidated health club operator LeisureNet, were jailed for an effective eight and seven years, respectively, by the Cape high court yesterday. The sentences follow their earlier conviction for fraud as the judge took a strong stand against deception.

Gardener was jailed for 12 years, of which four years were conditionally suspended, while Mitchell was jailed for 12 years, of which five years were conditionally suspended. The men were granted leave to appeal against their conviction and sentences and their bail of R500 000 each was extended.

On February 13 Acting Judge Dirk Uijs convicted Gardener and Mitchell on a charge of fraud for failing to disclose to the LeisureNet board that each of them had a secret 20 percent interest in Dalmore, a company that sold its 50 per cent stake in a German fitness firm to LeisureNet for DM10 million in 1999. They each received DM2 million when Dalmore sold the stake.

Uijs was not impressed with argument by Francois van Zyl, their senior counsel, that an appropriate sentence would be one of correctional supervision, a suspended sentence and a hefty fine. Uijs would be failing in his duty if he did not send the men to jail, he said yesterday. The court had to take into account the crime of which they were convicted, the community's interest and the criminals themselves.

"Fraud has always been regarded as a particularly serious crime … You abused the trust of fellow directors, you abused the trust invested in you by the many investors, but indirectly you abused the trust bestowed on you by members of the public who bought your product

"You did not play open cards with your board, you kept silent. The size of the crime, R6 million, is a huge amount of money," he said.

Uijs considered the factors that counted in Gardener and Mitchell's favour. The court did find that they actually did not cause the firm a loss, or a loss equivalent to their gain, nor did their actions lead to the demise of LeisureNet.

"Nevertheless to walk away from a deception with R6 million each … is a very serious offence. That, gentlemen, despite the fact that you paid it all back, plus the fact that the single most mitigating factor is you paid back not just R12 million but … R16.5 million. That's the best thing you did, you paid back."

Crime, especially white-collar crime, had to be stamped out, Uijs said. It was in society's interest that people be told by way of sentences that crime would not be tolerated.

"The question which has sat in my head since the day that I found you [Gardener] guilty is why? What did you need to do this for? You were independently wealthy. Mr Mitchell, apart from the fact that you did not become involved in ripping your company off, the same goes for you. Why did you do this?"

The duo looked visibly shocked when they left the court and brushed off requests for comment.

# MODULE 7
# FIXED ASSETS

**Note to the Teacher:**

Fixed assets were extensively covered in Grades 10 and 11. Learners were required to do the following:

- Calculate depreciation using the cost and diminishing balance method.
- Make the necessary entries in the General Journal and General Ledger.
- Record the entries to record a purchase or disposal of an asset.
- Record entries, and understand the need for a Fixed Asset Register.
- Complete the note to Fixed / Tangible assets in the Financial Statements.
- Discuss internal control measures relating to fixed assets.
- Discuss ethical issues relating to fixed assets.

The Grade 12 CAPS document calls for an interpretation and reporting on the movements of fixed assets and therefore does not require all the Grade 11 work to be re-taught. In the final examination learners will more likely be asked to interpret and answer questions on the fixed assets as against drawing up ledger accounts, etc. However, two things need to be remembered:

- The CAPS document states that 20% of the work can come from prior learning, i.e. Grade 10 and 11. Therefore, the examiners can ask some questions on prior knowledge, e.g. calculation of depreciation, sale of an asset, completion of a Balance Sheet, etc.
- Learners will find it very difficult to interpret and analyse questions on fixed assets if they do not have the prior knowledge. Therefore, you may have to do some revision on this work.

However, what is very important is to note that CAPS only allows half a week for this Module, so your time is very limited. We would suggest that learners who do not have a sound understanding of the prior work be made to do some revision on their own. You cannot re-teach this work in class as you will run out of time and not expose the learners to the type of questions they will get in the final examination. Your task is to prepare the learners for Grade 12 examinations and any other background work will have to be done after hours.

CAPS only introduces this topic in Term 2, after companies have been studied. However, as fixed assets often become a note to the financial statements you can integrate some of these Tasks in the company Modules, if your learners need revision before handling the adjustments.

There are many Tasks in this Module – far more than your learners can ever be expected to do. However, we have made sure there is a range of tasks from easy to challenging while also looking at different contexts. Only learners who are capable of the challenge should do the Tasks that are marked with  . You are also urged to choose the Tasks that you think your learners will relate to. Then, of course, there will be extra Tasks for those learners who want to put in some extra work.

# TASK 7.1 Barney Baby Shop: Ledger & Fixed assets note

**7.1.1** **GENERAL LEDGER OF BARNEY BABY SHOP**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **VEHICLES** **B** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | |
| Mar | 1 | Balance | b/d | 390 000 | Dec | 31 | Asset disposal | GJ | 90 000 |
| | | | | | 20.3 | | | | |
| | | | | | Feb | 28 | Balance | c/d | 300 000 |
| | | | | **390 000** | | | | | **390 000** |
| 20.3 | | | | | | | | | |
| Mar | 1 | Balance | b/d | 300 000 | | | | | |

**ACCUMULATED DEPRECIATION ON VEHICLES** **B**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | |
| Dec | 31 | Asset disposal[3] | GJ | 51 000 | Mar | 1 | Balance | b/d | 108 000 |
| 20.3 | | | | | Dec | 31 | Depreciation[1] | GJ | 15 000 |
| Feb | 28 | Balance | c/d | 132 000 | 20.3 | | | | |
| | | | | | Feb | 28 | Depreciation[2] | GJ | 60 000 |
| | | | | **183 000** | | | | | **183 000** |
| | | | | | 20.3 | | | | |
| | | | | | Mar | 1 | Balance | b/d | 132 000 |

[1] 90 000 x 20% x $^{10}/_{12}$ [2] 390 000 – 90 000 = 100 000 x 20% [3] 36 000 + 15 000

**NOMINAL ACCOUNTS SECTION**

**DEPRECIATION** **N**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.3 | | | | |
| Dec | 31 | Acc dep on vehicles | GJ | 15 000 | Feb | 28 | Profit and Loss | GJ | 91 800 |
| 20.3 | | | | | | | | | |
| Feb | 28 | Acc dep on vehicles | GJ | 60 000 | | | | | |
| | | Acc dep on equip. | GJ | 16 800 | | | | | |
| | | (13 800[1] + 3 000[2]) | | | | | | | |
| | | | | **91 800** | | | | | **91 800** |

[1] 174 000 – 40 000 – 42 000 x 15% [2] 40 000 x 15% x $^{6}/_{12}$

**Dr** **ASSET DISPOSAL** **N** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | |
| Dec | 31 | Vehicle | GJ | 90 000 | Dec | 31 | Acc dep on vehicles | GJ | 51 000 |
| | | Profit on sale of asset | GJ | 12 750 | | | Debtors control | GJ | 51 750 |
| | | | | **102 750** | | | | | **102 750** |

### 7.1.2 NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 20.3

**Fixed/Tangible Assets**

| | Land and Buildings | Vehicles | Equipment | Total |
|---|---|---|---|---|
| Carrying value at beginning of year | 1 080 000 | 282 000 | 92 000 | 1 454 000 |
| Cost (Equipment: 174 000 – 42 000) | 1 080 000 | 390 000 | 134 000 | 1 604 000 |
| Accumulated depreciation | - | (108 000) | (42 000) | (150 000) |
| **Movements** | 120 000 | (114 000) | 23 200 | 29 200 |
| Additions at cost | 120 000 | - | 40 000 | 160 000 |
| Disposals at carrying value | - | (39 000) | - | (39 000) |
| Depreciation | - | (75 000) | (16 800) | (91 800) |
| Carrying value at end of year | **1 200 000** | **168 000** | **115 200** | **1 483 200** |
| Cost | 1 200 000 | 300 000 | 174 000 | 1 674 000 |
| Accumulated depreciation | - | (132 000) | (58 800) | (190 800) |

## TASK 7.2 ⌘ Rambo Stores: Ledger, Analysis, Interpretation

**7.2.1**

| NO. | ANSWER | WORKINGS |
|---|---|---|
| **(a)** | Asset disposal | |
| **(b)** | Asset disposal | |
| **(c)** | GJ | |
| **(d)** | R220 000 | Same as Cr side of Vehicles account. |
| **(e)** | Accumulated depreciation on vehicles | |
| **(f)** | R137 500 | Same as Cr side of Asset disposal account. |
| **(g)** | Debtors control | Folio number is DJ |
| **(h)** | Profit on sale of asset | On the Dr side of the Asset disposal account. |
| **(i)** | R95 000 | R220 000 + R12 500 – R137 500 |
| **(j)** | CJ | Contra is Creditors control. |
| **(k)** | R680 000 | Same as balance b/d. |
| **(l)** | R180 000 | Balancing figure: 220 000 + 680 000 – 720 000 |
| **(m)** | Depreciation | |
| **(n)** | R140 000 | R720 000 – 220 000 = R500 000 x 25% = R125 000<br>R180 000 x 25% x $^{4}/_{12}$ = R15 000 |
| **(o)** | R220 000 | R190 000 + 27 500 + 140 000 – 137 500 = R220 000 |
| **(p)** | R357 500 | Total |

| **7.2.2** | **Besides the cost method of depreciation what other method can be used in a business?** |
|---|---|
| Diminishing balance method. | |

| **7.2.3** | **Briefly discuss why you think Rambo Stores used the cost method of depreciating their vehicles and not the alternative method.** |
|---|---|
| Easy to use.<br>Tax advantages. | |

| **7.2.4** | **Explain to Rambo Stores what one benefit would have been to rather use the alternative method.** |
|---|---|
| Assets are valued at realistic values. | |

| **7.2.5** | **After your discussion Rambo have decided to change the method of depreciating their vehicles with immediate effect. Is this permissible? Why?** |
|---|---|
| No.<br>Once a policy has been decided business needs to be consistent so that comparisons can be made. | |

## TASK 7.3 ⌘ Murdock: Ledger, Analysis, Interpretation

**7.3.1**

| NO. | ANSWER | WORKINGS |
|---|---|---|
| **(a)** | R80 000 | 240 000 ÷ 3 |
| **(b)** | Equipment | |
| **(c)** | R80 000 | Same as Cr side of Equipment account. |
| **(d)** | Depreciation | |
| **(e)** | R8 330 | (R240 0000 – R97 200) ÷ 3 = R47 600<br>R47 600 x 25% x $^{7}/_{12}$ = R8 330 |
| **(f)** | Asset disposal | |
| **(g)** | R40 730 | R97 200 ÷ 3 + R8 330 |
| **(h)** | Accumulated depreciation on Equipment | |
| **(i)** | Creditors control | Computer was traded-in against a new computer. |
| **(j)** | GJ | |
| **(k)** | R30 000 | R80 000 – 40 730 – 9 270 |
| **(l)** | Loss on sale of asset | |
| **(m)** | R72 000 | R42 000 (still owing) + R30 000 (trade-in value). |
| **(n)** | R232 000 | R240 000 + 72 000 – 80 000 |
| **(o)** | R37 560 | (R240 000 – 80 000) – (R97 200 – 32 400) x 30% = R28 560<br>R72 000 x 30% x $^{5}/_{12}$ = R9 000 |
| **(p)** | R102 360 | R97 200 + 8 330 + 37 560 – 40 730 |

| 7.3.2 | **In your opinion was it a wise decision to trade-in the computer on 1 October 20.3. Discuss briefly by giving two possible reasons why they decided to trade in at this point in time.** |
|---|---|

Yes although they made a loss:

- They will be getting a more up-to-date computer. Computers are developing at a very quick rate and you need to constantly be buying new computers in order to keep up-to-date.
- Perhaps the computer was too slow and they needed a quicker computer.
- Computer might have crashed.

OR No because they made a loss:

- They should rather continue with the old computer as the computer is only 18 months old.
- They need to back-up their data so that the amount of data stored on the computer is reduced to ensure the computer works more efficiently.

| 7.3.3 | **The owner of Murdock is concerned that the computer has made a loss when it was traded-in. He is of the opinion that the accountant has manipulated this by writing off depreciation. Explain to the owner, with reference to the applicable GAAP principle, why depreciation is written off.** |
|---|---|

According to the Prudence concept businesses must be realistic; therefore assets like computers must be depreciated.

A computer will lose value once it has been used and the technology starts to become out-of-date.

## TASK 7.4 ⌘ Fixed Assets Register

| | |
|---|---|
| **7.4.1** | **What was the cost price of the Toyota ND 89567?** |
| R40 000 | |
| **7.4.2** | **Explain the difference between the depreciation and accumulated depreciation columns.** |
| Depreciation shows the amount written off for that year only.<br>Accumulated depreciation shows the total depreciation written off over the years. | |
| **7.4.3** | **Explain why the figures in the depreciation column are the same each year.** |
| The cost method (fixed instalment) of deprecation is been used in this case. | |
| **7.4.4** | **Give a possible reason for the entry on 1 July 20.5.** |
| The vehicle is been sold, scrapped, stolen. | |
| **7.4.5** | **How much would the vehicle have to be sold for, on 1 July 20.5, in order to make a profit of R5 000?** |
| R13 000 + 5 000 = R18 000 | |
| **7.4.6** | **The vehicles account in the General Ledger of 1 January 20.5 showed a balance of R210 000. Why is this different from the cost price of the Toyota mentioned above?** |
| The vehicles account will show the balance of all the vehicles that the business owns.<br>The Fixed Asset Register shows details of each separate vehicle.<br>Therefore, this business owns more than one vehicle. | |
| **7.4.7** | **Explain why it is important to keep a Fixed Asset Register as well as the ledger accounts. Discuss three reasons.** |
| The Fixed Asset Register gives details of each individual asset, e.g.:<br>• The original cost price.<br>• The date on which the asset was bought.<br>• The total depreciation written off the asset.<br>• The book value of the asset. | |

## TASK 7.5 Ben Mbana: Recording in Register, Ledger and Fixed/Tangible assets note

**NOTE**: In the interest of time you can reduce the Task so that learners only complete one or two Fixed Asset Registers.

### 7.5.1 FIXED ASSET REGISTER

***Page 1 of Fixed Asset Register***

| | |
|---|---|
| **ASSET** | Speedo One |
| **COST PRICE** | R180 000 |
| **DATE OF PURCHASE** | 01 January 20.2 |
| **DEPRECIATION RATE** | 30% p.a. on diminishing balance |

**RECORD OF DEPRECIATION**

| Year ending | Depreciation | Accumulated depreciation | Carrying/book value |
|---|---|---|---|
| 31 December 20.2 | 54 000 | 54 000 | 126 000 |
| 31 December 20.3 | 37 800 | 91 800 | 88 200 |
| 31 December 20.4 | 26 460 | 118 260 | 61 740 |
| 31 December 20.5 | 18 522 | 136 782 | 43 218 |
| 31 December 20.6 | 12 965 | 149 747 | 30 253 |
| | | | |

***Page 2 of Fixed Asset Register***

| | |
|---|---|
| **ASSET** | Speedo Two |
| **COST PRICE** | R200 000 |
| **DATE OF PURCHASE** | 30 September 20.3 |
| **DEPRECIATION RATE** | 30% p.a. on diminishing balance |

**RECORD OF DEPRECIATION**

| Year ending | Depreciation | Accumulated depreciation | Carrying/book value |
|---|---|---|---|
| 31 December 20.3 (3 months) | 15 000 | 15 000 | 185 000 |
| 31 December 20.4 | 55 500 | 70 500 | 129 500 |
| 31 December 20.5 | 38 850 | 109 350 | 90 650 |
| 31 December 20.6 | 27 195 | 136 545 | 63 455 |

***Page 3 of Fixed Asset Register***

| | |
|---|---|
| **ASSET** | Speedo Three |
| **COST PRICE** | R230 000 |
| **DATE OF PURCHASE** | 01 July 20.4 |
| **DEPRECIATION RATE** | 30% p.a. on diminishing balance |

**RECORD OF DEPRECIATION**

| Year ending | Depreciation | Accumulated depreciation | Carrying/book value |
|---|---|---|---|
| 31 December 20.4 (6 months) | 34 500 | 34 500 | 195 500 |
| 31 December 20.5 | 58 650 | 93 150 | 136 850 |
| 31 December 20.6 | 41 055 | 134 205 | 95 795 |

***Page 4 of Fixed Asset Register***

| | |
|---|---|
| **ASSET** | Speedo Four |
| **COST PRICE** | R260 000 |
| **DATE OF PURCHASE** | 31 August 20.6 |
| **DEPRECIATION RATE** | 30% p.a. on diminishing balance |

**RECORD OF DEPRECIATION**

| Year ending | Depreciation | Accumulated depreciation | Carrying/book value |
|---|---|---|---|
| 31 December 20.6 (4 months) | 26 000 | 26 000 | 234 000 |

**7.5.2** **GENERAL LEDGER OF BEN MBANA**
**BALANCE SHEET ACCOUNTS SECTION**

**(a) Dr** **VEHICLES** **B** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.6 | | | | |
| Jan | 1 | Bank | CPJ | 180 000 | Dec | 31 | Balance | c/d | 870 000 |
| 20.3 | | | | | | | | | |
| Sept | 30 | Bank | CPJ | 200 000 | | | | | |
| 20.4 | | | | | | | | | |
| July | 1 | Bank | CPJ | 230 000 | | | | | |
| 20.6 | | | | | | | | | |
| Aug | 31 | Bank | CPJ | 260 000 | | | | | |
| | | | | **870 000** | | | | | **870 000** |
| 20.6 | | | | | | | | | |
| Jan | 1 | Balance | b/d | 870 000 | | | | | |

**(b)** **ACCUMULATED DEPRECIATION ON VEHICLES** **B**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | |
| Dec | 31 | Balance | c/d | 54 000 | Dec | 31 | Depreciation | GJ | 54 000 |
| | | | | **54 000** | | | | | **54 000** |
| 20.3 | | | | | 20.3 | | | | |
| Dec | 31 | Balance | c/d | 106 800 | Jan | 1 | Balance | b/d | 54 000 |
| | | | | | Dec | 31 | Depreciation[1] | GJ | 52 800 |
| | | | | **106 800** | | | | | **106 800** |
| 20.4 | | | | | 20.4 | | | | |
| Dec | 31 | Balance | c/d | 223 260 | Jan | 1 | Balance | b/d | 106 800 |
| | | | | | 20.4 | | | | |
| | | | | | Dec | 31 | Depreciation[2] | GJ | 116 460 |
| | | | | **223 260** | | | | | **223 260** |
| 20.5 | | | | | 20.5 | | | | |
| Dec | 31 | Balance | c/d | 339 282 | Jan | 1 | Balance | b/d | 223 260 |
| | | | | | 20.5 | | | | |
| | | | | | Dec | 31 | Depreciation[3] | GJ | 116 022 |
| | | | | **339 282** | | | | | **339 282** |
| 20.6 | | | | | 20.6 | | | | |
| Dec | 31 | Balance | c/d | 446 497 | Jan | 1 | Balance | b/d | 339 282 |
| | | | | | 20.6 | | | | |
| | | | | | Dec | 31 | Depreciation[4] | GJ | 107 215 |
| | | | | **446 497** | | | | | **446 497** |
| | | | | | 20.7 | | | | |
| | | | | | Jan | 1 | Balance | b/d | 446 497 |

[1] 37 800 + 15 000 = 52 800
[2] 26 460 + 55 500 + 34 500 = 116 460
[3] 18 522 + 38 850 + 58 650 = 116 022
[4] 12 965 + 27 195 + 41 055 + 26 000 = 107 215

**NOMINAL ACCOUNTS SECTION**

**(c) Dr** **DEPRECIATION** **N** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.2 | | | | | 20.2 | | | | |
| Dec | 31 | Acc dep on vehicles | GJ | 54 000 | Dec | 31 | Profit & loss account | GJ | 54 000 |
| 20.3 | | | | | 20.3 | | | | |
| Dec | 31 | Acc dep on vehicles | GJ | 52 800 | Dec | 31 | Profit & loss account | GJ | 52 800 |
| 20.4 | | | | | 20.4 | | | | |
| Dec | 31 | Acc dep on vehicles | GJ | 116 460 | Dec | 31 | Profit & loss account | GJ | 116 460 |
| 20.5 | | | | | 20.5 | | | | |
| Dec | 31 | Acc dep on vehicles | GJ | 116 022 | Dec | 31 | Profit & loss account | GJ | 116 022 |
| 20.6 | | | | | 20.6 | | | | |
| Dec | 31 | Acc dep on vehicles | GJ | 107 215 | Dec | 31 | Profit & loss account | GJ | 107 215 |
| | | | | | | | | | |

### 7.5.3 NOTE TO THE FINANCIAL STATEMENTS ON 31 DECEMBER 20.6

**Fixed/Tangible Assets**

| | **Vehicles** |
|---|---|
| Carrying value at beginning of year | 270 718 |
| Cost | 610 000 |
| Accumulated depreciation | (339 282) |
| **Movements** | 152 785 |
| Additions at cost | 260 000 |
| Disposals at carrying value | - |
| Depreciation | (107 215) |
| Carrying value at end of year | **423 503** |
| Cost | 870 000 |
| Accumulated depreciation | (446 497) |

| **7.5.4** | **Ben is concerned about 'Speedo One' as it has become quite old and needs constant repair. Another taxi operator offered him R40 000 for the vehicle. He is prepared to pay him a deposit of R20 000 and the balance over 12 months. On the other hand a vehicle dealer offered him a trade-in value of R28 000 on the purchase of a new one. Which option do you think Ben should take? Provide reasons for your answer.** |
|---|---|

Open-ended. Some suggestions are provided below:
Accept the offer of R40 000.
This is R12 000 more than the trade-in value.
The R20 000 deposit may be used as part payment for the new vehicle.
He will have to ensure that the balance of R20 000 is repaid – he needs to check the credentials of the buyer.
If he decides to trade-in the vehicle he should approach the dealer and negotiate for a better trade-in value.
The trade-in gives him instant value while the other offer entails a 12 month waiting period.
Also the possibility of bad debts cannot be ruled out.
Any other suitable answer.

## TASK 7.6 ⌘ Calcor Ltd: Fixed/Tangible asset note

| 7.6.1 | Explain why the depreciation for the current period is R39 999 and not R40 000. |
|---|---|

Note that the book value of the vehicle is R40 000.
Therefore, the assets cannot be depreciated by more than R40 000.
In practice it is customary to depreciate down to an amount of R1.
The depreciation amount is therefore adjusted to make its value equal to R1 ( i.e. depreciation of R39 999).

| 7.6.2 | Calculate the age of this vehicle. |
|---|---|

5 years (20% each year = R40 000)
160 000 ÷ 40 000 = 4
Add on 1 more year for the depreciation for the current period.

| 7.6.3 | What are your recommendations with regard to this vehicle? |
|---|---|

The vehicle is old as the carrying value is R1.
It should have been replaced or traded-in.
Running costs may escalate as the vehicle may require constant repair.
On the other hand the company may be happy with the vehicle even though it is old.
It is possible that the vehicle is properly maintained and serviced regularly and could last a few more years.

## TASK 7.7 Bryanston Squash Club: Fixed/Tangible asset note

**7.7.1 BRYANSTON SQUASH CLUB**
**FIXED/TANGIBLE ASSET NOTE ON 31 DECEMBER 20.8**

| | Vehicles | Equipment |
|---|---|---|
| Carrying value at beginning of year | 64 800 | 17 800 |
| Cost | 90 000 | 25 000 |
| Accumulated depreciation | [25 200] | [7 200] |
| **Movements** | 23 140 | 22 889 |
| Additions at cost | 38 000 | 27 000 |
| Disposals at carrying value | 0 | [805] |
| Depreciation | [14 860] | [3 306] |
| Carrying value at end of year | **87 940** | **40 689** |
| Cost | 128 000 | 49 600 |
| Accumulated depreciation | [40 060] | [8 911] |

**Calculations**:

**VEHICLES**

Accumulated depreciation on vehicles (beginning):

| | | | |
|---|---|---|---|
| 01 July 20.6 – 31 December 20.6: | 90 000 x 20% x $^{6}/_{12}$ | = | 9 000 |
| 01 January 20.7 – 31 December 20.7: | 90 000 – 9 000 x 20% | = | 16 200 |
| | | | 25 200 |

Depreciation for the year:

| | | | | |
|---|---|---|---|---|
| 64 800 x 20% | = | R12 960 | | |
| Depreciation on additional vehicle | = | 40 060 – 25 200 | = | R14 860 |
| | | R14 860 – 12 960 | = | R1 900 |

Cost price of additional vehicle:

| | | | |
|---|---|---|---|
| Depreciation per annum | = | 20% | |
| Depreciation for 3 months | = | 20% x 3 ÷ 12 | = 5% |
| Cost price of additional vehicle | = | 1 900 x $^{100}/_{5}$ | = R38 000 |

**EQUIPMENT**

Additions at cost:

25 000 + 2 000 = R27 000

Disposals at carrying value:

| | | | | |
|---|---|---|---|---|
| Depreciation (update) | = | 840 x 10% x $^{5}/_{12}$ | = | R35 |
| Accum. depreciation at beginning | = | 2 400 – 840 | = | R1 560 |
| Accum. depreciation on 31 May 20.8 | = | 1 560 + 35 | = | R1 595 |
| Disposals at carrying value | = | 2 400 – 1 595 | = | R805 |

Depreciation for the year:

| | | |
|---|---|---|
| On equipment traded-in | = | R35 |
| On remaining equipment | = | [25 000 – 2 400] – [7 200 – 1 560] x 10% |
| | = | 22 600 – 5 640 x 10% |
| | = | R1 696 |
| On new equipment | = | 25 000 + 2 000 x 10% x $^{7}/_{12}$ |
| | = | R1 575 |
| Total depreciation | = | 35 + 1 696 + 1 575 |
| | = | R3 306 |

Cost price at year-end:

25 000 – 2 400 + 25 000 + 2 000 = R49 600

Accumulated depreciation at year-end = 7 200 + 3 306 – 1 595 = R8 911

| **7.7.2** | **Calculate the amount paid to the supplier of the new equipment.** |
|---|---|

Trade-in value = 805 – 500
= R305

Amount paid = 25 000 – 305 – 9 000
= R15 695

## TASK 7.8 ⌘ Emptron Ltd: Analysis/Interpretation

| **7.8.1** | **The cost price of premises has increased in 20.9. Provide a reason for this.** |
|---|---|

Extensions.
Additional property may have been acquired.

| **7.8.2** | **The current market value of the premises is R750 000 yet the company reflects R500 000 in their Balance Sheet. What concept of GAAP is being applied here?** |
|---|---|

Historical cost concept/Prudence concept (fair representation).

| **7.8.3** | **Calculate the cost price of the new equipment bought.** |
|---|---|

| | |
|---|---|
| Cost price at the beginning of the year | 260 000 |
| Less cost of asset sold | (20 000) |
| | 240 000 |
| Addition (difference between R300 000 and R240 000) | **60 000** |
| Cost at the end of the year | 300 000 |

### 7.8.4 NOTE TO THE FINANCIAL STATEMENTS ON 28 FEBRUARY 20.9

**Fixed/Tangible asset**

| | Land and Buildings | Equipment | Total |
|---|---|---|---|
| Carrying value at beginning of year | 400 000 | 129 800 | 529 800 |
| Cost | 400 000 | 260 000 | 660 000 |
| Accumulated depreciation | - | [130 200] | [130 200] |
| **Movements** | 100 000 | 14 000 | 114 000 |
| Additions at cost | 100 000 | 60 000 | 160 000 |
| Disposals at carrying value | - | [4 000] | [4 000] |
| Depreciation | - | [42 000] | [42 000] |
| Carrying value at end of year | **500 000** | **143 800** | **643 800** |
| Cost | 500 000 | 300 000 | 800 000 |
| Accumulated depreciation | - | [156 200] | [156 200] |

## TASK 7.9⌘ DuBois Stores: Analysis/Interpretation

**7.9.1 Calculate the rate of depreciation per annum applied to vehicles.**

15 000 x 100 = 12.5% for 6 months
120 000 1
12.5% x 2 = **25% p.a.**

**7.9.2 Refer to the Accumulated depreciation on vehicles account.**

**(a) State the reason for the depreciation entry (R15 000) on 31 August 20.8.**

The vehicle that was sold on 31 August but has been in use by the business for the period 01 March 20.8 – 31 August 20.8, therefore it has to be depreciated for that period, i.e. 6 months.

**(b) What is the purpose of the debit entry (R105 000) in this account?**

This is the total depreciation on the vehicle sold.
Since the vehicle does not belong to the business the accumulated depreciation on the vehicle must be reversed/written back/cancelled.
There should be no accumulated depreciation on an asset that is no longer with the business.

**(c) Calculate the accumulated depreciation on the vehicle sold on 01 March 20.8.**

105 000 – 15 000 = **R90 000**

**7.9.3 Calculate the carrying/book value of motor vehicles on 28 February 20.9**

Depreciation on the existing vehicles: 900 000 – 120 000 x 25% = R195 000
Carrying/book value on 28 Feb. 20.9 = [900 000 – 120 000] – [600 000 + 15 000 + 195 000 – 105 000]
= 780 000 – 705 000
= **R75 000**

**7.9.4 Calculate the carrying/book value of the vehicles sold on 31 August 20.8.**

120 000 – 105 000 = **R15 000**

**7.9.5 Calculate the profit/loss on disposal of vehicles on 31 August 20.8.**

18 000 – 15 000 = **R3 000 profit**

**7.9.6 What amount will appear in respect of depreciation in the Profit and Loss account on 28 February 20.9?**

195 000 + 15 000 = **R210 000**

| 7.9.7 | **Indicate if the following statements are true or false. Give reasons if the answer is false.** |
|---|---|
| | **(a)** True |
| | **(b)** False – the cost price is R780 000 (900 000 – 120 000) |
| | **(c)** True |
| | **(d)** False – the contra account in the Asset disposal account is Debtors control therefore it was sold on credit. |
| | **(e)** True |
| | **(f)** False – Fixed/Tangible assets are shown at carrying/book value, i.e. cost price minus accumulated depreciation. |
| | **(g)** True |
| | **(h)** False – the contra account would be Donation. |
| | **(i)** True |
| | **(j)** True |

## TASK 7.10 Belbar Travel CC: Analysis/Interpretation

| 7.10.1 | **What are your views on Belinda's policy to upgrade computers every two years? Provide reasons for your answers.** |
|---|---|

Computer technology is changing all the time.
As all her business is done on computers it is wise to upgrade to newer and updated technology regularly.
Bookings/reservations and other enquiries from clients need to be executed quickly and efficiently.
Updated computer equipment will save time and ensure that transactions are processed efficiently and accurately.

| 7.10.2 | **Comment on Belinda's decision to donate computers to charity. Does her business benefit in any way from this?** |
|---|---|

Her business does not gain financially from donations but donations provide an excellent opportunity for free publicity for her business.
People become aware of her acts of charity and her service to the community.
This augurs well for future business.
In line with the King Kode businesses are encouraged to give back to their communities.

| 7.10.3 | **Does her business benefit in any way from selling computers to staff and friends? Provide reasons for your answer.** |
|---|---|

Yes, she is getting back some cash for the computers – this would help in the purchase of the new equipment.
Furthermore the cash offsets against the depreciation written off over the two years.
Selling to staff at a reduced price promotes staff loyalty.
Although the computers are two years old they can still be used for many more years.
Selling to friends may also promote business for her in the future – hopefully they would do business with her.

| 7.10.4 | **If she were to advertise the computers in the local paper instead of selling to staff and friends would she make a profit? Provide reasons for your answers.** |
|---|---|

The resale value of computers is generally low.
It is possible that she may get a better price – the ruling market price of these computers will be a determining factor.
She also has the other option of trading in the old computers with her supplier provided he accepts trade-ins.

| 7.10.5 | **Explain each of the entries in the Asset Disposal account. Provide reasons for each entry.** |
|---|---|
| [1] | Cost price of the computers that is being disposed off. The Equipment account is credited with this amount making the balance of this account zero. |
| [2] | The accumulated depreciation that is being written back/reversed. The Accumulated depreciation account is debited with this amount resulting in the balance of this account being zero. |
| [3] | The book/carrying value of the two computers being donated. Donation account is debited and is shown as an expense to the business. |
| [4] | The cash proceeds from the sale of the computers. Bank account is debited with this amount. Bank increases with this amount if bank is favourable or decreases if bank is overdrawn. |
| [5] | The loss incurred as the result of the sale of the three computers. This is shown as an expense to the business. |

| 7.10.6 | **Calculate the following:** |
|---|---|
| | **(a) The cost price of one computer.** |
| 50 000 ÷ 5 = **R10 000** | |
| | **(b) The depreciation amount per year for each computer.** |
| 10 000 x 30% = **R3 000** | |
| | **(c) The book/carrying value of the computers donated.** |
| R8 000<br>This may also be computed as follows:<br>[2 x 10 000] – [2 x 3 000 x 2 years] = 20 000 – 12 000 = **R8 000** | |
| | **(d) The book/carrying value of the computers sold.** |
| [3 x 10 000] – [3 x 3 000 x 2 years] = 30 000 – 18 000 = **R12 000** | |

## TASK 7.11 ⌘ Opticon CC: Audit

**SUGGESTION:**
In the interest of time you can split the class into groups and then let them give a short report-back.

**Land and buildings:**
If the property is fully owned verify this with the title deeds.
Make certain that the deeds are kept in a safe place – safekeeping in a bank vault may be advisable.
If a bond was taken out on the property check the bond details, repayments and the interest being charged.
Ensure that the interest charged is the lowest available – many financial institutions offer attractive deals with lower interest payments.
Confirm that the entries in the Fixed Assets Register are up-to-date.
Check the condition of the buildings – obtain the services of a professional to do this. Report to management and advise accordingly.
Compare the Balance Sheet value with the current market value. A property evaluator can advise on this.
Ensure that the property is properly and fully utilised. Unused property should be let or sold.

**Vehicles:**
Check invoices and ensure that the Fixed Assets Register is up-to-date.
Reconcile the Register with invoices and a physical count.
Ensure that depreciation is applied correctly and is calculated at the applicable rate.
Analyse running costs per vehicle and advise management.
Check insurance details ensuring the premiums are paid promptly.
Ensure the proper utilisation of vehicles – the business policy with regard to the use of vehicles for private reasons must be adhered to.
Ascertain that vehicles are efficiently utilised. Vehicles that are idle should be sold.

**Equipment:**
Check invoices and ensure that the Fixed Assets Register is up-to-date.
Reconcile the Register with invoices and a physical count.
Ensure that depreciation is applied correctly and is calculated at the applicable rate.
Analyse running costs per item and advise management.
Ensure that equipment is updated on a regular basis, e.g. computers.
Check insurance details ensuring the premiums are paid promptly.
Ensure the proper and efficient utilisation of equipment – the business policy with regard to the use of equipment for private reasons must be adhered to.
Ascertain that all equipment is fully utilised. Equipment that is not used should be sold or traded-in for better equipment.

## TASK 7.12 Kyon Lok CC: Internal control, Calculations, Analysis and interpretation

| | |
|---|---|
| **7.12.1** | **Although the vehicle is used solely for business purposes Mr Lok acquired the vehicle in his own name and not in the name of the CC. Suggest reasons as to why he did this.** |

Various answers are possible.
If registered in the name of the CC the vehicle would have to be disclosed in the Balance Sheet.
Assets and subsequently Owner's equity increase.
His intention is to undervalue the worth of his business.
He may also want to use the vehicle for his private purposes.
Consider the Business entity concept of GAAP concept whereby the financial affairs of a business are kept entirely separate from the financial affairs of the owner.

| | |
|---|---|
| **7.12.2** | **How does the provision of transport for employees affect productivity and profit?** |

Employees start work early resulting in increased productivity.
Workers need not stress about transport arrangements any longer as this is provided.
The transport arrangement is convenient and safe for the employees.

| | |
|---|---|
| **7.12.3** | **Is it possible that the driver is using the new tyres and spare parts for some other vehicle not belonging to the CC? Explain.** |

Yes. Since the vehicle is well-maintained there should be no need for requests for additional spares.

| | |
|---|---|
| **7.12.4** | **Do you think that the driver is using the vehicle for private purposes? Explain why.** |

Yes. The mileage is high and he is constantly requesting petrol.

| | |
|---|---|
| **7.12.5** | **What control measures can Mr Lok put in place to ensure that the vehicle is not being used for private purposes?** |

He should lay down rules regarding the use of the vehicle, e.g. it should be locked in a garage when not in use.
A tracking device could be installed.
He should keep the keys for the vehicles on himself.
Physical checks should be conducted regularly.

| | |
|---|---|
| **7.12.6** | **The minibus was purchased for R220 000 on 01 July 20.6. The current depreciation rate on this vehicle is 25% p.a. on the diminishing balance method. Calculate the book/carrying value on 31 December 20.9. Use the table below for your calculations. Round off calculations to the Rand where applicable.** |

| Year ending | Depreciation | Accumulated depreciation | Book/Carrying value |
|---|---|---|---|
| 20.6:12:31 | 27 500 | 27 500 | 192 500 |
| 20.7:12:31 | 48 125 | 75 625 | 144 375 |
| 20.8:12:31 | 36 094 | 111 719 | 108 281 |
| 20.9:12:31 | 27 070 | 138 789 | 81 211 |

| 7.12.7 | **Will Kyon Lok CC benefit financially should Mr Lok decide to sell the vehicle? Give a reason for your answer.** |
|---|---|
| No.<br>The vehicle is not registered in the name of the business. | |
| **7.12.8** | **How would the workers react should Mr Lok decide to charge them a fee for transporting them?** |
| Open-ended.<br>Some may be willing to pay for the convenience while others may not. | |

## TASK 7.13 Jayque Marketers (Pty) Ltd: Fixed/Tangible asset note, Interpretation

**7.13.1 FIXED/TANGIBLE ASSETS**

| | **Land and Buildings** | **Vehicles** | **Equipment** |
|---|---|---|---|
| Carrying value at beginning of year | **1 200 000** | 151 875 | 40 000 |
| Cost | 1 200 000 | 640 000 | **200 000** |
| Accumulated depreciation | 0 | **[488 125]** | [160 000] |
| **Movements** | **100 000** | **162 031** | **140 000** |
| Additions at cost | **100 000** | 240 000 | 180 000 |
| Disposals at carrying value | 0 | 0 | **[10 000]** |
| Depreciation | 0 | **[77 969]** | [30 000] |
| Carrying value at end of year | **1 300 000** | **313 906** | **180 000** |
| Cost | 1 300 000 | **880 000** | 180 000 |
| Accumulated depreciation | 0 | **[566 094]** | 0 |

**Calculations**:

Depreciation on vehicles:
151 875 x 25% = R37 969
240 000 x 25% x $^{8}/_{12}$ = 40 000
R77 969

Disposals at carrying value:
Cost price = R200 000
Acc. depreciation = 160 000 + 30 000
= R190 000
Carrying value = 200 000 – 190 000
= R10 000

| 7.13.2 | **Explain why there is no accumulated depreciation on equipment at the end of the year.** |
|---|---|
| All of the existing equipment (R200 000) was sold.<br>The new equipment (R180 000) was purchased on the last day of the financial year, i.e. 28 February 20.8. | |
| **7.13.3** | **Although Land and buildings are reflected at R1 300 000, a property evaluator estimates the value of the property to be R2 000 000. What principle(s) of GAAP is/are being applied here?** |
| Historical cost – assets are recorded at the original cost price. | |
| **7.13.4** | **What factors would have been considered when the company decided to acquire another vehicle?** |
| The existing vehicles are old or slow.<br>Increase in sales might have justified the purchase of a new vehicle.<br>The company might have wished to replace the vehicles with more modern ones.<br>Any other suitable answer. | |

## TASK 7.14 ⌘💧💧💧 BBN Taxi Service: Problem solving, Analysis and Interpretation

| **Taxi no. 1:** |
|---|
| Learner identifies two of the following:<br>• High running costs (R6.10 / km).<br>• Age (fully depreciated).<br>• Safety concern.<br>• Earning R9.00 / km (1 080 000/ 120 000) (Profit R2.90 / km). |
| **Taxi no. 2:** |
| Learner identifies two of the following:<br>• Lack of revenue in comparison to the other taxis (R288 000 i.e. R4.11/km).<br>• Likelihood of theft / fraud by the driver.<br>• Revenue per km is less than running costs per km (R4.11 compared to R4.80). |
| **Taxi no. 3:** |
| Learner identifies two of the following:<br>• Under-utilisation (34 000 km – others doing almost 70 000 km or 120 000 km).<br>• Running costs are low (R4.70 / km) – should be used more.<br>• Lack of work ethic of the driver.<br>• Earning R9.00 / km (306 000 / 34 000) (Profit of R4.30 / km excluding depreciation). |

## TASK 7.15 ⌘💧💧 Ethics and control, Problem solving

| No. | Problem | Solution |
|---|---|---|
| **1.** | He is not an employee of the business. He is in total disregard of business policy. Employees of the business may feel that they are being unfairly treated. | The owner should have a word with his son on the matter. He needs to ensure that his son is aware of business policy and rules and the effect his actions may have on staff morale. |
| **2.** | It is clear that he is not using the allowance for its intended purpose. The allowance is granted to promote good customer relations and increase sales. Entertaining family and friends is not business-related. | The matter should be discussed with him. He may need to be reminded of the purposes of the allowance. Claim vouchers submitted by him will have to be properly scrutinised. |
| **3.** | The driver is in contravention of business policy. Business assets used for personal reasons and even for personal gain affects running costs (fuel, repairs, etc.) which the business has to pay for, thus affecting profits. | The driver must be approached and the matter discussed with him. He should be reminded of company policy with regard to the private use of business vehicles. Should he not comply he may have to be reprimanded or dismissed. Management must ensure that they comply with the procedures applicable to worker dismissal. |
| **4.** | The business is being overcharged as a result of the Sales Manager's actions. The procedure for the awarding of contracts is irregular. | The matter should be queried with the Sales Manager – he needs to know that this could amount to fraud. The owner will have to review the procedure in awarding contracts. |

| No. | Problem | Solution |
|---|---|---|
| **5.** | The TV was purchased for business use and not personal use. It could be damaged or stolen while being transported to his home. Insurance policies may not cover the item if it is used outside the business premises. The additional usage of the TV decreases its lifespan resulting in added costs for the business. Other employees may feel that the Personnel Manager is being given preferential treatment. This is not good for staff morale. | Guidelines with regard to the use of equipment other than for business purposes should be clearly stipulated to all employees. These must be adhered to. Defaulters should be reprimanded. Failure to comply could result in dismissal. Frequent checks need to be undertaken by the owner/auditor/senior personnel. |
| **6.** | The Fixed Assets Register will not reconcile with actual physical stock on hand. Assets will not be shown correctly in the Balance Sheet. | The Accounting procedure for the disposal of assets will have to be explained to the owner. As the proprietor he is entitled to take assets for personal purposes but these must be recorded. (Business entity concept) |
| **7.** | This action amounts to insurance fraud and is a criminal act. The owner is trying to defraud the insurance company. Insurance policies do not cover intentional damage to property. | The insurance company will not cover the claim as this is a deliberate act. Insurance companies usually conduct investigations before claims are paid out. His act may also affect his future relationship with the insurance company, e.g. premiums, no-claim bonuses, etc. |
| **8.** | There may not be a problem if she follows correct procedure when buying items from this company. Other employees may not be comfortable with this situation. The gifts should actually be given to the business as the Secretary represents the business when she orders from the company. | The owner will have to check if he is getting the best deal with this company. He will have to be convinced that the Secretary is not compromising the interests of the business with that of her own. |
| **9.** | Male employees may be unhappy with this arrangement. They might feel that they are being unfairly discriminated against. They can take the matter up with their union as the implication is that only male staff is dishonest. | Since this is a sensitive issue the rights of the individual will have to be respected. Body searches of females may be undertaken in private and conducted by female security personnel. |

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Calculate depreciation, accumulated depreciation, book value on fixed assets that have been sold during the financial year. | | | |
| Draw up a Fixed Asset Register and validate fixed assets. | | | |
| Explain and draw up an Asset Disposal account. | | | |
| Make the necessary entries in the Financial statements. | | | |
| Report on Fixed/Tangible assets. | | | |
| Discuss control measures that need to be taken to protect the assets of the business. | | | |
| Discuss ethical issues relating to the use of the assets of the business. | | | |

# MODULE 8
# CLOSE CORPORATIONS

**Note to Teacher:**
The curriculum does not cover specific bookkeeping entries or year-end adjustments in the context of Close Corporations. Some extension Tasks (not for examination purposes), have however been included at the end of this chapter for those who wish to broaden their knowledge of these concepts.

## TASK 8.1 ⌘ Differences between a CC and a Partnership

**8.1.1**

| | Close corporation | | Partnership |
|---|---|---|---|
| **1.** | Is a legal personality – able to sue and be sued. | **1.** | Has no legal personality – partners will be sued in their own names. |
| **2.** | Member's liability for debts of the business is limited to amounts invested. | **2.** | Jointly and severally liable for the debts of the business. |
| **3.** | Name must end with CC. | **3.** | No additions required in the name. |
| **4.** | Minimum of 1 and maximum of 10 members. | **4.** | Minimum of 2 and maximum of 20 partners. |
| **5.** | Owners are called members. | **5.** | Owners are called partners. |
| **6.** | Capital contribution is limited to 10 members. | **6.** | Capital limited to the creditworthiness of 20 partners. |
| **7.** | The profits of a CC are taxed in the same manner as a Company. | **7.** | Profits are taxed in the individual names of each partner. |
| **8.** | Continuity is not limited as a CC is a separate legal personality. | **8.** | Continuity is limited. If a partner leaves or dies the partnership ceases to exist. |
| **9.** | Founding statement was required to register a CC. | **9.** | Partnership can be established by means of a verbal or written agreement between the partners. |
| **10.** | Additional logical answers are to be accepted. | **10.** | Additional logical answers are to be accepted. |

**8.1.2 Compare your answers with other learners' responses and add any that you do not have in order to ensure your list is complete.**

## TASK 8.2 ⌘ Differences between a CC and a Public Company

**8.2.1**

| | Close corporation | | Public Company |
|---|---|---|---|
| **1.** | Name must end with 'CC'. | **1.** | Name must end with 'LTD'. |
| **2.** | Minimum 1 and Maximum 10 members. | **2.** | Minimum 7 shareholders and maximum is only limited by the number of shares available. |
| **3.** | Members have a personal interest in the management of the CC. No separation of ownership and control. | **3.** | Management by an appointed board of directors. Separation of ownership and control. |
| **4.** | Can no longer be registered but existing CC's may continue as per amendments to the Companies Act No. 71 of 2008. | **4.** | Stringent Registration requirements with "The Companies and Intellectual Properties Commission" according to the Companies Act No. 71 of 2008. |
| **5.** | Little regulation as owners and management are the same. | **5.** | Strict statutory control as there is separation of ownership and management. |
| **6.** | Voting is in proportion to the % interest each member has in the CC. | **6.** | Voting in accordance with the number of shares (shareholding) they hold and the category of shares held. |
| **7.** | No audit required. Accounting Officer must report on financial statements. | **7.** | Audit required by Independent Auditors. |
| **8.** | Other logical answers are to be accepted. | **8.** | Other logical answers are to be accepted. |

**8.2.2 Compare your answers with other learners' responses and add any that you do not have in order to ensure your list is complete.**

## TASK 8.3 Story Book CC: Members' interest

Dick : Tom : Harry = 1 : 1 : 1 or 33.3% each

**New Ratio:**
Dick: 33.3% + (½ of 33.3%) = 33.3% + 16.7% = 50%
Tom: 33.3% + (½ of 33.3%) = 33.3% + 16.7% = 50%

## TASK 8.4 Terminology: Company vs Close Corporation

| No. | Terminology used in the books of ABC Ltd | Terminology used in the books of XYZ CC |
|---|---|---|
| **1.** | Ordinary share capital | **Members contributions** |
| **2.** | **Audit fees** | Accounting Officer's salary |
| **3.** | **Retained income** | Undrawn profits |
| **4.** | **Shareholders for dividends** | Distributions payable to members |
| **5.** | Ordinary share dividends | **Distributions to members** |
| **6.** | **Shareholding** | Members' interest |
| **7.** | Income tax | **Income tax** |
| **8.** | **SARS (Income tax)** | SARS (Income tax) |
| **9.** | Ordinary shareholders' equity | **Members equity** |

## TASK 8.5 Calculation of Undrawn profits and Members equity

**8.5.1**

| | |
|---|---|
| **Undrawn profit at the beginning of the year** | 55 000 |
| Add: Net profit after tax (220 000 – 63 800) | 156 200 |
| Less: Distributions to members | (95 000) |
| Distributions during the year | 45 000 |
| Distributions payable to members | 50 000 |
| **Undrawn profit at the end of the year** | **116 200** |

**8.5.2**

| | |
|---|---|
| **MEMBERS EQUITY** | 746 200 |
| Members contributions (550 000 + 50 000 + 30 000) | 630 000 |
| Undrawn profits / Retained Income | 116 200 |
| | |

## TASK 8.6 ⌘ Differences in Financial Statements

| Close Corporation | Public Company |
|---|---|
| Payments to members (Members salaries, Rent paid to a member, etc.) are shown as operating expenses on the Income Statement and detailed in the Transactions with members note to the financial statements. | Directors Fees must be shown as a separate amount on the Income Statement. Directors Fees may not be included in the Salaries figure. |
| Accounting Officer's fees / salary will be shown on the Income Statement as an operating expense. Some CC's may also show auditors fees if the owners choose to have the financial statements of their business audited. | The Financial statements of a Public company must be audited by independent auditors. Audit fees will be shown under the operating expenses section of the Income Statement. |
| Loans to members shown under Current assets or Non-Current assets on the Balance Sheet. This depends whether the loans will be paid back in the short term or long term. | No loans to shareholders. |
| Loans from members may be treated as a Current liability or a Non-Current liability depending on the time period that these loans will be repaid. | If there are loans they would be treated in the same way. Debentures (loans from shareholders) fall outside the scope of your curriculum. |
| Capital contributions are shown as "Members Contributions" on the Balance Sheet. | Capital is show as "Share Capital" on the Balance Sheet. There may be different categories of shares, e.g.: Ordinary Share Capital, Preference Share Capital. |
| Undrawn profits are shown as part of Member's Equity on the Balance Sheet. | Retained Income / Profits are shown as part of Ordinary Shareholders' Equity on the Balance Sheet. |
| Profits are paid out in the form of "Distributions to members" and are shown as a deduction in the Undrawn profits note to the Balance Sheet. | Profits are paid out in the form of "Ordinary Share Dividends" and are shown as a deduction in the Retained Income note to the Balance Sheet. |
| Distributions agreed upon but not yet paid to members are shown as "Distributions payable to members" under Current liabilities on the Balance Sheet. | Dividends declared but not yet paid to shareholders are shown as "Shareholders for Dividends" under Current liabilities on the Balance Sheet. |
| All transactions with members must be shown in detail in a separate note to the financial statements. | No transactions with shareholders. |

## TASK 8.7 Extension Task: Sandown CC

**GENERAL LEDGER OF SANDOWN CC**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **Members' contribution** **B** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | 20.7 | | | | |
| | | | | | Sept | 1 | Balance | b/d | 2 000 |
| | | | | | | | | | |

**Loan from D. Down** **B**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.7 | | | | |
| Nov | 30 | Bank | CPJ | 7 250 | Sept | 1 | Balance | B/d | 75 000 |
| 20.8 | | | | | Nov | 30 | Interest on loan | GJ | 2 250 |
| May | 31 | Bank* | CPJ | 9 263 | 20.8 | | | | |
| Aug | 31 | Bank | CPJ | 6 950 | Feb | 28 | Interest on loan | GJ | 2 100 |
| | | Balance | c/d | 60 000 | May | 31 | Interest on loan | GJ | 2 163 |
| | | | | | Aug | 31 | Interest on loan | GJ | 1 950 |
| | | | | **83 463** | | | | | **83 463** |
| | | | | | Sept | 1 | Balance | b/d | 60 000 |
| | | | | | | | | | |

*5 000 + 2 100 + 2 163

**Dr** **Loan to S. San** **B** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.7 | | | | |
| Sept | 1 | Balance | b/d | 20 000 | Dec | 1 | Bank | CPJ | 2 000 |
| | | | | | 20.8 | | | | |
| | | | | | Aug | 31 | Balance | c/d | 18 000 |
| | | | | **20 000** | | | | | **20 000** |
| 20.8 | | | | | | | | | |
| Sept | 1 | Balance | b/d | 18 000 | | | | | |

**Undrawn profits/ Retained income** **B**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.8 | | | | | 20.7 | | | | |
| Aug | 31 | Balance | c/d | 18 000 | Sept | 1 | Balance | b/d | 18 000 |
| | | | | **18 000** | | | | | **18 000** |
| | | | | | Sept | 1 | Balance | b/d | 18 000 |

**SARS (Income tax)** **B**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.8 | | | | |
| Sept | 1 | Balance | b/d | 14 000 | Aug | 31 | Income tax | GJ | 125 000 |
| 20.8 | | | | | | | | | |
| Feb | 18 | Bank | CPJ | 40 000 | | | | | |
| Aug | 25 | Bank | CPJ | 60 000 | | | | | |
| | 31 | Balance | c/d | 11 000 | | | | | |
| | | | | **125 000** | | | | | **125 000** |
| | | | | | Sept | 1 | Balance | b/d | 11 000 |

**NOMINAL ACCOUNTS SECTION**

**Distribution to members** **N**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.8 | | | | | 20.8 | | | | |
| Jan | 25 | Bank | CPJ | 80 000 | Aug | 31 | Appropriation a/c | GJ | 195 000 |
| Aug | 31 | Dist. payable to members | GJ | 115 000 | | | | | |
| | | | | **195 000** | | | | | **195 000** |

**FINAL ACCOUNTS SECTION**

**Appropriation account** **F**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.8 | | | | | 20.8 | | | | |
| Aug | 31 | Income tax | GJ | 125 000 | Aug | 31 | Profit & loss a/c | GJ | 320 000 |
| | | Dist. to members | GJ | 195 000 | | | | | |
| | | | | **320 000** | | | | | **320 000** |

## TASK 8.8 Extension Task: Woody Traders CC

**GENERAL LEDGER OF WOODY TRADERS CC**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **Trading stock** **B** **Cr**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Balance | b/d | 213 100 | Feb | 28 | Balance | c/d | 218 000 |
| | | Cost of sales | GJ | 1 875 | | | | | |
| | | Trading stock surplus | GJ | 3 025 | | | | | |
| | | | | **218 000** | | | | | **218 000** |
| Mar | 1 | Balance | b/d | 218 000 | | | | | |

**NOMINAL ACCOUNTS SECTION**

**Stationery** **N**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Total/Balance | b/f | 2 775 | Feb | 28 | Prepaid expenses | GJ | 400 |
| | | | | | | | Profit & loss a/c | GJ | 2 375 |
| | | | | **2 775** | | | | | **2 775** |

**Distribution to members** **N**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Distribution payable to | | | Feb | 28 | Appropriation a/c | GJ | 150 000 |
| | | members | GJ | 150 000 | | | | | |

**FINAL ACCOUNTS SECTION**

**Trading account** **F1**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Cost of sales | | | Feb | 28 | Sales (1 155 560 - | | |
| | | (405 500 – 1 875) | GJ | 403 625 | | | 12 240 – 2 700) | GJ | 1 140 620 |
| | | Profit & loss a/c | GJ | 736 995 | | | | | |
| | | | | **1 140 620** | | | | | **1 140 620** |

**Dr** **Profit and Loss account** **F2** **Cr**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Bad debts | | | Feb | 28 | Trading account | GJ | 736 995 |
| | | (3 350 + 1 440) | GJ | 4 790 | | | Discount received | GJ | 2 150 |
| | | Discount allowed | GJ | 4 270 | | | Commission income | GJ | 200 000 |
| | | Stationery | GJ | 2 375 | | | Trading stock surplus | GJ | 3 025 |
| | | (see ledger account) | | | | | | | |
| | | Telephone | GJ | 8 900 | | | | | |
| | | Water & electricity | | | | | | | |
| | | (41 740 + 1 100) | GJ | 42 840 | | | | | |
| | | Salaries | GJ | 222 100 | | | | | |
| | | Int. on loan: Reddy | | | | | | | |
| | | (22 000 + 16 000) | GJ | 38 000 | | | | | |
| | | Wages | | | | | | | |
| | | (81 986 + 1 000) | GJ | 82 986 | | | | | |
| | | Prov. for bad debts | | | | | | | |
| | | adjustment | GJ | 700 | | | | | |
| | | Loss on disposal | GJ | 1 700 | | | | | |
| | | Depreciation (1 500 + | | | | | | | |
| | | 10 838 + 45 200 + 750) | GJ | 58 288 | | | | | |
| | | Accounting Officer's remuneration | GJ | 60 000 | | | | | |
| | | Repairs | GJ | 6 000 | | | | | |
| | | Salary: Woo | GJ | 50 000 | | | | | |
| | | Salary: Reddy | GJ | 50 000 | | | | | |
| | | Rent: Reddy | GJ | 9 600 | | | | | |
| | | Appropriation a/c | GJ | 299 621 | | | | | |
| | | | | **942 170** | | | | | **942 170** |

**Appropriation account** **F3**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Income tax | GJ | 116 500 | Feb | 28 | Profit & Loss account | GJ | 299 621 |
| | | Dist. to members | GJ | 150 000 | | | | | |
| | | Undrawn profits | GJ | 33 121 | | | | | |
| | | | | **299 621** | | | | | **299 621** |

**8.8.2 WOODY TRADERS CC**
**POST-CLOSING TRIAL BALANCE ON 28 FEBRUARY 20.8**

| Balance Sheet accounts section | Fol | Debits | Credits |
|---|---|---|---|
| Members contributions | | | 90 000 |
| Undrawn profits (20 000 + 33 121) | | | 53 121 |
| Loan from D. Reddy | | | 350 000 |
| Land & buildings (396 900 – 6 000) | | 390 900 | |
| Vehicles | | 332 000 | |
| Equipment (128 380 – 20 000 + 30 000) | | 138 380 | |
| Accumulated depreciation on vehicles (106 000 + 45 200) | | | 151 200 |
| Accumulated depreciation on equipment (28 000 + 1 500 – 6 500 + 10 838 + 750) | | | 34 588 |
| Trading stock (See ledger account) | | 218 000 | |
| Debtors control (77 841 – 2 700 – 1 440) | | 73 701 | |
| Bank | | 24 600 | |
| Cash float | | 186 | |
| Creditors control (110 658 – 11 800 + 30 000) | | | 128 858 |
| SARS (Income tax) ( 84 500 – 116 500) | | | 32 000 |
| Expenses payable (1 100 + 60 000 + 16 000 + 100 000 + 9 600) | | | 186 700 |
| SARS (PAYE) | | | 180 |
| Creditors for wages | | | 820 |
| Provision for bad debts | | | 700 |
| Prepaid expenses | | 400 | |
| Distributions payable to members | | | 150 000 |
| | | **1 178 167** | **1 178 167** |

## TASK 8.9 Extension Task: Musica CC - Financial statements

**MUSICA CC**
**INCOME STATEMENT / STATEMENT OF COMPREHENSIVE INCOME**
**FOR YEAR ENDED 28 FEBRUARY 20.8**

| | Note | |
|---|---|---|
| Sales [610 000 – 8 000] | | 602 000 |
| Cost of sales | | (300 000) |
| **Gross profit** | | 302 000 |
| **Other operating income** | | 13 050 |
| Rent income [9 600 – 800] | | 8 800 |
| Commission income [4 450 – 400] | | 4 050 |
| Bad debts recovered | | 200 |
| **Gross operating income** | | 315 050 |
| **Operating expenses** | | (219 028) |
| Packing material [4 500 – 440] | | 4 060 |
| Salaries and wages [143 000 + 32 000] | | 175 000 |
| Bad debts [1 700 + 350] | | 2 050 |
| Trading stock deficit [800 + 2 500] | | 3 300 |
| Remuneration of the Accounting Officer | | 900 |
| Sundry expenses [31 800 – 380 – 900] | | 30 520 |
| Advertisements | | 600 |
| Provision for bad debts | | 258 |
| Depreciation [1 500 + 840] | | 2 340 |
| **Operating profit** | | 96 022 |
| Interest income 800 + 60 | 1 | 860 |
| **Profit before interest expense** | | 96 882 |
| Interest expense / financing cost [19 000 + 1 900] | 2 | (20 900) |
| **Net profit before tax** | | 75 982 |
| Income tax | | (31 000) |
| **Net profit after tax** | 9 | **44 982** |

**BALANCE SHEET / STATEMENT OF FINANCIAL POSITION ON 28 FEBRUARY 20.8**

| **ASSETS** | **Note** | |
|---|---|---|
| **Non-current assets** | | 230 760 |
| Fixed/Tangible assets | 3 | 215 060 |
| Loans to members | 4 | 8 200 |
| Financial assets: | | |
| Fixed deposit | | 7 500 |
| **Current assets** | | 90 822 |
| Inventory | 5 | 59 740 |
| Trade and other receivables | 6 | 22 432 |
| Cash and cash equivalents | 7 | 8 650 |
| **Total assets** | | **321 582** |
| **EQUITY AND LIABILITIES** | | |
| **Members Equity/Funds** | | 104 982 |
| Members contributions | 8 | 80 000 |
| Undrawn profits | 9 | 24 982 |
| **Non-current liabilities** | | 116 700 |
| Mortgage loan | | 110 000 |
| Loan from members | 10 | 6 700 |
| **Current liabilities** | | 99 900 |
| Trade and other payables | 11 | 99 900 |
| Bank overdraft (if any) | | 0 |
| **Total equity and liabilities** | | **321 582** |

**NOTES TO THE FINANCIAL STATMENTS FOR THE YEAR ENDED 28 FEBRUARY 20.8**

| **1. INTEREST INCOME** | |
|---|---|
| From investments | 860 |
| | **860** |
| **2. INTEREST EXPENSE** | |
| On mortgage loan | 20 900 |
| | **20 900** |

**3. FIXED/TANGIBLE ASSETS**

| | **Land & buildings** | **Equipment** | **Total** |
|---|---|---|---|
| Carrying value at beginning of year | 179 000 | 38 400 | 217 400 |
| Cost | 179 000 | 62 000 | 241 000 |
| Accumulated depreciation | - | (23 600) | (23 600) |
| **Movements** | - | (2 340) | (2 340) |
| Additions at cost | - | - | - |
| Disposals at carrying value | - | - | - |
| Depreciation | - | (2 340) | (2 340) |
| Carrying value at end of year | **179 000** | **36 060** | **215 060** |
| Cost | 179 000 | 62 000 | 241 000 |
| Accumulated depreciation | - | (25 940) | (25 940) |

| 4. LOANS TO MEMBERS | Singh | Long | Total |
|---|---|---|---|
| Balance at beginning of year | 38 400 | - | 38 400 |
| New loans | 1 800 | - | 1 800 |
| Loan repayments | (32 000) | - | (32 000) |
| Balance at end of year | **8 200** | **-** | **8 200** |
| **Interest at 0% charged on loans** | | | |

| 5. INVENTORIES | |
|---|---|
| Trading inventory | 59 300 |
| Packing materials on hand | 440 |
| | **59 740** |
| **6. TRADE AND OTHER RECEIVABLES** | |
| Net trade debtors | 21 992 |
| Trade debtors | 23 150 |
| Provision for bad debts | (1 158) |
| Accrued income / Income receivable | 60 |
| Prepaid expenses | 380 |
| | **22 432** |
| **7. CASH AND CASH EQUIVALENTS** | |
| Bank | 8 150 |
| Cash float | 500 |
| | **8 650** |
| **8. MEMBER'S CONTRIBUTIONS** | |
| Contributions at beginning | 80 000 |
| Additional contributions | 0 |
| Repayments of contributions | 0 |
| Contributions at end | **80 000** |
| **9. RETAINED EARNINGS / UNDRAWN PROFITS** | |
| Undrawn profits at beginning of year | 40 000 |
| Net profit (loss) after tax for the year | 44 982 |
| Distribution to members: | (60 000) |
| Interim distribution during the year | 0 |
| Final distribution | 60 000 |
| Undrawn profits at end of year | **24 982** |

| 10. LOANS FROM MEMBERS | Singh | Long | Total |
|---|---|---|---|
| Balance at beginning of year | - | 6 700 | 6 700 |
| New loans | - | - | - |
| Loan repayments | - | - | - |
| Balance at end of year | **-** | **6 700** | **6 700** |
| **Interest at 0% charged on loans** | | | |

| 11. TRADE AND OTHER PAYABLES | |
|---|---|
| Trade creditors | 15 800 |
| Expenses payable / accrued expenses | 1 900 |
| Income received in advance / Deferred income | 1 200 |
| SARS (Income tax) | 21 000 |
| SARS (PAYE) | 0 |
| Distribution payable to members | 60 000 |
| | **99 900** |

**TRANSACTIONS WITH MEMBERS**

Profit before taxation is shown after the following:

| | Singh | Long | Total |
|---|---|---|---|
| Members' remuneration | 32 000 | - | 32 000 |
| | **32 000** | **-** | **32 000** |

## TASK 8.10 Extension Task: Ngobo Cake Shop CC - Financial indicators

| **8.10.1** | **Calculate the return on members' equity for 20.9. (23%)** |
|---|---|
| $\frac{30\,600 + 5\,600}{(140\,000 + 100\,000 + 50\,000 + 40\,000) \div 2} \times \frac{100}{1}$<br>$\frac{36\,200}{165\,000} \times \frac{100}{1}$<br>**21.9%** | |

| **8.10.2** | **Comment on this return and state whether you think the members should be happy or not.** |
|---|---|
| This has decreased from last year but is still above alternative investments so the members should be happy but need to monitor. | |

| **8.10.3** | **Calculate the debt : equity ratio for 20.9. (2.2 : 1)** |
|---|---|
| 340 000 : 190 000<br>**1.7 : 1** | |

| **8.10.4** | **Calculate the return on total capital employed for 20.9. (17%)** |
|---|---|
| $\frac{40\,600 + 5\,600 + 52\,000}{(140\,000 + 100\,000 + 50\,000 + 40\,000 + 340\,000 + 320\,000) \div 2} \times \frac{100}{1}$<br>$\frac{98\,200}{495\,000} \times \frac{100}{1}$<br>**19.8%** | |

| **8.10.5** | **Comment on the gearing and risk of the business.** |
|---|---|
| The risk of the business has decreased although there is still high risk.<br>The gearing has improved from 17% to 19.8% which means positive gearing as the interest is higher than the interest on the loans.<br>The loans have increased but it has resulted in a positive impact. | |

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Define the characteristics, advantages and disadvantages of a Close Corporation. | | | |
| Compare a Close Corporation with partnerships and companies. | | | |
| Calculate the percentage interest of different members and new members. | | | |
| Explain the difference between an Accounting Officer and a Chartered Accountant. | | | |
| Understand the terms: Members' contributions; loans to and from members. | | | |
| Identify the differences and similarities in the financial statements of companies and Close Corporations. | | | |

# MODULE 9
# INTERNAL CONTROL AND AUDITING OF BUSINESSES

## TASK 9.1 ⌘ Music Mania (Pty) Ltd Part 1: Baseline assessment

**9.1.1** **Make a list of all the stakeholders who are likely to be involved in this company, and identify what their main interest will be in the company (i.e. why they would want to be involved with this company).**

| *No.* | *Stakeholders* | *Main interest in the company* |
|---|---|---|
| 1. | Shareholders | Profit, dividends and share price. |
| 2. | Customers | Quality of products, prices. |
| 3. | Lenders | Ability to repay loan and pay interest. |
| 4. | Employees | Wages, secure jobs, working conditions. |
| 5. | Owners of shopping mall | On-going rental. |
| 6. | Suppliers of stock | On-going orders of stock. |
| 7. | SARS | VAT and Income tax due. |
| 8. | Community | Potential employment, satisfaction of commercial needs, mutual respect. |

**9.1.2** **As the major shareholder, you obviously want the company to be a success. What would be your vision, aims and objectives for this company?**

Various opinions possible, e.g. happy customers, vibrant image, happy and helpful employees, good profits, professional relationship with stakeholders.

**9.1.3** **Why is it important for stakeholders to assess the risks before getting involved in a business organisation, and why is it important for businesspersons to try to minimise the risks they face?**

Various options possible, e.g. stakeholders may be investing money in the business – they need a decent return.
Minimising risks makes the business sustainable in the long-run.

**9.1.4** **As the major shareholder, you face certain risks in starting this business. The company itself, as a separate legal entity, also faces risks. Make a list of the major potential risks and describe how you would try to minimise or avoid them.**

| *No.* | *Potential risks* | *Ways to minimise the risk* |
|---|---|---|
| 1. | Loss of customers | Ensure customers are happy, research their needs. |
| 2. | Disloyalty of employees | In-service training, evaluation, communication on their needs, in-depth interviews of new employees to assess attitude, detailed job descriptions (expectations). |
| 3. | Theft or fraud | Internal control systems, internal audit, physical security. |
| 4. | Fire | Physical security, insurance. |
| 5. | Decline in quality of products | Communication with suppliers, research alternative sources. |
| 6. | Competition | Offer more than competitors in terms of venue, atmosphere, price and product range, special offers. |

| 9.1.5 | **What dangers could exist for the company if all stakeholders do not share a common vision? Provide a practical example of this scenario.** |
|---|---|
| Conflict, disagreement, confusion amongst customers.<br>Example: Employees are not productive and are merely there to earn a wage and have a careless attitude.<br>Customers will not enjoy shopping there.<br>They will support competitors. | |
| **9.1.6** | **As the major shareholder and as a director, what would you do when you notice other stakeholders not sharing your vision?** |
| Discussion, liaison, development and publication of mission statement, job descriptions in line with mission statement, assessment of staff, etc.<br>Support of the community – mutual respect.<br>Care for the environment – do not abuse. | |
| **9.1.7** | **Apart from the profit motive, what other objectives are important for business organisations to adopt for themselves.** |
| Reflect ethical attitudes and values – to earn respect of all stakeholders. | |
| **9.1.8** | **Explain the roles that can be played by the following people in helping you achieve your vision for the company, and in minimising the risks relating to the company:** |
| | • **Internal auditor.** |
| Has a role in monitoring the internal control processes and in developing the code of good business practice to which the company can aspire – assures stakeholders that risks are being minimised | |
| | • **Independent auditor (external auditor).** |
| Reports to stakeholders on the reliability of the financial results – engenders trust. | |

## TASK 9.2 Theory: Baseline assessment

| 9.2.1 | **What is meant by the 'separation of ownership from control' in the case of companies?** |
|---|---|
| Ownership is by the shareholders who have provided the capital.<br>Control is by the directors who have been appointed by the shareholders to run the company for them. | |
| **9.2.2** | **What advantages arise from the separation of ownership from control?** |
| Shareholders can get on with their own jobs.<br>Directors can be appointed for their own skills.<br>Company continues even if ownership changes. | |
| **9.2.3** | **Provide examples of problems that could arise as a result of the separation of ownership from control.** |
| Directors might not share the commitment desired by the shareholders.<br>Shareholders cannot observe the usage of the capital on a day-to-day basis. | |
| **9.2.4** | **Shareholders and other stakeholders are obviously interested in whether the company is well run by the directors, i.e. whether 'good corporate governance' exists. Refer to the published annual report of the company you have chosen. What evidence is there in this annual report that good corporate governance exists in this company?** |
| Various answers possible. This depends on the content in the annual report.<br>Leading companies will generally want to assure shareholders that the company is well run.<br>There is likely to be a section on corporate governance in the annual report. | |

| 9.2.5 | **Shareholders are obviously interested in investing in 'sustainable' companies. What do you understand by the term 'sustainable' and how does good management serve to ensure this?** |
|---|---|
| Sustainable: Likely to continue as a successful organisation well into the future.<br>Good management will ensure that the correct systems are in place and that the desired values and attitudes exist amongst directors, and other stakeholders to ensure that the company succeeds. | |

## TASK 9.3 ⌘ Theory: Baseline assessment

| 9.3.1 | **A friend is starting a company. He has never heard of the concept of 'internal control'. What would you tell him about the nature of and need for internal control?** |
|---|---|
| All systems which are put in place to ensure that the assets of a business are safeguarded.<br>These include documentation and other accounting controls, physical controls and division of duties. | |
| **9.3.2** | **Match up the type of control in the first column, with the appropriate description in the second column.** |

| NO. | TYPE OF CONTROL | DESCRIPTION |
|---|---|---|
| 1. | Preventative | C |
| 2. | Detective | A |
| 3. | Corrective | D |
| 4. | Accounting controls | B |

| 9.3.3 | **Accounting controls are effective as a preventative measure only if the following conditions apply:**<br>• **Division of duties.** |
|---|---|
| Tasks of employees are carefully worked out so that one employee serves as a check on another. | |
| | • **Proper documentation.** |
| Proper documentation – source documents serve as proof that a transaction has occurred. | |
| | • **Proper authorisation.** |
| Proper authorisation – responsible people in the organisation are required to sign certain documents or use certain codes to give permission for a transaction to occur. | |
| | • **Proper recording and follow-up.** |
| Proper recording and follow-up – entries in the books will identify differences which highlight a problem. | |

## TASK 9.4 ⌘ Music Mania (Pty) Ltd Part 2: Control of Fixed assets

| **What is wrong with the job description of Will Steele? What procedures should be put in place to improve internal control over fixed assets?** |
|---|
| Various answers:<br>The job description is too vague, there is no indication of how the fixed assets are to be managed.<br>There is a problem with Will Steele writing out cheques without another person co-signing the cheque.<br>Cash purchases for assets may not be the most suitable or cost effective method of paying for assets.<br>No internal controls have been set up to protect the company and Will Steele from unethical practices, etc. |

## TASK 9.5 ⌘ Cloud Nine Ltd: Statement by Board of directors

**9.5.1 Explain the significance of the sections denoted 1 to 9.**

| | |
|---|---|
| 1. | The directors are responsible for setting up the bookkeeping, accounting and internal control systems that result in reliable information for the financial statements. |
| 2. | The financial statements must comply with the law of the land, GAAP and internationally agreed standards. |
| 3. | The directors give an assurance that the financial information is reliable and that risks in this regard have been minimised. |
| 4. | The financial information is honest and objective and is not biased towards the interests of any particular group (i.e. it is 'fair' to all). |
| 5. | The directors give an assurance that the books on which the financial information is based, are reliable and that risks in this regard have been minimised. |
| 6. | Appropriate policies have been used (e.g. depreciation, stock valuation) and the rule of prudence has been applied – the results are not over-stated. |
| 7. | The information is fair to all (unbiased) and reflects the profit (i.e. the results of operations for a certain period) and the balance sheet (i.e. the financial position on a certain date) |
| 8. | The company is expected to continue for the foreseeable future and there is no reason to think otherwise. |
| 9. | The entire board of directors places their names to this assurance. |

**9.5.2 Explain the significance of the sections denoted 1 to 8. Certain key words have been underlined for you. Ensure that your answer covers the significance of those words.**

| | |
|---|---|
| 1. | The directors are responsible for setting up the bookkeeping, accounting and internal control systems that result in reliable information for the financial statements. |
| 2. | The auditors have done all reasonable checks, but they do not check every transaction. They cannot guarantee that fraud has not taken place. |
| 3. | Tests are done by the auditors – not every transaction is checked. |
| 4. | The auditors have assessed the assumptions on which the financial statements are prepared, e.g. depreciation, stock valuation. |
| 5. | The auditors have assessed the overall manner in which the financial results of the company are reflected, e.g. understandability, materiality. |
| 6. | The tests they performed enable them to come to a valid opinion. |
| 7. | The information is fair to all (unbiased) and reflects the profit (i.e. the results of operations for a certain period) and the Balance Sheet (i.e. the financial position on a certain date) and the Cash Flow Statement. |
| 8. | Only accountants with a CA (SA) qualification can express an audit opinion. One of the partners in the audit form signs on behalf of the auditing firm. |

## TASK 9.6 ⌘ Using financial indicators to assess internal control

**9.6.1 Operating profit on sales has decreased from 12% (in 20.7) to 5% (in 20.8).**

The internal auditor should do tests to check whether any unauthorised or unusual overhead expenses have been incurred.
Compare to the previous year and inspect documents and authorisation.
Or maybe sales income has declined significantly.
Do tests to check that all sales income is accounted for.

| 9.6.2 | **The debtors' collection period for 20.8 is 45 days (the figure for the previous year was 30 days).** |
|---|---|
| Check why debtors are taking too long to pay.<br>Maybe sales are being made to unreliable customers and maybe the proper screening of debtors has not taken place.<br>Maybe some receipts from debtors have not been recorded or banked. | |
| **9.6.3** | **The creditors' payment period has changed from 29 days (in 20.7) to 30 days in 20.8.** |
| There does not appear to be a significant difference. The financial indicator does not reflect a problem. | |
| **9.6.4** | **In comparison to the previous year, the stock turnover rate has decreased from 6 times to 3 times.** |
| There is a problem.<br>The auditor should check whether orders of stock are being properly authorised and controlled.<br>Maybe too much is being ordered, or maybe sales are declining.<br>The reasons should be investigated because stock is an asset which does not earn a return until it is sold. | |
| **9.6.5** | **Gross profit on cost of sales was 50% in 20.7, but it is 40% in 20.8.** |
| The internal auditor should check to ensure that discounts on selling prices are properly authorised.<br>These are beneficial if it leads to an increase in sales and gross profit.<br>However, the internal auditor should ensure that the price reductions are not simply given to certain friends.<br>Also, he should check that all sales of goods are accounted for – if fraud has occurred this will be under-stated. | |
| **9.6.6** | **Interest as a % of fixed deposits has decreased from 8% in 20.7 to 5% in 20.8.** |
| There might be no problem.<br>There might have been a general decline in interest rates.<br>The internal auditor should assess this to ensure that no fraud or errors have occurred. | |
| **9.6.7** | **Motor vehicle expenses have increased by 6% over the past year.** |
| There might be abuse of vehicles and their expenses.<br>The auditor should check documents to ensure that the expenses are valid and relate to business vehicles. | |
| **9.6.8** | **Rent income has decreased by 20% over the past year.** |
| There might be no problem.<br>There might have been a conscious decision not to rent out certain property.<br>The minutes of meetings should be inspected for a decision in this regard.<br>Also check that all rent owing has been received or accrued. | |
| **9.6.9** | **The telephone expenses have increased by 25% from 20.7 to 20.8.** |
| There appears to be a problem.<br>Employees may be abusing the telephone privileges.<br>Compare the 25% increase to the increase in Telkom rates.<br>Maybe too many employees have cell-phone privileges.<br>The causes of the increase must be investigated.<br>Track expenditure on a month to month basis.<br>Consider physical controls to record telephone usage, e.g. user codes. | |
| **9.6.10** | **Debtors' allowances as a % of gross sales were 1% in 20.7, but this has increased to 2% in 20.8.** |
| There might be a problem.<br>The internal auditor should do checks on the credit notes issued to assess if they are valid.<br>The problem might lie with lack of quality of stock, and this should be rectified as soon as possible. | |

## TASK 9.7 Music Mania (Pty) Ltd Part 3: Using financial indicators

| 9.7.1 | **Which income and expense items should the internal auditor focus on?** |
|---|---|
| | • **Explain your reasons for choosing these.** |

- Sales – these have declined significantly.
- Commission income – has declined significantly.
- Wages – have increased significantly.
- Telephone costs – have increased by 80%.
- Delivery expenses – have increased significantly.
- Bad debts – have increased significantly.
- Trading stock deficit - this has increased more than 5 times.
- Sundry expenses - this has more than doubled.

| | • **Explain which type of fraud or error can be expected.** |
|---|---|

- Sales – possible fraud through not recording certain invoices or cash slips.
- Commission income – compare who paid commission and the value of that commission to the previous year.
- Wages – this is unusual as sales have declined.
- Telephone costs –- this is unusual as sales have declined – there might be abuse of the system.
- Delivery expenses – this is unusual as sales have declined.
- Bad debts – this is unusual as sales have declined.
- Trading stock deficit – this could be a problem of control over stock and/or shoplifting.
- Sundry expenses – invalid payments might have been made.

| | • **Explain how he should go about detecting fraud or error in those areas.** |
|---|---|

- Sales - investigate monthly trends and document sequence – trace stock withdrawals to sales recorded.
- Commission income – contact commission payers to verify payments this year.
- Wages – do a physical inspection of wage pay-outs – check to clock cards.
- Telephone costs – track monthly payments – consider physical controls such as user codes.
- Delivery expenses – monitor procedures to assess potential abuse.
- Bad debts – inspect the screening processes – maybe sales are made to people who should never have been approved as debtors – inspect the application forms for opening of accounts and how these are authorised.
- Trading stock deficit – inspect the internal controls – check the write off of stock, the circumstances and who is authorising this.
- Sundry expenses – inspect the entire ledger account and verify to source document.

| 9.7.2 | **Consider all the items in the Balance Sheet. What checks should the internal auditor carry out in order to ensure that the figures are correct and that the assets and liabilities actually exist?** |
|---|---|

Fixed assets - check Fixed Asset Register to ledger and do a physical count.
Investments – check to statements received from the financial institutions.
Inventories – check ledger to stock records and stock sheets to physical count.
Debtors – check ledger to Debtors List – check Debtors List to statements.
Cash – compare to physical count and to bank statements and reconciliations.
Loans – check to statements received from the financial institutions.
Creditors – check to Creditors List; to creditors statements and Creditors Reconciliations.

| 9.7.3 | **It is common practice for auditors to undertake checks on a 'test' or 'sample' basis i.e. auditors do not have to check every transaction. Explain:** |
|---|---|
| | • **Why this would be acceptable auditing practice.** |

It would be impossible for auditors to check every transaction – the cost involved would be prohibitive.
Do this only if there is suspicion that a big problem exists.

| | |
|---|---|
| | • **What the internal auditor should do to ensure that the check on a 'test' or 'sample' basis will not lead him to incorrect conclusions.** |

Use statistical theories and probability theories – determine the size of the tests on the level of confidence required – choose documents to be checked completely on a random basis – do not allow human tendencies to interfere with the selection process.

## TASK 9.8 ⌘ Spandex Sports Gear Ltd: Control of cash sales

**9.8.1 Place the 13 steps in the correct sequence (order). The first two have been done for you.**

The steps could vary slightly. Teachers should check for logical sequence.

| | STEPS IN RESPECT OF CASH SALES: | |
|---|---|---|
| 1. | The supervisor gives the cashier a cash float of R500 in different denominations in a tray at the start of his shift. The cashier checks this in the presence of the supervisor and **signs acknowledgement.** | (1) |
| 2. | The customer comes in and selects the goods to be purchased. | (9) |
| 3. | The cashier scans the price tag of each item selected by the customer. | (5) |
| 4. | A **cash slip** is printed from the cash register for the customer. A copy of the cash slip is retained in the computer system. | (4) |
| 5. | If the customer pays by cash, the cash collected is counted by the cashier and placed in the cash register tray. If change is due, this is given from the cash register tray by the cashier to the customer. | (6) |
| 6. | If the customer pays by credit card, the card is swiped in the credit-card machine and a **credit card voucher is printed**, which the customer signs. The cashier places the signed credit card voucher in the tray. | (13) |
| 7. | The supervisor prepares a **print-out from the cash register** which reflects all cash slips issued by the cashier to customers during the shift. | (11) |
| 8. | At the end of the shift, the cashier takes all cash in the cash register tray to the supervisor's office. | (12) |
| 9. | All cash and credit card vouchers deposited by the cashier in the cash register tray are counted by the supervisor in the presence of the cashier and a witness. | (2) |
| 10. | The cashier **prepares and signs a reconciliation** of the cash float, cash sales and cash on hand. Any difference is recorded in the reconciliation. | (10) |
| 11. | The supervisor **checks the reconciliation and signs it**. Differences are reported to the accountant (any shortfall more than R10.00 is deducted from the cashier's salary at the end of the month). | (3) |
| 12. | The cash and credit card vouchers from cash sales are handed over by the supervisor in the presence of the cashier to the Chief Cashier who is responsible for banking. The **Chief Cashier signs on the reconciliation** to acknowledge receipt of the cash and credit card vouchers. | (8) |
| 13. | The supervisor secures the cash float of R500 in the safe after the shift. | (7) |

**9.8.2 Highlight or underline the points at which a signed document will be prepared.**

See above.

**9.8.3 Use your highlighted points to determine an audit trail of documents to be checked in an audit.**

Acknowledgement of cash float → Cash slip → Credit card voucher → Cash register print-out → Reconciliation of cash float, cash slips, cash, and credit card vouchers.

**9.8.4 What further checks would the auditor carry out to make sure that the entries in the journal and ledger are correct?**

Check to bank deposit slips.
Check that documents are correctly entered in the journals.
Check posting to ledger.
Check arithmetical accuracy of balances and totals in ledger.
Check to Trial Balance.

| 9.8.5 | **There are two cashiers. If approximately 100 cash slips are processed by each cashier per day, how many cash slips should the auditor track through the system to determine whether or not collections from cash sales are reliable.** |
|---|---|
| Total cash slips = 100 x 2 cashiers x 30 days per month = 6 000.<br>Test 10% = 600 If a problem is detected with any one, expand the check to 30%. | |

## TASK 9.9 Interviewing an auditor

**Expected responses:**
This is completely open-ended. Responses will depend on the responses of the auditor or trainee interviewed.

## TASK 9.10 Research: Internal control of stock

**Expected responses:**
This is completely open-ended. Responses will depend on the responses of the shop manager or owner interviewed.

The Teacher should direct the learners towards the responses of those businesses which reflect strictest control over stock.

## TASK 9.11 ⌘ Checks by the internal auditor: Group work - 6 persons

| **Member A** | List the checks you would expect the Internal Auditor to perform in order to check that **cash sales and VAT** in each department are properly recorded and accounted for. |
|---|---|
| • Inspect the process of making cash sales and the cash slips generated.<br>• On selected cash slips, test the calculation of the total sales, VAT and cost of sales.<br>• Check the selected cash slips to the CRJ.<br>• Check the posting of the CRJ to the General Ledger.<br>• Check the resultant bank deposit slip for cash sales and VAT.<br>• Check the resultant cheque for payment of VAT to SARS. | |
| **Member B** | List the checks you would expect the Internal Auditor to perform in order to check that **debtors** are properly recorded and accounted for. |
| • Inspect the process of opening accounts for debtors – applications and screening checks.<br>• Inspect the process of making credit sales and the invoices generated.<br>• On selected invoices, test the calculation of the total sales, VAT and cost of sales.<br>• Check the selected invoices to the DJ.<br>• Check the posting of the DJ to the General Ledger and the Debtors Ledger.<br>• Check the arithmetical accuracy of selected DL accounts. | |
| **Member C** | List the checks you would expect the Internal Auditor to perform in order to check that **purchases of stock** are properly received, valued, recorded, and accounted for. |
| • Inspect the process of opening accounts with creditors – properly authorised.<br>• Inspect the process of making credit purchases and the order forms generated and invoices received.<br>• On selected invoices, test the calculation of the total purchases.<br>• Check the selected invoices to the stock records and CJ.<br>• Check the posting of the CJ to the General Ledger and the Creditors Ledger.<br>• Check the arithmetical accuracy of selected CL accounts.<br>• Check the resultant receipt for payments to creditors.<br>• Check outstanding creditors' balances to statements and Creditors Reconciliations. | |

| **Member D** | List the checks you would expect the Internal Auditor to perform in order to check that **fixed assets** are properly received, valued, recorded and accounted for. |
|---|---|

- Inspect the process of purchasing fixed assets – properly authorised.
- Inspect the order forms generated and invoices received.
- On selected invoices, test the calculation of the total fixed assets bought.
- Check the selected invoices to the Fixed Assets Register and the journal.
- Check the posting to the General Ledger.
- Check the resultant receipts for payments to the supplier.
- Do a physical check of fixed assets to the Fixed Assets Register.
- Check Fixed Assets Register to ledger and Trial Balance.

| **Member E** | List the checks you would expect the Internal Auditor to perform in order to check that **salaries and wages** are properly valued, recorded and accounted for. |
|---|---|

- Check appointment of staff to personnel records and files – check proper authorisation.
- Check salary and wage scales to letters of appointment and authorisation
- Check entries in SJ for monthly salary and deductions.
- Check entries in WJ to clock cards, wage scales and deductions.
- Check arithmetical accuracy of SJ and WJ.
- Check posting to GL.
- Check arithmetical accuracy in GL accounts.
- Check payments in respect of net salaries and deductions.

| **Member F** | List the checks you would expect the Internal Auditor to perform in order to check that **petty cash** is properly handled, recorded and accounted for. |
|---|---|

- Check selected petty cash vouchers for validity and authorisation.
- Check entry in PCJ.
- Check posting to GL.
- Check arithmetical accuracy in GL account for Petty Cash.
- Check cheque to reimburse float (Cheque = total petty cash vouchers for the month).
- Physical count on a selected day: Petty cash on hand + Vouchers = Float.

## TASK 9.12 Suncoast Clothing Ltd: Group work - 6 persons

**1. A brief description of checks that you have carried out.**

Refer to Task 9.11 above.

**2. At least two examples of fraud or error that you have detected.**

Varied answers possible, e.g.:
Cash sales and VAT: Cash sales recorded on fictitious documents which are not entered in the books; Theft of cash prior to cash being deposited.
Credit sales and debtors: Credit sales recorded on fictitious documents which are not entered in the books – cash collected directly from the buyer; Theft of cash collected from customer – customer then gets written off as a bad debt.
Trading stock and creditors: Stock ordered is not entered into stock; stock ordered at an inflated price, seller then gives employee a kick-back; physical theft of stock from store room or shelves.
Fixed assets – Fixed assets ordered are intercepted prior to delivery; fixed assets stolen after being recorded; unauthorised usage of fixed assets.
Salaries and wages – Fictitious employees recorded with net earnings being diverted to a private bank account; physical theft of cash drawn to pay wages.
Petty cash – Fictitious petty cash vouchers created; cash physically stolen.

**3. Identification of the person/s to be held accountable.**

- The perpetrator of the crime.
- The person who should be authorising the transaction.
- The person who should be carrying out the physical checks.
- The internal auditor (if he/she is negligent in performing the checks).

| 4. | A list of recommendations for the directors to implement to improve internal control. |
|---|---|

- Appointment of internal auditor.
- Creation of standing instructions for physical checks.
- Division of duties amongst employees.
- Proper registers, e.g. Fixed Assets Register.
- Direct transfers of funds, e.g. to pay wages directly into bank accounts of employees.

## TASK 9.13 Smith Brothers: Scenario

| 9.13.1 | Briefly describe the nature of the fraud for which the Smith brothers are accused. |
|---|---|

They created a fictitious company and diverted income into that company.

| 9.13.2 | Do you agree with the strategy of the State to seize their assets? Explain. |
|---|---|

Yes – the funds were obtained by illegal means.
Asset forfeiture is a legal process.

| 9.13.3 | Apart from the Smith brothers, are there any other stakeholders who could be held accountable for the alleged fraud? If so, what action should they have taken? |
|---|---|

The customers should have been alert to the fraud – they should have 'blown the whistle' on the culprits.

| 9.13.4 | If you were appointed as internal auditor, would it have been possible to detect this fraud at earlier stage? Explain. |
|---|---|

Various answers possible.
The internal auditor should be alert to this type of fraud as it is quite common.
Procedures in recording orders should be re-assessed.
Division of duties important.

## TASK 9.14 Kaos Ltd: Scenarios

| 1. | Persons to be held accountable: |
|---|---|

The manager – for the crime.
The supplier – for agreeing to the plan.
The internal auditor – for not picking up this obvious practice.
The directors – for not instituting controls to prevent this type of fraud.

| 2. | Persons to be held accountable: |
|---|---|

The Level 1 employee – for being irresponsible.
The director – for the delegating to an irresponsible person, and not checking.

| 3. | Persons to be held accountable: |
|---|---|

The wages clerk – for the fraud.
The cashier – for collaborating.
The internal auditor – for failing to detect the fraud.
The directors – for not instituting controls to prevent this type of fraud.

| 4. | Persons to be held accountable: |
|---|---|

The directors concerned – for the fraud.
The board of directors – for not being alert to the potential of this fraud.
The internal auditor – for failing to detect the fraud.
The shareholders – for failing to attend the AGM and not appointing the right sort of directors.

| 5. | **Persons to be held accountable:** |
|---|---|
| The director concerned – for the fraud.<br>The bank – for not checking on the powers of the director and for not checking on proper authorisation.<br>The accountant – for not gaining correct authorisation for the cheque to be paid to the director personally. | |
| **6.** | **Persons to be held accountable:** |
| The salesmen – for being irresponsible in selling to people who will not settle debts.<br>The directors – for not establishing rules and procedures regarding opening of accounts. | |
| **7.** | **Persons to be held accountable:** |
| The petty cashier – for the fraud.<br>The internal auditor – for not being alert to this sort of fraud and not detecting it.<br>The external auditors – for not detecting this fraud as it has occurred for several years. | |
| **8.** | **Persons to be held accountable:** |
| The internal auditor – for not being alert to this sort of error.<br>The stock clerk – for not identifying obsolete stock.<br>The directors – for not detecting a stock problem.<br>The external auditors – for not detecting this error as it is significant and should have been obvious. | |

**CHECKLIST:**

| **Skills** | **Yes – proficient** | **Requires more attention** | **Complete** |
|---|---|---|---|
| Understand the risks associated with running a business. | | | |
| Understand the concept 'internal control'. | | | |
| Appreciate the need for internal control. | | | |
| Devise systems for internal control. | | | |
| Understand the different roles of independent and internal auditors and differences in their reports. | | | |
| Understand the use of financial indicators in auditing. | | | |
| Understand the role of statistical sampling in auditing. | | | |
| Devise audit tests on various aspects of a business – determining an audit trail. | | | |
| Understand accountability and the fact that all stakeholders may be held accountable. | | | |

# MODULE 10
# INVENTORY SYSTEMS

**Note to the Teacher:**

Learners have been exposed to the perpetual stock system since Grade 9 when the retailer was introduced. In Grade 11 they looked at the periodic stock system, firstly as a topic on its own but secondly under Club Accounting. Therefore the beginning of this Module is to be treated as revision. Be selective with the Tasks that you choose depending on the learner's prior learning.

The emphasis of the Module is, however, on stock valuation, i.e. how do we come up with a value for the final stock. From Grade 10 learners have been exposed to the adjustment where a physical stock taking is conducted and a value of trading stock is given. The question that has been avoided up to this point in time is how the value is determined. Physically counting means that we will know how **many items** we have but we still need to **multiply that by a value**. If prices were to stay constant then this will not be much of a problem but we live in times when prices generally are increasing, but they can also decrease. Suppliers offer specials or bulk discounts which will reduce the cost price of the items.

The curriculum requires a study of the following methods:

- Specific identification of the cost price of an item.
- FIFO (first in first out) method.
- Weighted average method.

In the textbook we have drawn pictures to help illustrate the principles of the methods. You can bring items into class in order to demonstrate this principle. Once the learners' understand the difference then the calculations should not be too much of a problem.

It is very important to also discuss internal control and ethical issues relating to the stock valuation. You will find that most Tasks have questions of this nature included.

CAPS have allocated two weeks to this Module. This provides you with adequate time to introduce the topic and demonstrate the differences before you actually start with the Tasks.

## TASK 10.1 ⌘ Alpok Operations: Trading stock account - Interpretation

| **10.1.1** | **Total cash sales for the month amounted to R60 000. Alpok Operations uses a fixed mark-up percentage on all their products. Calculate the mark-up percentage.** |
|---|---|
| Gross profit | = 60 000 – 30 000 |
| | = R30 000 |
| Mark-up | = $\frac{30\,000}{30\,000} \times \frac{100}{1}$ |
| | = **100%** |

| **10.1.2** | **Calculate the total credit sales for the month.** |
|---|---|
| Cost of sales | = 45 000 |
| Credit sales | = $45\,000 \times \frac{200}{100}$ |
| | = **R90 000** |

| | |
|---|---|
| **10.1.3** | **The owner became aware of the donation of R500 for the first time. Further investigations revealed that stock donations of between R500 and R1 000 were being made regularly in the past. Since the owner has not authorised these donations what plan of action would you recommend to him?** |

This is a serious matter which has to be investigated immediately.
He will need to establish the identity of the person responsible for authorising these donations and to whom these donations are being made.
It may have been made with good intentions or this could be a clever way of defrauding the business.
For example, the donation could be made to a 'ghost' organisation, i.e. an organisation that does not exist.
The culprit could actually be donating the goods to himself or he may be selling the stock privately and keeping the proceeds.
The person responsible could be creating the donation fictitiously to conceal stock thefts which could be taking place.
The owner may reprimand the person responsible and instruct him to get authorisation from him first before making any donations.
If there is proof that the donations are false he may institute legal action against the culprit.
A written policy as to procedures to be followed by all employees before donations are made must be put into place immediately.

| | |
|---|---|
| **10.1.4** | **A physical stock-take was conducted on the 31 January 20.8. The stock count revealed an amount of R58 300.** |
| | **(a) Provide the double entry to record the shortfall.** |

Debit Trading stock deficit; Credit Trading stock

| | |
|---|---|
| | **(b) Assume that 31 January 20.8 is the end of the financial period.** |
| | • **What amount will be shown in the Income Statement in respect of the shortfall?** |

64 300 – 58 300 = <u>R6 000</u> (Record this amount as an operating expense)

| | |
|---|---|
| | • **What amount will be shown in the Balance Sheet for trading stock?** |

<u>R58 300</u>

| | |
|---|---|
| | **(c) What suggestions do you have regarding the shortfall in January? In the past stock shortages have occurred but were not as large as this one.** |

The shortfall is high and needs to be investigated.
The Trading stock account may have to be rechecked.
There could be errors in the account – stock may have been sold but not recorded, returns may not have been recorded, journals may have been incorrectly totalled, etc.
It could also be possible that the stock was marked incorrectly or the stock count is incorrect.
There could be leakages – theft by staff or shoplifting by customers.
He will have to devise a system to improve stock control – security cameras, security personnel, scanning devises, shop detectives, etc.

| | |
|---|---|
| | **(d) Is it possible for there to be a trading stock surplus? Give two examples to explain how this can happen.** |

Yes.
Stock may have been purchased but not recorded in the Trading stock account.
The physical stock will therefore be higher than the Trading stock account balance.
Errors in the stock-taking procedure could also result in a surplus, e.g. an item or a group of items may have been counted twice resulting in the stock value being overstated.

| 10.1.5 | **The owner has withdrawn a large amount of stock for his personal use. He withdraws about the same amount every month. What is your opinion on the stock withdrawals by the owner?** |
|---|---|

He should be made aware of the dangers of excessive drawings and the impact this has on his equity – withdrawals that are higher than net profit result in negative growth which is obviously not good for the business.
The business not only loses the cost price of the goods withdrawn but also the profit that would have been made had the goods been sold.

| 10.1.6 | **Compare the opening stock with the closing stock. Give two possible reasons for the large difference.** |
|---|---|

- Sales could have been lower in this month than the previous month (December – which is the holiday period).
- Turnover in the previous month may have been high resulting in a low opening balance.
- Stock purchases are higher in this month (January) than the previous month.
- He purchased more stock because he may have been offered a better price or a higher discount.

## TASK 10.2 McGregor Hardware: Trading stock account, Interpretation

**10.2.1** **GENERAL LEDGER OF MCGREGOR HARDWARE**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **Trading stock** **B** **Cr**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 1 | Balance | b/d | 48 626 | June | 30 | Cost of sales [1] | DJ | 31 266 |
| | 30 | Cost of sales [2] | DAJ | 852 | | | Cost of sales [3] | CRJ | 52 006 |
| | | Bank | CPJ | 25 563 | | | Creditors control | CAJ | 659 |
| | | Petty cash [4] | PCJ | 300 | | | Drawings | GJ | 922 |
| | | Creditors control | CJ | 43 070 | | | Consumables | GJ | 446 |
| | | Drawings | GJ | 42 | | | Loss due to fire | GJ | 3 600 |
| | | | | | | | Balance | c/d | 29 554 |
| | | | | **118 453** | | | | | **118 453** |
| Feb | 1 | Balance | b/d | 29 554 | | | | | |

**Working:**

[1] $62\,532 \times \frac{100}{200} = R31\,266$

[2] $1\,200 + 504 \times \frac{100}{200} = R852$

[3] $138\,471 - 34\,221 - 238 = R104\,012$
$200 + 504 \times \frac{100}{200} = 104\,012 \times \frac{100}{200}$
$= R52\,006$

[4] $697 - 120 - 67 - 190 - 20 = R300$

| 10.2.2 | **Refer to the General Journal. Provide an explanation for each journal entry.** |
|---|---|

12th: The owner took stock, at cost price, for his personal use.
14th: The owner returned stock which he had previously taken for his own use OR
He may have been overcharged by R42 on his drawings on the 12th. This is therefore the correction entry.
20th: Correction of an error in posting: Consumables were incorrectly charged to Trading stock OR
Trading stock was withdrawn for business use, e.g. in the office.
24th: This is the cost price of stock lost or damaged by a fire in the business.

| 10.2.3 | **In what way can the owner verify the stock balance in the Trading stock account?** |
|---|---|

He will have to physically count stock on the last day of the month.
The amount arrived at is compared with the balance of the Trading stock account.
An entry is made in the books to record the shortfall or surplus.
Should the shortfall be exceptionally high an investigation will have to be carried out.

## TASK 10.3 ⌘ Caprice Ltd.: Calculations, Interpretation

| 10.3.1 | **Calculate the following for 20.9. (The previous year's indicators are provided in brackets).** |
|---|---|

**(a) Stock turnover rate. (20.8: 10 times)**

Average stock = (106 200 + 69 000) ÷ 2
= R87 600
Stock turnover rate = 700 800 ÷ 87 600
= **8 times**

**(b) Number of days for which enough stock is on hand. (20.8: 60 days)**

Stock period = $\frac{87\,600}{700\,800} \times \frac{365}{1}$
= **46 days (45.6 days)**

**(c) Debtors collection period (in days). (20.8: 37 days)**

Average debtors = (89 300 + 48 700) ÷ 2
= R69 000
Debtors collection = $\frac{69\,000}{630\,000} \times \frac{365}{1}$
= **40 days**

**(d) Creditors payment period (in days). (20.8: 19 days)**

Average creditors = (76 000 + 38 000) ÷ 2
= R57 000
Creditors period = $\frac{57\,000}{700\,800} \times \frac{365}{1}$
= **30 days (29.7 days)**

| 10.3.2 | **Explain the meaning of the calculations above. Comment on your observations and make your recommendations.** |
|---|---|

**Meanings:**

Stock turnover rate indicates how many times the stock is being sold (turned over).

The answer indicates that stock is sold so many times per year, e.g. a stock turnover rate of 8 implies that stock is replaced 8 times in a year.

The stock turnover rate will vary according to the nature of the business, e.g. the rate for a car dealer will be far lower than that of a fresh produce vendor.

Number of days for which enough stock is on hand shows how long it takes a business, on average, to sell its stock.

Debtor's collection period indicates on average how long debtors take to pay their accounts.

Creditor's payment period indicates on average how long the business takes to pay their creditors.

**Observations/Recommendations:**

Stock turnover rate decreased by 2 in 20.9.

Possible reasons: increasing competition from other stores; prices may have increased; latest fashions are not available; etc.

Recommendations: promote sales by advertising and offering incentives such as discounts; have mark-down sales; improve customer service; etc.

The number of days for which stock is on hand has decreased by 14 days. This may be significant for a clothing store where changes in fashion can result in existing stocks becoming obsolete or outdated.

Debtor's collection period increased by 3 days, this indicates that debtors are taking slightly longer to pay their debts. Encourage them to pay sooner by offering incentives such as cash discounts. Send out statements regularly, emails, or SMS's as reminders, etc. Most debtors should be settling their accounts within 30 days.

Creditor's payment period increased by 11 days. Debtors take 40 days to settle their debts while Caprice Ltd takes 30 days to pay their creditors. Ideally debtors should pay before the creditors are paid so as not to put pressure on working capital and on cash flow.

## TASK 10.4 ⌘ Turbo Stores: Purchases account, Calculations

Use this Task to revise with the learners how to calculate **cost of sales** and **gross profit** under the periodic stock system. As they move on to studying the different cost valuation methods this becomes important. If they can do these calculations now you can then focus on the valuation methods in later tasks and not get caught up in explaining how to calculate cost of sales and gross profit.

**10.4.1** **GENERAL LEDGER OF TURBO STORES**
**NOMINAL ACCOUNTS SECTION**

**Dr** **Purchases** **N** **Cr**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Bank | CPJ | 100 240 | June | 30 | Drawings | GJ | 2 700 |
| | | Creditors control | CJ | 120 650 | | | Donation | GJ | 1 200 |
| | | Drawings | GJ | 500 | | | Trading account | GJ | 218 940 |
| | | Consumable stores | GJ | 1 450 | | | | | |
| | | | | **222 840** | | | | | **222 840** |

**10.4.2 Calculate the cost of sales.**

| | |
|---|---|
| Opening stock | 46 000 |
| Purchases [100 240 + 120 650 – 2 700 + 500 – 1 200 + 1 450] | 218 940 |
| Carriage on purchases [12 450 + 420 + 590] | 13 460 |
| Customs duty | 1 500 |
| Cost price of goods available for sale | 279 900 |
| Closing stock | [56 700] |
| **Cost of sales** | **223 200** |

**Note**: If no purchases account is required then show the calculations in brackets.

**10.4.3 Calculate the gross profit for the year.**

Sales = 250 000 + 150 000 – 2 400 = R397 600
Cost of sales = R223 200
Gross profit = R397 600 – R223 200 = **R174 400**

## TASK 10.5 Wizzy Washing Machines: Specific identification and calculations

**10.5.1 STOCK SUMMARY OF WIZZY WASHING MACHINES FOR THE MONTH OF JUNE 20.6**

| Model | Cost price | Stock on 1 June 20.6 | | Units bought | | Units sold | | | Stock on 30 June 20.6 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | No. of units | Stock value | No. of units | Total cost | No. of units | Selling price | Total sales | No. of units | Stock value |
| Climax 20.6 | **R3 000** | **5** | R15 000 | **20** | R60 000 | **18** | **R4 800** | R86 400 | 7 | R21 000 |
| Apex 20.6 | **R4 000** | **2** | R8 000 | **30** | R120 000 | **22** | **R6 000** | R132 000 | 10 | R40 000 |
| Ultimex 20.6 | **R6 000** | **4** | R24 000 | **15** | R90 000 | **14** | **R8 700** | R121 800 | 5 | R30 000 |
| | | **11** | R47 000 | **65** | R240 000 | **54** | | R340 200 | **22** | R91 000 |

**10.5.2 GENERAL LEDGER OF WIZZY WASHING MACHINES**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **Trading stock** **B** **Cr**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 1 | Balance | b/d | 47 000 | June | 30 | Cost of sales * | CRJ6 | 226 000 |
| | 30 | Creditors control | CJ6 | 270 000 | | | Balance | c/d | 91 000 |
| | | | | **317 000** | | | | | **317 000** |
| July | 1 | Balance | b/d | 91 000 | | | | | |

*Cost of sales can be checked as follows:
(18 x R3 000) + (22 x R4 000) + (14 x R6 000) = 54 000 + 88 000 + 84 000 = R226 000

**10.5.3 Calculate the gross profit.**

340 200 – R226 000 = R114 200
OR: Calculate using the gross profit per washing machine
(18 x R1 800) + (22 x R2 000) + (14 x R2 700) = 32 400 + 44 000 + 37 800 = R114 200

**Calculation of average mark-up % on all models.**

$\frac{114\,200}{226\,000} \times \frac{100}{1} = 50.5\%$

# TASK 10.6 ⌘ Carel's Car Dealers: Specific identification and calculations

**10.6.1 STOCK SUMMARY OF CAREL'S CAR DEALERS FOR THE YEAR ENDED 31 AUGUST 20.4**

| Model | Cost and carriage per unit | | Stock on 1 Sep 20.3 | | Units bought | | Units sold | | | Stock on 31 Aug 20.4 | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cost | Carriage | No. of units | Stock value | No. of units | Total cost | No. of units | Selling price | Total sales | No. of units | Stock value |
| XS1800 | **R120 000** | **R10 000** | **3** | R390 000 | **36** | R4 680 000 | **31** | **R200 000** | R6 200 000 | 8 | R1 040 000 |
| TD2000 | **R170 000** | **R10 000** | **4** | R720 000 | **40** | R7 200 000 | **38** | **R270 000** | R10 260 000 | 6 | R1 080 000 |
| LX2400 | **R240 000** | **20%** | **2** | R576 000 | **15** | R4 320 000 | **16** | **R440 000** | R7 040 000 | 1 | R288 000 |
| | | | **9** | R1 686 000 | **91** | R16 200 000 | **85** | | R23 500 000 | 15 | R2 408 000 |

**10.6.2 GENERAL LEDGER OF CAREL'S CAR DEALERS**
**FINAL ACCOUNTS SECTION**

**Dr Trading account B Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.4 | | | | |
| Aug | 31 | Opening stock | | 1 686 000 | Aug | 31 | Sales | | 23 500 000 |
| | | Purchases* | | 14 720 000 | | | Closing stock | | 2 408 000 |
| | | Carriage inwards** | | 1 480 000 | | | | | |
| | | Profit & loss# | | 8 022 000 | | | | | |
| | | | | **25 908 000** | | | | | **25 908 000** |

*Purchases = (36 x R120 000) + (40 x R170 000) + (15 x R240 000) = R14 720 000
**Carriage inwards = (36 x R10 000) + (40 x R10 000) + (15 x R48 000) = R1 480 000
# Gross profit can be checked = (31 x R70 000) + (38 x R90 000) + (16 x R152 000) = 2 170 000 + 3 420 000 + 2 432 000 = R8 022 000

**10.6.3 Calculation of cost of sales**

R1 686 000 + R14 720 000 + R1 480 000 – R2 408 000 = R15 478 000
OR: R23 500 000 – R8 022 000 = R15 478 000

**Calculation of average mark-up % on all models.**

$$\frac{8\,022\,000}{15\,478\,000} \times \frac{100}{1} = 51.8\%$$

## TASK 10.7 ⌘ Humbert Stores: FIFO – Calculations, Trading account

**10.7.1 Calculate the value of the closing stock on 31 December 20.8.**

| | |
|---|---|
| **STOCK VALUE of 36 units** | |
| 20 x R800 | 16 000 |
| 16 x R700 | 11 200 |
| **VALUE OF CLOSING STOCK** | **R27 200** |

**10.7.2 Calculate the cost of sales for the period 1 January – 31 December 20.8.**

| | |
|---|---|
| Opening stock | 0 |
| Purchases (36 000 + 28 000 + 16 000) | 80 000 |
| Closing stock | (27 200) |
| **COST OF SALES** | **R52 800** |

**OR**
60 x R600 = R36 000
24 x R700 = R16 800
Cost of sales = R52 800

**10.7.3 Calculate the gross profit made during the year ended 31 December 20.8.**

| | |
|---|---|
| Sales [84 x 1 000] | 84 000 |
| Cost of sales | (52 800) |
| **GROSS PROFIT** | **R31 200** |

**10.7.4 GENERAL LEDGER OF HUMBERT STORES**
**FINAL ACCOUNTS SECTION**

**Dr** **Trading account** **F1** **Cr**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Oct | 31 | Opening stock | | 0 | Oct | 31 | Sales | | 84 000 |
| | | Purchases | | 80 000 | | | Closing stock | | 27 200 |
| | | Profit & loss (gross profit) | | 31 200 | | | | | |
| | | | | **111 200** | | | | | **111 200** |

## TASK 10.8 ⌘ Belar Ltd.: FIFO - Calculations

**10.8.1 Calculate the following:**

**(a) Total sales for the period January – March 20.8.**

| | | |
|---|---|---|
| January: | 400 units at R1 000 per unit | 400 000 |
| February: | 350 units at R1 000 per unit | 350 000 |
| March: | 430 units at R1 000 per unit | 430 000 |
| | 20 units at R900 per unit | 18 000 |
| **TOTAL SALES FOR THE PERIOD** | | **1 198 000** |

**(b) The value of the closing stock using the FIFO method.**

| | |
|---|---|
| **NO. OF UNITS ON HAND** | |
| Opening stock | 200 |
| Number of briefcases bought [520 + 570 + 280] | 1 370 |
| Total sold [400 + 350 + 450] | (1 200) |
| Total on hand | **370** |
| | |
| **STOCK VALUE** | |
| 280 x (R620 + 25) | 180 600 |
| 90 x (R680 + 20) | 63 000 |
| **VALUE OF CLOSING STOCK** | **243 600** |

**(c) Total cost of sales for the period January – March 20.8.**

| | |
|---|---|
| Opening stock [200 x 640] | 128 000 |
| Purchases [343 200 + 387 600 + 173 600] | 904 400 |
| Carriage on purchases [10 400 + 11 400 + 7 000] | 28 800 |
| Cost of goods available to be sold | 1 061 200 |
| Closing stock | (243 600) |
| **COST OF SALES** | **817 600** |

**(d) Gross profit for the period ending 31 March 20.8.**

| | |
|---|---|
| Sales | 1 198 000 |
| Cost of sales | (817 600) |
| **GROSS PROFIT** | **380 400** |

**10.8.2**

**GENERAL LEDGER OF BELAR LTD**
**FINAL ACCOUNTS SECTION**

**Dr** **TRADING ACCOUNT** **F1** **Cr**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Mar | 31 | Opening stock | | 128 000 | Mar | 31 | Sales | | 1 198 000 |
| | | Purchases | | 904 400 | | | Closing stock | | 243 600 |
| | | Carriage on purchases | | 28 800 | | | | | |
| | | Profit & loss (gross profit) | | 380 400 | | | | | |
| | | | | **1 441 600** | | | | | **1 441 600** |

**10.8.3** **GENERAL LEDGER OF BELAR LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **TRADING STOCK** **B** **Cr**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Jan | 1 | Balance | b/d | 128 000 | Mar | 31 | Cost of sales | | 817 600 |
| Mar | 31 | Bank / Creditors *control | | 933 200 | | | Balance | c/d | 243 600 |
| | | | | **1 061 200** | | | | | **1 061 200** |
| Apr | 1 | Balance | b/d | 243 600 | | | | | |

*904 400 + 28 800

**FINAL ACCOUNTS SECTION**
**TRADING ACCOUNT** **F1**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Mar | 31 | Cost of sales | | | Mar | 31 | Sales | | 1 198 000 |
| | | Profit & loss (gross profit) | | 380 400 | | | | | |
| | | | | | | | | | |
| | | | | **1 198 000** | | | | | **1 198 000** |

## TASK 10.9 Dube Shoe Stores: FIFO – Calculations, Interpretation

**10.9.1** **Calculate the following:**

**(a) The value of the closing stock on 31 August 20.8.**

**No of units on hand:** 60 + 730 – 604 = 186

**Value of closing stock:**
110 x R60 = R6 600
76 x R62 = R4 712
TOTAL = **R11 312**

**(b) The cost of sales for the three months ended 31 August 20.8.**

| | |
|---|---|
| Opening stock | 3 360 |
| Net purchases + carriage [39 890 – (210 + 116)] | 39 564 |
| Total available to be sold | 42 924 |
| Closing stock | (11 312) |
| COST OF SALES | **R31 612** |

**(c) The gross profit for the period 1 June 20.8 – 31 August 20.8.**

54 360 – 31 612 = **R22 748**

**(d) The mark-up % achieved by the business.**

$^{22\,748}/_{31\,612}$ x 100 = **71.9%** (72%)

**10.9.2** **The owner has asked for your advice as to whether he should increase the selling price of the shoes. In your opinion what should he do? Why? Your opinion must be sub-stantiated with facts or figures.**

Increase the selling price. The cost price has been increasing but the selling price remained R90 over the period. Therefore they are making less profit.
OR keep the price the same. Due to the economic downturn if he increases the price of the shoes he might not sell as many and his profit will be reduced.

## TASK 10.10 ⌘ Contour Dealers: Weighted average method - Calculations

**10.10.1** **Calculate the value of stock using the Weighted average method.**

| **WEIGHTED AVERAGE** | |
|---|---|
| 20 units at R18 per unit | R360 |
| 60 units at R20 per unit | 1 200 |
| 40 units at R30 per unit | 1 200 |
| 30 units at R35 per unit | 1 050 |
| Total purchases | R3 810 |
| WEIGHTED AVERAGE: 3 810 ÷ 150 | R25.40 |
| | |
| **VALUE OF STOCK** | |
| Stock value of 60 units: 60 x R25.40 | **R1 524** |

**10.10.2** **Calculate the cost of sales using the Weighted average method**

| **Cost of sales**: | |
|---|---|
| Opening stock | 360 |
| Purchases | 3 450 |
| Closing stock | (1 524) |
| **COST OF SALES** | **R2 286** |

**10.10.3** **Calculate the gross profit using the Weighted average method.**

| **GROSS PROFIT** | |
|---|---|
| Sales: 90 x R45 | 4 050 |
| Cost of sales | [2 286] |
| **GROSS PROFIT** | **R1 764** |

## TASK 10.11 ⌘⌘ Premium Ltd: Weighted average method - Calculations, Trading account

**10.11.1** **Calculate the number of units that have not been sold by 31 March 20.8.**

| **NO. OF UNITS ON HAND** | |
|---|---|
| Opening stock | 200 |
| Number of units bought [520 + 570 + 280 – 20] | 1 350 |
| Number of units sold | (1 200) |
| **TOTAL ON HAND** | **350** |

**10.11.2** **Calculate the value of the closing stock on 31 March 20.8 using the Weighted average method.**

Weighted average = (128 000 + 353 600 + 399 000 + 180 600 – 12 400) ÷ 1 550
= 1 048 800 ÷ 1 550
= R676.65
Value of closing stock = 350 x 676.65
= **R236 827.50**

**10.11.3 Calculate the cost of sales for the period January to March 20.8.**

| **COST OF SALES** | |
|---|---|
| Opening stock [200 x R640] | 128 000.00 |
| Purchases [343 200 + 387 600 + 173 600 – 12 400] | 892 000.00 |
| Carriage on purchases [10 400 + 11 400 + 7 000] | 28 800.00 |
| Cost of goods available to be sold | 1 048 800.00 |
| Closing stock | (236 827.50) |
| **COST OF SALES** | **R811 972.50** |

**10.11.4 Calculate the gross profit for the period January to March 20.8.**

| **GROSS PROFIT** | |
|---|---|
| Sales [1 200 x 1 000] | 1 200 000.00 |
| Cost of sales | (811 972.50) |
| **GROSS PROFIT** | **R388 027.50** |

**10.11.5 GENERAL LEDGER OF PREMIUM LTD**
**FINAL ACCOUNTS SECTION**

**Dr TRADING ACCOUNT F1 Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.8 | | | | | 20.8 | | | | | |
| Mar | 31 | Opening stock | | 128 000.00 | Mar | 31 | Sales | | 1 200 000.00 |
| | | Purchases | | 892 000.00 | | | Closing stock | | 236 827.50 |
| | | Carriage on purchases | | 28 800.00 | | | | | |
| | | Profit & loss (gross profit) | | 388 027.50 | | | | | |
| | | | | **1 436 827.50** | | | | | **1 436 827.50** |

## TASK 10.12 ⌘ FIFO and Weighted average method

**10.12.1 (a) FIFO**

| **NO. OF UNITS ON HAND (UNSOLD)** | |
|---|---|
| Opening stock | 500 |
| Purchases | 1 050 |
| Sales | (1 286) |
| **UNITS UNSOLD** | **264** |
| **TOTAL VALUE OF STOCK UNSOLD**: 264 x R23 | **R6 072** |
| **COST OF SALES** | |
| Opening stock | 5 000 |
| Purchases + carriage (4 500 + 3 600 + 5 000 + 6 900) | 20 000 |
| Closing stock | (6 072) |
| **COST OF SALES** | **R18 928** |

| | |
|---|---|
| **OR:** | |
| 500 x R10 | 5 000 |
| 300 x R15 | 4 500 |
| 200 x R18 | 3 600 |
| 250 x R20 | 5 000 |
| 36 x R23 | 828 |
| **COST OF SALES** | **R18 928** |
| | |
| **GROSS PROFIT** | |
| Sales | 28 148 |
| Cost of sales | (18 928) |
| **GROSS PROFIT** | **R9 220** |

**(b) Weighted average**

| | |
|---|---|
| **NO. OF UNITS ON HAND (UNSOLD)** | |
| Opening stock | 500 |
| Purchases | 1 050 |
| Sales | (1 286) |
| **UNITS UNSOLD** | **264** |
| | |
| **STOCK VALUE** | |
| Weighted average: 25 000 ÷ 1 550 = R16.13 | |
| | |
| **TOTAL VALUE OF STOCK UNSOLD**: 264 x R16.13 | **R4 258.32** |
| | |
| **COST OF SALES** | |
| Opening stock | 5 000 |
| Purchases + carriage (4 500 + 3 600 + 5 000 + 6 900) | 20 000 |
| Closing stock | (4 258.32) |
| **COST OF SALES** | **R20 741.68** |
| | |
| **GROSS PROFIT** | |
| Sales | 28 148 |
| Cost of sales | (20 741.68) |
| **GROSS PROFIT** | **R7 406.32** |

| **10.12.2** | **Explain why the weighted average method results in a lower gross profit than the FIFO.** |
|---|---|
| When using FIFO as a method of stock valuation the most recent price (which is usually the highest) is assigned to the value of stock. This results in a lower cost of sales amount hence a higher gross profit.<br>In the case of the weighted average method the highest price is averaged with the lower prices resulting in a higher cost of sales hence gross profit is lower. | |

## TASK 10.13 Ponsammy Stores: FIFO and Weighted average method

**10.13.1 FIFO**

| | |
|---|---|
| **NO. OF UNITS SOLD** | |
| Opening stock | 2 200 |
| Purchases [5 710 – 20] | 5 690 |
| Units on hand | (1 980) |
| **UNITS SOLD** | **R5 910** |
| | |
| **STOCK VALUE** | |
| 1 270 x 150 | 190 500 |
| 710 x 145 | 102 950 |
| **TOTAL VALUE OF STOCK ON HAND** | **R293 450** |
| | |
| **COST OF SALES** | |
| Opening stock (2 200 x R100) | 220 000 |
| Purchases (216 000 – 2 300 + 180 700 + 181 250 + 190 500) | 766 150 |
| Closing stock | (293 450) |
| **COST OF SALES** | **R692 700** |
| | |
| **OR:** | |
| 2 200 x R100 | R220 000 |
| 1 800 x R120 | 216 000 |
| 20 x R115 | (R2 300) |
| 1 390 x R130 | 180 700 |
| 540 x R145 | 78 300 |
| **COST OF SALES** | **R692 700** |
| | |
| **GROSS PROFIT** | |
| Sales [5 910 x 200] | 1 182 000 |
| Cost of sales | (692 700) |
| **GROSS PROFIT** | **R489 300** |

**10.13.2 Weighted average**

| | |
|---|---|
| **NO. OF UNITS SOLD** | |
| Opening stock | 2 200 |
| Purchases [5 710 – 20] | 5 690 |
| Units on hand | **(1 980)** |
| **UNITS SOLD** | **5 910** |
| | |
| **STOCK VALUE** | |
| Weighted Average: 986 150 ÷ 7 890 = R124.99 | |
| **TOTAL VALUE OF STOCK ON HAND**: 1 980 x R124.99 | **R247 480** *(Rounded off)* |
| | |

| | |
|---|---|
| **COST OF SALES** | |
| Opening stock (2 200 x R100) | 220 000 |
| Purchases + carriage<br>(216 000 – 2 300 + 180 700 + 181 250 + 190 500) | 766 150 |
| Closing stock | (247 480) |
| **COST OF SALES** | **R738 670** |
| | |
| **GROSS PROFIT** | |
| Sales [5 910 x 200] | 1 182 000 |
| Cost of sales | (738 670) |
| **GROSS PROFIT** | **R443 330** |

## TASK 10.14 Mary's Fashions: FIFO and Weighted average method – Calculations, Interpretation

| **10.14.1** | **Calculate the following using the FIFO method:** |
|---|---|
| | **(a) Value of the closing stock.** |

| | |
|---|---|
| 15 x R221 | 3 315 |
| 4 x R231 | 924 |
| **TOTAL** | **R4 239** |

| | |
|---|---|
| | **(b) The cost of sales.** |

5 040 + 35 713 - 4 239 = **R36 514**

| | |
|---|---|
| | **(c) The gross profit.** |

46 080 - 36 514 = **R9 566**

| | |
|---|---|
| | **(d) The actual mark-up% achieved.** |

$^{9\,566}/_{36\,514}$ x 100 = **26%** (26.2%)

| **10.14.2** | **The owner is of the opinion that the business would have shown a greater profit if they had used the Weighted average method? Do you agree? Show your calculations to answer this question.** |
|---|---|

40 753 ÷ 183 = R222.69
Value of the final stock: 19 x 222.69 = R4 231 *(rounded off)*
Profit = 46 080 - (5 040 + 35 713 - 4 231)
= 46 080 – 36 522
= **R9 558**
No insignificant amount of difference in this case (only R8). (Or any valid comment based on calculations)

| **10.14.3** | **The number of bags stolen.** |
|---|---|

183 - 144 = 39
39 – 19 = **20 stolen**

| **10.14.4** | **The owner is undecided about the mark-up % and whether he should increase / decrease / leave it unchanged. Comment quoting evidence from the question.** |
|---|---|

Must have aimed at a higher mark-up as no profit has been made on the goods stolen.

| 10.14.5 | **The owner is considering changing to the perpetual stock system. Do you agree with her decision? Discuss by explaining one advantage and one disadvantage of the perpetual stock system in comparison to the periodic stock system.** |
|---|---|
| Yes or No.<br>Advantage – can calculate stock shortages. Easy under perpetual system.<br>Disadvantage – could be difficult to calculate the cost of sales so she will need a computer with a bar code system. | |

## TASK 10.15 ⌘ Banyana Stores: FIFO and Weighted average method – Calculations, Interpretation

| 10.15.1 | **Calculate the following for rugby jerseys:** |
|---|---|
| | • **Value of the closing stock using the weighted average method (round off to the nearest Rand)** |
| (216 000 + 750 500 + 30 200) ÷ (1 200 + 3 400)<br>= 996 700 ÷ 4 600<br>= R217 (R216.67)<br>900 x 217 = **R195 300** | |
| | • **Cost of sales** |
| 996 700 – 195 300 = **R801 400** | |
| | • **Gross profit** |
| 1 680 000 – 801 400 = **R878 600** | |
| **10.15.2** | **Calculate the following for rugby balls:** |
| | • **Value of the closing stock using the FIFO method** |
| 200 x 225 = 45 000<br>(500 – 200) = 300 x 190 = 57 000<br>45 000 + 57 000 = **R102 000** | |
| | • **Cost of sales** |
| 249 600 + 901 000 - 102 000 = **R1 048 600** | |
| | • **Gross profit** |
| 1 662 000 – 1 048 600 = **R613 400** | |

| 10.15.3 | **Which department is contributing the most to the profitability of the business? Show appropriate calculations to support your answer.** |
|---|---|
| **Rugby jerseys mark up:**<br>$^{878\,600}/_{801\,400}$ x 100 = **109.6%**<br><br>**Rugby balls mark-up:**<br>$^{613\,400}/_{1\,048\,600}$ x 100 = **58.5%**<br>Rugby jerseys as they have the highest mark-up% and also the highest sales and gross profit.<br><br>**NOTE**:<br>As the question asks for profitability it would be wrong just to compare the sales and/or gross profit figures – a discussion on the mark-up is required as well. Learners could also say that overhead expenses relating to each product should also be taken into account (e.g. administration, selling and distribution expenses which will be shown in the Income Statement under Operating expenses). | |

| 10.15.4 | **How effectively have Banyana Stores controlled their stock during the financial year? Make the necessary calculations to support your answer.** |
|---|---|

**Rugby jerseys:**
1 200 + 3 400 – 3 500 = 1 100 jerseys on hand according to the book.
1 100 – 900 (actual stock) = 200 jerseys gone missing.
**Rugby balls:**
1 040 + 5 000 – 5 540 = 500 balls on hand according to the books.
500 – 500 (actual stock) = 0
Rugby balls have been very well controlled as no balls are missing.
Rugby jerseys have not been controlled well as 200 jerseys are missing.

| 10.15.5 | **Why do you think Banyana Stores makes use of a different stock valuation method for valuing the rugby jerseys and the rugby balls? Discuss giving two comments each to support their decisions.** |
|---|---|

**Note:** It could be argued that FIFO should be used for both these products are they are discrete units with relatively high cost and selling prices.
**Rugby jerseys: (Weighted average method)**
They are selling more rugby jerseys and it is simpler to use the weighted average method.
**Rugby balls: (FIFO)**
Ensures that the stock is valued at the current prices.

| 10.15.6 | **Banyana Stores are considering changing from the perpetual stock system to the periodic stock system but you do not agree. Briefly explain two advantages and two disadvantages of the perpetual stock system in comparison to the periodic stock system.** |
|---|---|

**Advantages of perpetual method over periodic method:**
- Better stock control as shortages are known.
- The stock value is on hand at any point in time.

**Disadvantages of perpetual over periodic method:**
- Requires a more expensive system, i.e. computerised system to monitor the purchases and sales.
- More complicated system.

## TASK 10.16 PMB Golf Shop: FIFO and Weighted average method – Calculations, Interpretation

| 10.16.1 | **Calculate the following for golf balls:** |
|---|---|
| | • **Value of the closing stock using the weighted average method (round off to the nearest Rand)** |

(96 000 + 960 000) ÷ (4 800 + 54 000)
= 1 056 000 ÷ 58 800
= R18 (R17.96)
7 600 x 18 = **R136 800**

| | • **Cost of sales** |
|---|---|

96 000 + 960 000 – 136 800 = **R919 200**

| | • **Gross profit** |
|---|---|

1 219 200 – 919 200 = **R300 000**

| 10.16.2 | **Calculate the following for golf clubs:** |
|---|---|
| | • **Value of the closing stock using the FIFO method** |

160 x (2 100 + 210) = R369 600
500 x (2 010 + 201) = R1 105 500
720 – 160 – 500 = 60 x (2 025 + 202.50) = R133 650
369 600 + 1 105 500 + R133 650 = **R1 608 750**

| | |
|---|---|
| | • **Cost of sales** |
| (648 000 + 2 331 000 + 233 100) – 1 608 750 = **R1 603 350** | |
| | • **Gross profit** |
| 2 040 000 – 1 603 350 = **R436 650** | |
| **10.16.3** | **Briefly discuss why in your opinion the PMB Golf Shop has made use of the weighted average method to value the golf balls but the FIFO method to value the golf clubs. Give one reason each.** |
| **Golf balls**:<br>It is not easy to distinguish one golf ball from another so therefore the weighted average method is the most appropriate.<br>The value of the golf balls is small so the weighted average method will be the best.<br><br>**Golf clubs**:<br>Golf clubs are been valued at the latest prices if the FIFO method is used.<br>The value of the golf clubs is much higher and therefore this would give a more realistic value. | |
| **10.16.4** | **How effectively has the PMB Golf Shop controlled their stock during the year? Quote at least two figures to support your answer.** |
| The golf clubs have not been well controlled:<br>120 golf clubs have gone missing (360 + 1 160 – 680) = 840. (840 – 720 = 120 missing.)<br>The business is holding too much stock in golf clubs. They only sold 680 clubs during the year and have a further 720 on hand.<br>Golf balls have also not been well controlled:<br>As there is a shortfall of 400 golf balls (4 800 + 54 000 – 50 800) = 8 000.<br>8 000 – 7 600 = 400 missing. (Golf balls are small and easy to steal.)<br>The business stock holding of balls is good – they have sold 50 800 balls and only have 7 600 on hand. | |
| **10.16.5** | **The owner is not happy with the profits of the business and is considering closing down the business.** |
| | **(a) Discuss two factors that the owner needs to take into account before making this decision.** |
| • Staff will lose their jobs and therefore their income.<br>• He should look to see if he can improve the situation by cutting costs or increasing revenue.<br>• Will he be able to earn a better return elsewhere?<br>Any other reasonable suggestion. | |

| | |
|---|---|
| | **(b) The owner has asked for your assistance. If he is to keep the business open he needs to make a better return on his investment. Offer three suggestions as to measures he could consider introducing to improve the profitability and therefore his return in the business.** |
| • Do not hold so much stock – buy just enough stock to keep the customers happy.<br>• Introduce better control mechanisms to prevent shortages and / or surpluses.<br>• Conduct a survey to determine what the customers want.<br>• Bring in a bigger range of goods.<br>• Offer a service, e.g. golf lessons to attract customers.<br>Any other feasible suggestion. | |

## TASK 10.17 ⌘ Ethics

| No. | Problem | Solution |
|---|---|---|
| **1.** | Unsuspecting customers are buying used or damaged products and paying the full price. This is not good business practice as the reputation of the business may become tarnished. | Damaged goods should be returned to the suppliers who can either refund the dealer or replace the product. Some dealers mark-down damaged or shop soiled merchandise. These products are then displayed separately and clearly marked as damaged or shop soiled. |
| **2.** | The Debtors Allowances Journal is not being updated. This results in incorrect turnover figures as debtors allowances are deducted from sales at year-end to show the net turnover. The trading stock account is also not being updated with the returns. The correct procedures for stock returns are not being adhered to. | Proper internal control measures need to be put in place to ensure that credit notes issued for returns are recorded timeously. The internal/external auditor may provide guidelines to staff in this regard. Many large stores have a separate department for dealing with returns by customers. It may also be a good idea to analyse the reasons for returns. The store could be dealing with products of inferior quality. |
| **3.** | Financial results become distorted and do not indicate a true reflection of the financial state of the business. The owner is unable to determine if an increase in profitability is as a result of normal business operations or as a result of his manipulations. | The internal auditors should have picked this up during his examination of the books. The actions of the trader may attract the attention of SARS. If the manipulations are made to evade tax he may face heavy penalties. In the interests of good Accounting and business practice the system of valuating stock should not be manipulated. The principle of consistency should apply. |
| **4.** | Prices changes are not updated on the computer system. Customers may feel that they are being deliberately overcharged yet this may not have been the intention of the supermarket. Customer loyalty may be adversely affected by such discrepancies. | Prices marked on the shelves must match with the prices stored on the computer data base in order to prevent embarrassment to the staff. Regular checking is advisable and any discrepancies fixed immediately. |
| **5.** | The owner is probably withdrawing stock during the year but is not recording it in the books. The Accounting procedure for recording deficits is not being complied with. The internal control of stock is not being properly maintained. | In order to represent a true state of affairs the owner needs to inform the bookkeeper or the auditor whenever he withdraws stock so that the correct entries can be processed. |
| **6.** | This is illegal and unethical and is punishable by law. The copyright holders (artists or musicians) of the CD receive royalties on originals sold. This action deprives them of their rightful income. The music store is benefiting at their expense illegally. | He should be made aware of the illegal nature of his business. Law enforcement officers may order him to shut down his business. The equipment which he uses for copying will most probably be confiscated and heavy fines may be imposed. |
| **7.** | This is unethical and does not constitute good business practice as customers are being misled by the dealer. Legal action can be taken against him if it can be proven that he tampers with the mileage of vehicles. | If the tampering with the mileage is proven this will become public knowledge. The buying public will lose all confidence in the dealer. He would lose his reputation as a car dealer and may have to shut down. He should also be made aware of the illegal and unethical nature of his deeds. |

| No. | Problem | Solution |
|---|---|---|
| **8.** | Customers have the right to return goods if they are unhappy with them provided certain conditions are met. The dealer could be aware of this but he does not want to lose the deal. He may, on the other hand, not be aware of the '7-day cool-off' period. | The dealer should be made aware of the '7-day cooling off' period for business transactions whereby customers can return unwanted goods for a full refund. The provision is that the goods are in its original packaging and have not been damaged in any way. To avoid this situation in the future he is advised to supply clients with sample tiles which they can take home. Instead of losing her business he could offer to exchange the tiles. |
| **9.** | It is possible that he may get complaints from the other 29 customers provided they read the manual. The computer dealer's supplier may have misled him. On the other hand the dealer may have knowingly advertised the units as 3.2 gigabytes instead of 3.0 gigabytes. | In the interests of good business practice and ethics he is advised to contact the 29 customers and explain the situation to them. He may either refund the full purchase price or he may offer a refund. If the supplier of the computer misled the dealer then he would have to take the matter up with him and claim for a refund. If the advertisement was deliberately meant to deceive customers then this would become unethical and would adversely affect his reputation in the future. |
| **10.** | This action amounts to insurance fraud and is a criminal act. The owner is trying to defraud the insurance company. Insurance policies do not cover intentional damage to property. | Insurance contracts do not cover deliberate acts such as this. Should the insurance company be able to prove that this was a deliberate act it is unlikely that he would be paid? Before claims are processed a thorough check is conducted by insurance assessors. The Fire Department also conducts an investigation. |

## TASK 10.18 Li Chang: Calculations, Problem solving

**10.18.1**

| Week ending | No. of blankets sold | Cash register readings (Actual) | Expected cash register readings | Shortfall/Surplus ('+' or '-') |
|---|---|---|---|---|
| 07:03:20.8 | 1 546 | 369 120 | 371 040 | -1 920 |
| 14:03:20.8 | 1 200 | 288 240 | 288 000 | +240 |
| 21:03:20.8 | 1 408 | 333 120 | 337 920 | -4 800 |
| 28:03:20.8 | 1 110 | 264 000 | 266 400 | -2 400 |
| **Total** | **5 264** | **1 254 480** | **1 263 360** | **-8 880** |

Amount lost = **R8 880**

| | |
|---|---|
| **10.18.2** | **Li is obviously concerned about this situation. In your groups apply your minds to this problem. You need to identify the problems and make recommendations to Li. Submit your findings and recommendations in the form of a written report. Your report must also include the table above.** |

**PROBLEMS:**

- He lost 0.7% ($^{8\,880}/_{1\,263\,360}$ x 100) of his sales. This is almost 1% in one month.
- If the situation is not remedied he could lose about 12% or more over a twelve-month period.
- He could be understaffed in the warehouse.
- The warehouse staff do not carry out their duties properly – incorrect calculations, under and over counting, wrong invoicing, not reconciling invoices and receipts with bank deposits, etc.
- The stock controller does not take stock.
- Any other suitable answer.

**RECOMMENDATIONS:**

- Conduct stocktaking regularly in order to detect deficits quickly.
- Employ more administrative staff and allocate specific duties to them.
- Employ an internal and/or independent auditor to check and verify accounting records.
- Check invoice details – the quantity indicated on the invoice must correspond with the actual number of blankets leaving the warehouse.
- Sales representatives also need to do a physical count of blankets issued to them.
- Check invoices against receipts issued by the sales staff and report any discrepancies.
- Check receipts against bank deposits – discrepancies must be reported.
- Discuss the matter with the sales personnel – they could be making mistakes when invoicing, or they could be selling blankets privately for their own account.
- Li can take legal action against the sales staff provided he has sufficient proof that they are stealing from him.
- Any other suitable answer.

**Suggested marking grid:**

| Criteria | Level 1 | Level 2 | Level 3 | Level 4 |
|---|---|---|---|---|
| **Calculations.** | Little attempt to identify the correct figures and complete the calculations.<br>(3 mark) | Some attempt at calculations.<br>(6 marks) | Appropriate figures identified and calculations good.<br>(9marks) | Comprehensive calculations showing excellent application of knowledge.<br>(12 marks) |
| **Problems identified.** | Little attempt to identify problems.<br>(2 mark) | Some attempt to identify problems.<br>(4 marks) | Identification of problems shows good understanding and application of knowledge.<br>(6 marks) | Excellent explanation of problems showing logical thinking and excellent understanding.<br>(8 marks) |
| **Ability to make feasible suggestions.** | Little attempt to make suggestions.<br>(1 mark) | Some attempt to make appropriate suggestions.<br>(2 marks) | Some good suggestions showing good problem solving and logical thinking.<br>(3 marks) | Makes excellent suggestions based on an in-depth understanding.<br>(4 marks) |
| | | | **Total marks available** | **24** |

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Record entries using the Perpetual stock system. | | | |
| Record entries using the Periodic stock system. | | | |
| Calculate ratios pertinent to stock. | | | |
| Calculate stock values using FIFO and Weighted average. | | | |
| Analyse and interpret results. | | | |
| Report on internal control of stock. | | | |
| Discuss ethical issues relating to stock. | | | |

# MODULE 11
# RECONCILIATIONS

**Note to the Teacher:**

Reconciliations are an important aspect of Accounting. It is an essential internal control procedure that, if done properly, will soon highlight errors and omissions. If there is any fraud or irregular bookkeeping happening, reconciliations are one method that will assist in identifying these. Although Reconciliations are taught separately, make sure that your learners understand the importance of this section.

## TASK 11.1 ⌘ Berg Traders: Creditor's Reconciliation

**11.1.1 GENERAL JOURNAL OF BERG TRADERS FOR JUNE 20.8** **GJ**

| No | D | Details | Fol | Dr | Cr | Debtors control | | Creditors control | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Dr | Cr | Dr | Cr |
| 111 | 3 | Trading stock | | 1 800 | | | | | |
| | | Acme Manufacturers | | | 1 800 | | | | 1 800 |
| | | Correction of invoice 2460 | | | | | | | |
| 112 | 15 | Trading stock | | 250 | | | | | |
| | | Acme Manufacturers | | | 250 | | | | 250 |
| | | Correction of debit note 35 | | | | | | | |

**Correct balance in the Creditors Ledger:**

**Acme Manufacturers:**

| |
|---|
| 9 225 |
| 1 800 |
| 250 |
| **11 275** |

**11.1.2 CREDITORS RECONCILIATION AS AT 30 JUNE 20.8**

| **ACME MANUFACTURERS** | |
|---|---|
| Balance per Acme statement | 17 075 |
| Discount not reflected on 7 June | (300) |
| Payment not reflected on 27 June | (5 000) |
| Discount not reflected on 27 June | (500) |
| Balance per ledger account | **11 275** |

## TASK 11.2 ⌘ Village Mall Retailers: Creditor's Reconciliation Statement

**Note**:
Before undertaking this Task, the Teacher should ask learners to identify and describe the entries that are on the statement and in the ledger account. The Teacher should ensure that learners understand the 'mirror image' of the one in relation to the other.

**11.2.1 GENERAL JOURNAL OF VILLAGE MALL RETAILERS FOR AUGUST GJ**

| No. | D | Details | Fol | Dr | Cr | Debtors control | | Creditors control | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Dr | Cr | Dr | Cr |
| 123 | 20 | Umgeni Shoes | | 500 | | | | 500 | |
| | | Discount received | | | 500 | | | | |
| | | Discount not entered on 30 June | | | | | | | |
| 124 | | Discount received | | 1 100 | | | | | |
| | | Umgeni Stores | | | 1 100 | | | | 1 100 |
| | | Correction of discount on 12 Aug. | | | | | | | |
| 125 | | Umgeni Shoes | | 1 800 | | | | 1 800 | |
| | | Trading stock | | | 1 800 | | | | |
| | | Correction of Invoice 458 | | | | | | | |
| 126 | | Umgeni Shoes | | 9 800 | | | | 9 800 | |
| | | Tugela Manufacturers | | | 9 800 | | | | 9 800 |
| | | Correction of Invoice 24338 | | | | | | | |
| 127 | | Trading stock | | 410 | | | | | |
| | | Umgeni Shoes | | | 410 | | | | 410 |
| | | Delivery charges not entered | | | | | | | |

**Correct balance in the Creditors Ledger:**

**Umgeni Shoes:**

| |
|---|
| 26 030 |
| (500) |
| 1 100 |
| (1 800) |
| (9 800) |
| 410 |
| **R15 440** |

**11.2.2 CREDITORS RECONCILIATION AS AT 31 AUGUST 20.9**

| **UMGENI SHOES** | |
|---|---|
| Balance per statement of Umgeni Shoes | 20 540 |
| Add: Correction of C/N 432 | 360 |
| Less: Invoice 477 (Correction of error) | (2 560) |
| Add: Invoice 562 not on statement | 5 900 |
| Less: Cheque 34622 not on statement | (8 000) |
| Less: Discount not on statement | (800) |
| Balance per ledger account | **15 440** |

## TASK 11.3 ⌘ Ashmore Traders: Creditor's Reconciliation Statement

| | Creditors Ledger of Ashmore Traders | Statement from Taljaard Suppliers |
|---|---|---|
| Balances | 8 310 | 11 790 |
| 1 | 500 | |
| 2 | (90) | |
| 3 | | 6 930 |
| 4 | | (3 000) |
| 5 | 7 000 | |
| Final Balance / Total | **15 720** | **15 720** |

## TASK 11.4 ⌘ Reconciling control accounts & Personal accounts

| No. | Transaction | Journal | Debtors Control/Debtor's personal account | | Creditors Control/ Creditor's personal account | |
|---|---|---|---|---|---|---|
| | | | Increase | Decrease | Decrease | Increase |
| | | | Dr | Cr | Dr | Cr |
| **1.** | Invoice issued for stock sold on credit. | DJ | + | | | |
| **2.** | Cheques received from debtors to pay their accounts. | CRJ | | - | | |
| **3.** | Invoices received for items purchased on credit. | CJ | | | | + |
| **4.** | Cheque payments made to creditors. | CPJ | | | - | |
| **5.** | Defective stock returned by debtors. | DAJ | | - | | |
| **6.** | Petty cash refund granted to debtor in respect of overcharge. | PCJ | + | | | |
| **7.** | Charge interest on the overdue account of a debtor. | GJ | + | | | |
| **8.** | Allowances granted to debtors for overcharged invoices. | DAJ | | - | | |
| **9.** | The cheque of a debtor is returned by the bank due to insufficient funds. | CPJ | + | | | |
| **10.** | Discounts allowed to debtors for early settlement. | CRJ | | - | | |
| **11.** | Discounts received for prompt payment. | CPJ | | | - | |
| **12.** | The account of a debtor is written off. | GJ | | - | | |
| **13.** | Cancellation of discount on r/d cheque. | GJ | + | | | |
| **14.** | Defective items returned to creditors. | CAJ | | | - | |
| **15.** | Interest charged by a creditor on overdue account. | GJ | | | | + |
| **16.** | Transfer a debit balance of a creditor in the Creditors Ledger to his account in the Debtors Ledger. | GJ | + | | | + |
| **17.** | Transfer a credit balance of a debtor in the Debtors Ledger to his account in the Creditors Ledger. | GJ | + | | | + |

## TASK 11.5 Ridge Stores: Probable causes for not agreeing

**The Debtors/Creditors list totals do not agree with the Debtors and Creditors control balances. List some probable causes why these totals / balances may not agree.**

- Errors/omissions in the journals.
- Incorrect/inaccurate posting from journals to the control accounts.
- Incorrect/inaccurate posting from journals to the Debtors ledger.

## TASK 11.6 Reconciling control accounts and Lists

| No. | Debtors | | Creditors | |
|---|---|---|---|---|
| | Debtors Control | Debtors List | Creditors Control | Creditors List |
| **Opening balances / totals** | **2 390** | **2 594** | **3 710** | **3 510** |
| **1.** | | +101 | | |
| **2.** | +320 | +320 | | |
| **3.** | | | -200 | |
| **4.** | +10 | | | |
| **5.** | | | -195 | -195 |
| **6.** | | | -50 | -50 |
| **7.** | | -35 | | |
| **8.** | +20 | +20 | | |
| **9.** | | -270 | | |
| **10.** | +130 | +130 | | |
| **11.** | | | | ±540 = 0 |
| **12.** | | +160 | | |
| **13.** | -36 | -36 | | |
| **14.** | -90 + -90 = -180 | -90 + -90 = -180 | | |
| **15.** | | -150 | | |
| **Closing balances / totals** | **2 654** | **2 654** | **3 265** | **3 265** |

## TASK 11.7⌘ Gilmore CC: Debtors control and Debtors List

**11.7.1 DEBTORS LEDGER OF GILMORE CC**

**Mpo Zungu** **DL1**

| Date | | Details | Fol | Debit | Credit | Balance |
|---|---|---|---|---|---|---|
| 20.8 | | | | | | |
| Jan | 1 | Accounts rendered | b/d | | | 3 120 |
| | 7 | Rec. 123 | CRJ | | 2 000 | **1 120** |
| | | Discount | CRJ | | 200 | **920** |
| | 18 | Inv. W1239 | DJ | 996 | | **1 916** |
| | 20 | C/N 411 | DAJ | | 188 | **1 728** |
| | 25 | Rec. 133 | CRJ | | 800 | **928** |
| | | | | | | |

**Sandipa Qwala** **DL2**

| Date | | Details | Fol | Debit | Credit | Balance |
|---|---|---|---|---|---|---|
| 20.8 | | | | | | |
| Jan | 1 | Accounts rendered | b/d | | | 2 456 |
| | 4 | Inv. W1240 | DJ | 200 | | **2 656** |
| | 8 | Rec. 128 | CRJ | | 1 900 | **756** |
| | | Discount | CRJ | | 86 | **670** |
| | 10 | Cheque unpaid | CPJ | 1 900 | | **2 570** |
| | 13 | Rec. 132 | CRJ | | 2 000 | **570** |
| | | | | | | |

**11.7.2** **GENERAL LEDGER OF GILMORE CC**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **DEBTORS CONTROL** **B** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.8 | | | | | 20.8 | | | | | |
| Jan | 1 | Balance[1] | b/d | 5 576 | Jan | 31 | Bank[3] | CRJ | 6 700 |
| | 31 | Sales[2] | DJ | 1 196 | | | Discount allowed[4] | CRJ | 286 |
| | | Bank (r/d) | CPJ | 1 900 | | | Debtors allowances | DAJ | 188 |
| | | | | | | | Balance | c/d | 1 498 |
| | | | | **8 672** | | | | | **8 672** |
| Feb | 1 | Balance | b/d | 1 498 | | | | | |
| | | | | | | | | | |

[1] 3 120 + 2 456 = 1 576
[2] 996 + 200 = 1 196
[3] 2 000 + 800 + 1 900 + 2 000 = 6 700
[4] 200 + 86 = 286

**11.7.3 DEBTORS LIST ON 31 JANUARY 20.8**

| | |
|---|---|
| Mpo Zungu | 928 |
| Sandipa Qwala | 570 |
| Balance as per Debtors control account | **1 498** |

## TASK 11.8 Gilmore CC: Debtors control and Debtors List - error correction

**11.8.1**

| | | |
|---|---|---|
| (i) | Dr Debtors control/Sandipa [+]; | Cr Discount allowed [R86] [-] |
| (ii) | Dr Debtors control/Mpo [+]; | Cr Debtors allowances [R70] [-] |
| (iii) | Dr Debtors control/Sandipa [+]; | Cr Sales [R20] [+] |
| (iv) | Dr Bad debts [+]; | Cr Debtors control/Sandipa [R676] [-] |
| (v) | Dr Debtors control/Mpo [+]; | Cr Interest income [R75] [+] |

**11.8.2 GENERAL JOURNAL OF GILMORE TRADERS** **GJ**

| No. | D | Details | Fol | Dr | Cr | Debtors control | | Creditors control | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Dr | Cr | Dr | Cr |
| 01 | 31 | Sandipa Qwala | | 86 | | 86 | | | |
| | | Discount allowed | | | 86 | | | | |
| | | Cancel discount on unpaid cheque | | | | | | | |
| 02 | | Mpo Zungu | | 70 | | 70 | | | |
| | | Debtors allowances | | | 70 | | | | |
| | | Correction of error | | | | | | | |

**GENERAL JOURNAL OF GILMORE TRADERS (Contd)** **GJ**

| No. | D | Details | Fol | Dr | Cr | Debtors control | | Creditors control | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Dr | Cr | Dr | Cr |
| 03 | 31 | Sandipa Qwala | | 20 | | 20 | | | |
| | | Sales | | | 20 | | | | |
| | | Correction of error | | | | | | | |
| 04 | | Bad debts | | *676 | | | | | |
| | | Sandipa Qwala | | | 676 | | 676 | | |
| | | Account written off | | | | | | | |
| 05 | | Mpo Zungu | | 75 | | 75 | | | |
| | | Interest income | | | 75 | | | | |
| | | Interest charged on overdue a/c | | | | | | | |
| | | | | | | **251** | **676** | | |
| | | | | | | B | B | | |

*570 + 86 + 20

**11.8.3** **GENERAL LEDGER OF GILMORE CC**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **DEBTOR'S CONTROL ACCOUNT** **B** **Cr**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Jan | 31 | Balance | b/d | 1 498 | Jan | 31 | Sundry accounts/ | | |
| | | Sundry accounts | GJ | 251 | | | Bad debts | GJ | 676 |
| | | | | | | | Balance | c/d | 1 073 |
| | | | | **1 749** | | | | | **1 749** |
| Feb | 1 | Balance | b/d | 1 073 | | | | | |

**11.8.4 DEBTORS LIST ON 31 JANUARY 20.8**

| | |
|---|---|
| Mpo Zungu [928 + 70 + 75] | 1 073 |
| Sandipa Qwala [570 + 86 + 20 – 676] | 0 |
| Balance as per Debtors control account | **1 073** |

## TASK 11.9 ⌘ Lotti Stores: Debtors control and Debtors List

**11.9.1** **GENERAL LEDGER OF LOTTI STORES**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **DEBTORS CONTROL** **B6** **Cr**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| July | 1 | Balance | b/d | 11 836 | July | 31 | Bank[6] | CRJ | 32 654 |
| | 31 | Sales[2] | DJ | 44 940 | | | Discount allowed | CRJ | 1 762 |
| | | Bank[5] | CPJ | 6 457 | | | Debtors allowances[3] | DAJ | 2 308 |
| | | Sundry accounts[1] | GJ | 3 928 | | | Sundry accounts[4] | GJ | 1 194 |
| | | | | | | | Balance | c/d | 29 243 |
| | | | | **67 161** | | | | | **67 161** |
| Aug | 1 | Balance | b/d | 29 243 | | | | | |

**Working:**
[1] 1 200 + 2 687 + 41 = R3 928
[2] 45 190 – 250 = R44 940
[3] 2 228 + 80 = 2 308
[4] 974 + 110 + 110 = R1 194
[5] 5 678 + 779 = R6 457
[6] 28 654 + 4 000 = R32 654

**11.9.2 DEBTORS LIST ON 31 JULY 20.9**

| | |
|---|---|
| G. Dwyer [14 069 + 779 + 41] | 14 889 |
| A. Hendriks [9 861 – 180] | 9 681 |
| M. Malinga [3 455 – 110 – 110] | 3 235 |
| G. Docrat [-2 687 + 2 687] | 0 |
| E. Ebenza [5 438 – 4 000] | 1 438 |
| Balance as per Debtors control account | **29 243** |

**Note to Teacher:**

An explanation of each of the errors/omissions is provided below:

1. Since the amount was entered in the Debtors Control column of the CRJ, Docrat's account was credited. This should not have been the case as his account was previously written off. Furthermore a credit in his account indicates that Lotti Stores owes him R2 687.
   Correction of error:
   A journal entry is required: Debtors Control/G. Docrat [+] is debited and Bad debts recovered account [+] is credited. Bank is not affected – all monies received should be recorded in CRJ and this was done but the amount was entered in the Debtors Control account. It should have been recorded in the Sundry accounts column and reflected as Bad debts recovered.

2. Sales is overstated by R250 therefore Sales must decrease by R250; Debtors allowances is understated by R80 therefore Debtors allowances must increase by R80.

3. Since this transaction was treated as a Sale, Debtors control/M. Malinga [+] was debited and Sales account [+] was credited.
   Correction of error:
   GJ entry: Dr Sales [-]; cr Debtors control/M. Malinga [-]
   Another journal entry is required to record the return:
   Dr Debtors allowances [+]; cr Debtors control/M. Malinga [-] (Done through the GJ as DAJ already posted)

4. No journal entry is required as the amount was correctly recorded in the journal. Debtors control account is not affected but the personal account of A. Hendriks was debited with R180 (1 861 – 1 681) extra.
   Correction of error:
   Subtract R180 in A. Hendrik's account in the Debtors ledger.

5. When the cheque was received:
   Bank was debited and Debtors control/G. Dwyer was credited [-].
   Discount allowed was debited [+] and Debtors control/G. Dwyer was credited [-].
   Correction of error:
   Dr Debtor's control/G. Dwyer [+] R779
   Cr Bank [-] R779
   Dr Debtor's control/G. Dwyer [+] R41
   Cr Discount allowed [-] R41
   Calculation of the discount:
   $779 \times {}^{5}/_{95} = R41$

6. Bank is debited [+]; Debtors control/E. Ebenza is credited [-]

## TASK 11.10 Msimang Traders: Creditors Control account and Creditors List

| Creditors control |
|---|
| 20 000 |
| 40 |
| 180 |
| |
| |
| |
| **20 220** |

| Creditors List |
|---|
| 19 140 |
| 240 |
| 980 |
| 40 |
| 180 |
| [360] |
| **20 220** |

## TASK 11.11 Pompom Trading Store: Debtors control and Debtors List

**11.11.1** **GENERAL LEDGER OF POMPOM TRADING STORE**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **DEBTORS CONTROL** **B6** **Cr**

| 20.7 | | | | | 20.7 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| April | 1 | Balance | b/d | 5 000 | April | 30 | Bank | CRJ | 4 200 |
| | 30 | Sales[1] | DJ | 12 210 | | | Discount allowed | CRJ | 210 |
| | | Sundry accounts[2] | GJ | 325 | | | Debtors allowances[3] | DAJ | 1 550 |
| | | Bank (r/d) | CPJ | 300 | | | Sundry accounts | GJ | 70 |
| | | | | | | | Balance | c/d | 11 805 |
| | | | | **17 835** | | | | | **17 835** |
| May | 1 | Balance | b/d | 11 805 | | | | | |
| | | | | | | | | | |

[1]12 000 – 150 + 360 = 12 210
[2]150 + 110 + 50 + 15 = 325
[3]1 500 + 50 = 1 550

**11.11.2 DEBTORS LIST ON 30 APRIL 20.7**

| | |
|---|---|
| Bill [610 + 360] | 970 |
| Zondi [2 780 + 50 – 180] | 2 650 |
| Tom [2 440 + 300 + 15 + 1 450 – 450] | 3 755 |
| Collin [-110 + 110] | 0 |
| Lisa [3 980 – 130] | 3 850 |
| Amina | 130 |
| Japp | 450 |
| Balance as per Debtors control account | **11 805** |

## TASK 11.12 ⌘ Hammox Traders: Debtors/Creditors control and Debtors/Creditors List

**11.12.1** **GENERAL LEDGER OF HAMMOX TRADERS**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **DEBTORS CONTROL** **B** **Cr**

| 20.7 | | | | | 20.7 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| April | 1 | Balance | b/d | 3 300 | April | 30 | Debtors allowances | DAJ | 450 |
| | 30 | Sales 24 550 + 540 | DJ | 25 090 | | | Bank | CRJ | 18 760 |
| | | Sundry accounts[1] | GJ | 1 160 | | | Discount allowed | CRJ | 350 |
| | | Bank (r/d) | CPJ | 430 | | | Sundry accounts[2] | GJ | 490 |
| | | | | | | | Balance | c/d | 9 930 |
| | | | | **29 980** | | | | | **29 980** |
| May | 1 | Balance | b/d | 9 930 | | | | | |

[1]670 + 350 + 120 + 20 = 1 160
[2]440 + 50 = 490

**DEBTORS LIST AS AT 30 APRIL 20.7**

| | |
|---|---|
| Collins [4 120 + 1 230 + 120 + 430 + 20] | 5 920 |
| Zimba Stores [-350 + 350] | 0 |
| Pillay [3 400 – 1 230] | 2 170 |
| Stahls [600 + 600] | 1 200 |
| Shultz [820 – 600] | 220 |
| Sanders [50 – 50] | 0 |
| Alan [120 + 540 – 120 – 120] | 420 |
| Balance as per Debtors control account | **9 930** |

**11.12.2** **GENERAL LEDGER OF HAMMOX TRADERS**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **CREDITORS CONTROL** **B** **Cr**

| 20.7 | | | | | 20.7 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| April | 30 | Bank | CPJ | 35 550 | April | 1 | Balance | b/d | 14 680 |
| | | Discount received | CPJ | 760 | | 30 | Sundry accounts[3] | CJ | 36 630 |
| | | Sundry accounts | CAJ | 420 | | | Sundry accounts[1] | GJ | 1 150 |
| | | Sundry accounts[2] | GJ | 1 760 | | | | | |
| | | Balance | c/d | 13 970 | | | | | |
| | | | | **52 460** | | | | | **52 460** |
| | | | | | May | 1 | Balance | b/d | 13 970 |

[1] 800 + 350 = 1 150
[2] 310 + 550 + 900 = 1 760
[3] 36 700 – 70 = 36 630

**CREDITORS LIST AS AT 30 APRIL 20.7**

| | |
|---|---|
| AV Supplies [2 330 – 550] | 1 780 |
| QA Wholesalers | 1 450 |
| Basco Traders [9 380 – 900] | 8 480 |
| Zimba Stores [710 + 350] | 1 060 |
| Starbuck & Co. [1 110 + 90] | 1 200 |
| Chin Lu Suppliers [660 – 600 – 60] | 0 |
| Balance as per Creditors control account | **13 970** |

## TASK 11.13 ⌘ JK Furnishers: Age Analysis, Interpretation

**11.13.1 AGE ANALYSIS**

| 90+ days | 60+ days | 30+ days | Current |
|---|---|---|---|
| Nil | R1 605 | R8 300 | R4 550 |

**Workings:**

| 90+ days<br>May + | 60+ days<br>June | 30+ days<br>July | Current<br>Aug |
|---|---|---|---|
| 2 400 – 1 200 – 60 - 1 140 | 6 000 – 600 – 660 – 90 – 2 000 – 100 – 900 - 45 | 8 300 | 1 150 + 3 400 |

| 11.13.2 | **Comment on the Age Analysis and offer advice to JK Furnishers.** |
|---|---|

They are not handling their debtors correctly.
They have allowed Ben to exceed normal credit terms. He is paying erratically.
Charge interest on accounts in the 60+ days category.
Offer a better discount for prompt payment.
Do not allow debtors to buy on credit if their accounts are not up to date.
Screen debtors better before allowing them to open accounts.

## TASK 11.14 Woodies Fashions: Age Analysis, Interpretation

**11.14.1 AGE ANALYSIS**

| 90+ days | 60+ days | 30+ days | Current |
|---|---|---|---|
| Nil | R7 960 | R4 020 | R1 780 |

**Workings:**

| 90+ days<br>Feb + | 60+ days<br>Mar | 30+ days<br>April | Current<br>May |
|---|---|---|---|
| 1 500 – 1 425 - 75 | 5 100 - 240 – 2000 – 100 + 3 200 + 2 000 + 100 + 3 000 – 1 200 – 1 300 - 600 – 1 000 + 1 000 | 4 400 - 380 | 850 – 170 + 1 100 |

| 11.14.2 | **Judging from this account, is Woodies Fashions handling their debtors properly? Explain, and offer three points of advice.** |
|---|---|

No, they are not handling their debtors correctly.
They have allowed Helen to exceed normal credit terms. She is paying erratically and her cheques are bouncing. (Two cheques have been dishonoured - R/D).
They allowed her to return goods on 10 May, 9 days after the purchase. This is going against their own policy.

**Advice:**
Must charge interest on accounts in the 60+ days category.
Offer a bigger discount for prompt payment.
Do not allow debtors to buy on credit if their accounts are not up to date.
Screen debtors better before allowing them to open accounts.

## TASK 11.15 ⌘ Donny's Dealers: Age Analysis, Interpretation

| | |
|---|---|
| **11.15.1** | **Briefly explain how the preparation of a Debtors Age Analysis can assist Donovan and Davie in controlling their debtors?** |

Effective method of credit control.
Action can be taken against debtors who do not comply by charging interest or taking legal action.
Bad debts can be minimised.
Make decisions based on age analysis of the debtor/s.

| | |
|---|---|
| **11.15.2** | **Donovan feels that the control of debtors has not been satisfactory since the appointment of the new credit controller. Provide Donovan with at least 4 key points as to what has possibly gone wrong with regards to the debtors.** |
| | **Refer to the Debtors' Age Analysis and the Debtors Control account provided by Davie below. Quote specific information from the Age Analysis (two points) and from the Debtors Control account (two points).** |

**Debtors Control account:**
Dishonoured cheques amount to 19.6% of payments received from debtors. Received R64 500; dishonoured cheques R12 630 (R12 250 + R 380). This is not acceptable.
R1 600 bad debts written off. They sold too much on credit to unreliable debtors; debtors are not being screened properly.
Debtors' allowances consist of 4.9% of sales. Too much stock is being returned by debtors (R3 200).

**Debtors Age Analysis:**
T. Cowie has been allowed to exceed the credit limit of R20 000 and owes a total of R35 000.
This should be investigated as to how this happened and who was responsible for allowing him to exceed the credit limit.
Furthermore, T. Cowie has also let us down further by not settling his debt on time and exceeding the credit terms of 30 days. He owes us R17 000 from 60 days and over. This is totally unacceptable and his account must be frozen immediately.

## TASK 11.16 ⌘ ABU'S Trading Store: Age Analysis, Debtors, Interpretation

| | |
|---|---|
| **11.16.1** | **(a) Briefly explain the concept of division of duties.** |

No one person must have complete control of an entire Accounting system.
If they do have such control it will be easy for them to commit fraud. Tasks / Duties of one person must serve as a check on the other person's work.
E.g.: Two separate bookkeepers should post to the Debtors Control account in the General Ledger and the Personal Accounts in the Debtors Ledger.
This will allow the accountant to check that the balance of the Debtors Control account and the total of the Debtors List at the end of the month agree thus maintaining Internal Control of debtors.

| | |
|---|---|
| | **(b) Explain why the Debtors' Control account balance should agree with the Debtors' List total.** |

The Debtors Control account is a summary of the individual debtors accounts and therefore the balance of the Debtors Control account should equal the total of the Debtors List drawn from the Debtors Ledger.

| | |
|---|---|
| **11.16.2** | **Explain TWO processes the bookkeeper should follow if he discovers a difference between the Debtors' Control Account balance and the Debtors' List total.** |

Check the entries in the journals.
Check casting / totalling of journals.
Control with the original source documents.
Check postings from journals.

| 11.16.3 | **Calculate the following:** |
|---|---|
| | **(a) The correct closing balance of the Debtors' Control account on 31 March 20.9. Take all relevant information listed below into account.** |
| 200 000 + 15 000 + 1 800 - 2 600 = R214 200 | |
| | **(b) The correct amounts owing by each of the following debtors of ABU'S Trading Store:** |
| | • **M. Grobler** |
| 42 100 + 15 000 – 8 300 = R48 800 | |
| | • **S. Naidu** |
| 22 100 + 1 800 – 2 700 = R21 200 | |
| | • **R. Zuma** |
| 7 900 + 12 000 + 8 300 = R28 200 | |
| **11.16.4** | **(a) Refer to the Age Analysis above. Briefly explain why you would be concerned about the control of debtors in this business. Quote relevant figures to support your answer.** |
| Their credit terms are 60 days and they are expecting 80% of debtors to adhere to these terms.<br>They however have outstanding debts of R 143 100, (i.e. R64 800 + R78 300), which amounts to 72% of outstanding debts (i.e. only 28% are complying with the credit terms). | |
| | **(b) Provide 3 procedures the owner could implement to improve the collection of money from debtors.** |
| Proper screening of debtors. Credit references must be check properly.<br>Charge interest on overdue accounts.<br>Offer cash discounts to debtors for paying within the credit terms (60 days in this case).<br>Follow up on outstanding debts with constant reminders, statements, emails and telephone calls. | |

## TASK 11.17 Report: Reconciliations

**Note to the Teacher**:

The learners must be encouraged to use creative thinking and draw on their previous knowledge as well as experience in answering this question. It is essential that learners in Grade 12 are competent in the skill of applying their knowledge to the situation or scenario given in the question. In this case their answers must be related to a superette.

**Suggested rubric for this activity:**

| Criteria | Level 1 | Level 2 | Level 3 | Level 4 | Marks |
|---|---|---|---|---|---|
| Identification of problem areas. | Little evidence indicating the ability to identify problem areas.<br><br>(2 marks) | Identifies most of the main problem areas.<br><br>(4 marks) | Identification of problem areas with some comprehensive discussion.<br><br>(6 marks) | Excellent discussion of problem areas showing insight and clear understanding.<br><br>(10 marks) | Max 10 |
| Suggestions for improvement. | Little evidence of suggestions for improvement.<br><br>(2 marks) | Some attempt to make suggestions but these are not always relevant.<br><br>(4 marks) | Good suggestions made but not all are relevant.<br><br>(6 marks) | Excellent suggestions made that are relevant and show good insight and understanding.<br>(10 marks) | Max 10 |
| **Maximum marks available** | | | | | **20** |

**Suggested answers for the learners report:**

**Problem areas:**
- Cash journal entries may be incomplete, e.g. deposits made or cheques paid are not being recorded.
- Cheque payments are possibly not verified with cheque counterfoils.
- Cheque counterfoils may not have been completed correctly.
- Possibly too many cheque payments per month.
- Possibly too many deposits per month.
- Daily postings are not being cross-checked.
- Any other appropriate answer.

**Suggestions:**
- Cash journals should be checked weekly.
- Obtain bank statements during the month (at the end of each week perhaps) and verify with cash journals. In this way, the work does not build up at month-end.
- She could get the person who does daily postings to assist her with reconciliation.
- She could suggest to the owner that he make electronic payments rather than cheque payments – safer, convenient and less costly in terms of fees.
- Any other appropriate answer.

The learner's marks must be reported according to the following assessment codes:

| Rank | 7 | 6 | 5 | 4 | 3 | 2 | 1 |
|---|---|---|---|---|---|---|---|
| | **Outstanding** | **Meritorious** | **Substantial** | **Adequate** | **Moderate** | **Elementary** | **Not achieved** |
| % | 80 – 100% | 70 – 79% | 60 – 69% | 50 – 59% | 40 – 49% | 30 – 39% | 0-29% |
| Mark | 17 - 20 | 15 - 16 | 13 – 14 | 11 - 12 | 9 - 10 | 7 - 8 | 0 - 6 |

Learners who achieve level 4 and below: indicate where they can improve and how. Allow them to re-write their report to improve their understanding and practice the skills of report writing.

Learners who achieve level 5 and 6, who are aiming for an A, also need to be given guidance on ways to improve either their understanding or skill in answering this type of question.

**Note to the Teacher:**

**How to use an assessment code table:**

If you are going to allocate marks to the above assessment, you must complete the following assessment code table for reporting these marks to the learner.

1. Determine the total marks you will award for each of the criteria.
2. Add the maximum marks for each criterion to obtain the total for this assessment.
3. Calculate the maximum marks per level, e.g. if the total is 50 marks, 29% = 15. Therefore, 0 – 15 marks will score level 1 on the assessment code table.

**IMPORTANT**:
The assessment level obtained by the learner will have no meaning or significance to the learner unless you, the Teacher, indicate to the learners where and how they can improve their level of competency.

## TASK 11.18 ⌘ Baseline Assessment: Bank Reconciliation

**Note to Teacher:**

Tasks 11.18 and 11.19 can both be used as Baseline Assessments to evaluate if the learner's skill and prior knowledge is sufficient to ensure that they can continue with this module successfully. You may select which Task you wish to use and hold the second as an additional evaluation of learner's whose prior knowledge and skills was found to be not quite proficient.

However, if the learner has been found to be proficient, it would be possible to skip the second Baseline Assessment and continue with the Module.
**Note:** No entry means no entry is made in the cash journals and / or bank statement.

| No. | Item | Cash Journal | | Bank Reconciliation Statement | | No entry |
|---|---|---|---|---|---|---|
| | | CRJ | CPJ | DR | CR | |
| **1.** | Bank charges as per B/S. | | X | | | |
| **2.** | Month-end balance of current B/S (favourable). | | | | X | |
| **3.** | Amount overstated in the CPJ. | X | | | | |
| **4.** | Cancellation of a cheque that has been issued. | X | | | | |
| **5.** | Month-end balance of current B/S (unfavourable). | | | X | | |
| **6.** | Cheques not yet presented for payment. | | | X | | |
| **7.** | R/d cheques. | | X | | | |
| **8.** | Cancellation of discount on R/d cheques. | | | | | X |
| **9.** | Previous month-end balance of B/S (unfavourable). | | | | | X |
| **10.** | Amount understated in the CPJ. | | X | | | |
| **11.** | Interest on overdraft. | | X | | | |
| **12.** | Post-dated cheques paid. | | X | X | | |
| **13.** | Incorrect debit entry made in the B/S. | | | | X | |
| **14.** | Rent deposited into banking account by tenant. | X | | | | |
| **15.** | Direct payment made by debtor into banking account of the business. | X | | | | |
| **16.** | Interest earned on current banking account. | X | | | | |
| **17.** | Post-dated cheques received. | | | | | X |
| **18.** | Previous month-end bank account balance (favourable). | | | | | X |
| **19.** | Current month-end bank account balance (unfavourable). | | | | X | |
| **20.** | Incorrect credit entry made in the B/S. | | | X | | |
| **21.** | Debit orders as reflected in the B/S. | | X | | | |
| **22.** | Deposit not yet credited by the bank. | | | | X | |
| **23.** | Credit card levies as reflected in the B/S. | | X | | | |

## TASK 11.19 Baseline Assessment: Bank Reconciliations

The following Task can also be used as a Baseline Assessment to test the learner's competency and prior knowledge. This Task is also a good opportunity to give learners who did not score well in the first baseline assessment (Task 11.18) the opportunity to ensure that their knowledge is sufficient to continue with this Module.

***A: Alan has an overdraft of R1 200.***

| | |
|---|---|
| **1.** | **Explain what is meant by an 'overdraft'.** |
| An overdraft occurs when the accountholder has withdrawn more funds than are actually in the account resulting in the account holder owing money to the bank.<br>He can only do this if he has previously arranged an overdraft facility from the bank. | |
| **2.** | **On which side of the Bank account in the general ledger would the overdraft appear?** |
| Credit | |
| **3.** | **On which side of the Bank Reconciliation Statement would the overdraft appear?** |
| Debit | |
| **4.** | **In the Balance Sheet the bank overdraft is shown as a/an ..... (Asset or Liability)** |
| Current Liability | |
| **5.** | **Does the bank benefit in any way by granting overdrafts?** |
| Yes, the bank charges interest on the outstanding daily balance. | |
| **6.** | **Does everyone qualify for an overdraft?** |
| No. | |
| **7.** | **What does the bank take into account before granting an overdraft?** |
| The bank will consider the creditworthiness of the applicant.<br>The bank may require supporting documents before it considers granting an overdraft, e.g. the Balance Sheet of a business; salary details in the case of a private individual, etc. | |

***B According to his bank account at month-end, Alan has an overdraft of R1 200. The Bank Statement does not reflect a deposit of R250 which Alan had made.***

| | |
|---|---|
| **8.** | **Explain what is meant by an 'outstanding deposit'.** |
| A deposit made and recorded in the books of a business but not reflected in the current bank statement.<br>Possible reason: the deposit may have been late, i.e. made after the current bank statement was processed. | |
| **9.** | **The outstanding deposit would be shown in the ..... (Bank account or Bank Reconciliation Statement).** |
| Bank Reconciliation Statement | |
| **10.** | **Provide a reason for your answer above.** |
| The deposit has already been recorded in the books of the business.<br>For reconciliation purposes the outstanding deposit would have to be recorded in the Reconciliation Statement (credit side).<br>When the deposit was made the Bank account was debited – the credit in the Reconciliation Statement would correspond with the debit in the Bank account. | |

| 11. | **Calculate the balance as per bank statement. Indicate if the balance is favourable or unfavourable.** |
|---|---|

| | Debit | Credit |
|---|---|---|
| Bank account balance (unfavourable) | | 1 200 |
| Outstanding deposit | | 250 |
| Bank statement balance (unfavourable) | 1 450 | |
| | **1 450** | **1 450** |

***C. Ntiki has an overdraft of R1 200 at month-end. A comparison of the bank statement with the cash journals revealed an outstanding deposit of R250 and outstanding cheques to the value of R300.***

| 12. | **Explain what is meant by an 'outstanding cheques'.** |
|---|---|

A cheque that has been drawn and recorded by the trader in the CPJ but which does not appear on the bank statement as the payee has not yet presented it for payment.

| 13. | **The outstanding cheques would be shown in the ..... (Bank account or Bank Reconciliation Statement).** |
|---|---|

Bank Reconciliation Statement.

| 14. | **Provide a reason for your answer above.** |
|---|---|

The cheque has already been recorded in the books, (CPJ), of the business.
For reconciliation purposes the outstanding cheque would have to be recorded in the Reconciliation Statement (debit side).
When the cheque was drawn Bank account was credited – the debit in the Reconciliation Statement would correspond with the credit in the Bank account.

| 15. | **Calculate the balance as per bank statement. Indicate if the balance is favourable or unfavourable.** |
|---|---|

| | Debit | Credit |
|---|---|---|
| Bank account balance (unfavourable) | | 1 200 |
| Outstanding deposit | | 250 |
| Outstanding cheque | 300 | |
| Bank statement balance (unfavourable) | 1 150 | |
| | **1 450** | **1 450** |

***D A comparison of the bank statement with the cash journals revealed an outstanding deposit of R250 and outstanding cheques to the value of R300. The month-end bank statement reflects a favourable balance of R1 340. The bank statement also shows an amount of R210 in respect of bank charges.***

| 16. | **Explain what is meant by 'bank charges'. Give two examples of bank charges.** |
|---|---|

Charges made by the bank in order to operate the banking account, e.g. service fees, levies, credit card levy, etc.

| 17. | **In which subsidiary journal would the bank charges appear?** |
|---|---|

Cash Payments Journal.

| 18. | **Bank charges is a ..... account. (Balance Sheet or Nominal)** |
|---|---|

Nominal.

| 19. | **What is the effect of bank charges on owners' equity? (Increase/Decrease/No effect)** |
|---|---|
| Decrease. | |

| 20. | **Prepare the Bank Reconciliation Statement.** |
|---|---|

**Bank Reconciliation Statement**

| | Debit | Credit |
|---|---|---|
| Bank statement balance (unfavourable) | | 1 340 |
| Outstanding deposit | | 250 |
| Outstanding cheque | 300 | |
| Bank account balance (favourable) | 1 290 | |
| | **1 590** | **1 590** |

***E Suzette had a favourable bank balance of R1 500 before taking the relevant items mentioned below into account. A comparison of the bank statement with the cash journals showed that there was an outstanding deposit of R250 and outstanding cheques to the value of R300. The bank statement shows an amount of R210 in respect of bank charges. An unpaid cheque for R180 also appears on the bank statement.***

| 21. | **Explain what is meant by an 'unpaid cheque'.** |
|---|---|
| A cheque that has been dishonoured by the bank.<br>The bank refuses to pay out this cheque due to insufficient funds in the drawer's account, errors on the cheque, etc. | |

| 22. | **In which subsidiary journal would the unpaid cheque be recorded?** |
|---|---|
| Cash Payments Journal. | |

| 23. | **What is the effect of the unpaid cheque on the accounting equation? (A favourable bank balance is assumed).** |
|---|---|
| No effect – assets increase when Debtors control is debited; assets decrease when Bank is credited. | |

| 24. | **Explain how discount allowed on the unpaid cheque is processed in Suzette's books.** |
|---|---|
| Dr Debtors control; Cr Discount allowed. (Cancel in the GJ) | |

| 25. | **Calculate the month-end bank balance. Indicate if the balance is favourable or unfavourable.** |
|---|---|
| 1 500 – 210 – 180 = R1 110 (favourable) | |

| 26. | **Prepare the Bank account in the General Ledger. Start with the balance of R1 500.** |
|---|---|

**GENERAL LEDGER**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **BANK** **B** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Jan | 31 | Balance | b/d | 1 500 | Jan | 31 | Bank charges | | | 210 |
| | | | | | | | Debtors control (r/d) | | | 180 |
| | | | | | | | Balance | c/d | | 1 110 |
| | | | | **1 500** | | | | | | **1 500** |
| Feb | 1 | Balance | b/d | 1 110 | | | | | | |
| | | | | | | | | | | |

| 27. | Prepare the Bank Reconciliation Statement. |
|---|---|

**Bank Reconciliation Statement**

| | Debit | Credit |
|---|---|---|
| Bank account balance (favourable) | 1 110 | |
| Outstanding deposit | | 250 |
| Outstanding cheque | 300 | |
| Bank statement balance (favourable) | | 1 160 |
| | **1 410** | **1 410** |

## TASK 11.20 Alpheus's business: Unpaid cheques

| 11.20.1 | Explain how dishonoured cheques impact on the cash position of Alpheus. |
|---|---|

Negative impact on cash flow and working capital – he is not being paid for the goods sold.

| 11.20.2 | How does Alpheus benefit from credit card payments? |
|---|---|

He is assured of payment by the bank as the amounts due are electronically transferred into his account. Should the debtor default on his payments this becomes a matter between the bank and the debtor and not Alpheus.

| 11.20.3 | What control measures can Alpheus put into place to reduce or eliminate unpaid cheques? |
|---|---|

Stringent screening of debtors; insist on bank guaranteed cheques; etc.

## TASK 11.21 Wishart Stores: Bank Reconciliation

**11.21.1** **GENERAL LEDGER OF WISHART STORES**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **BANK** **Cr**

| 20.6 | | | | | 20.6 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Mar | 1 | Balance | b/d | 12 344 | Mar | 31 | Total payments[2] | CPJ | 93 872 |
| | 31 | Total receipts[1] | CRJ | 97 899 | | | Balance | c/d | 16 371 |
| | | | | **110 243** | | | | | **110 243** |
| Apr | 1 | Balance | b/d | 16 371 | | | | | |

[1] 89 226 + 8 673 = R97 899
[2] 88 436 + 315 + 4 129 + 992 = R93 872

**11.21.2 BANK RECONCILIATION STATEMENT ON 31 MARCH 20.6**

| | Debit | Credit |
|---|---|---|
| Balance as per bank statement | | 15 431 |
| Outstanding deposit | | 4 454 |
| Outstanding cheques | 3 514 | |
| Balance as per bank account | 16 371 | |
| | **19 885** | **19 885** |

| 11.21.3 | The most common reason for a cheque being unpaid is insufficient funds in the drawer's account. Name at least 3 other reasons why a cheque could be dishonoured? |
|---|---|

Errors on the cheque; alterations on the cheque; irregular signature; drawer is insolvent; cheque is torn or damaged; stale cheque.

## TASK 11.22 ⌘ Venstrap CC: Bank Reconciliation

**11.22.1 CALCULATION OF BANK BALANCE ON 31 JULY 20.8:**

| | |
|---|---|
| Opening balance (unfavourable) | [21 500] |
| CRJ Provisional total | 310 260 |
| CPJ Provisional total | [254 290] |
| Correction of error (C12563) | [90] |
| Bank charges (210 + 260) | [470] |
| Interest on overdraft | [770] |
| Unpaid cheques | [2 800] |
| Electronic transfers | [3 880] |
| Electronic transfers | 1 000 |
| Closing balance (favourable) | **27 460** |

**11.22.2 BANK RECONCILIATION STATEMENT ON 31 JULY 20.8**

| | | **Debit** | **Credit** |
|---|---|---|---|
| Balance as per bank account | | 27 460 | |
| Outstanding deposit | | | 3 420 |
| Outstanding cheques: | C12582 | 1 230 | |
| | C12592 | 510 | |
| | C12598 | 1 890 | |
| | C12599 | 840 | |
| Balance as per bank statement | | | 28 510 |
| | | **31 930** | **31 930** |

**Note to Teacher:**
- Cheque C12582 does not appear on the July bank statement therefore it is listed again as outstanding.
- The July bank statement balance at month-end is not supplied. The bank statement balance of R28 510 is the balancing figure.

| **11.22.3** | **Assume that the bank charges a 4% levy on credit card sales. Calculate the total credit card sales for the month.** |
|---|---|
| $260 \times {}^{100}/_{4} = R6\ 500$ | |

## TASK 11.23 ⌘ AMA Stores: Bank Reconciliation – True/False

**PART A**

| | |
|---|---|
| **(a)** | False |
| **(b)** | True |
| **(c)** | True |
| **(d)** | False |
| **(e)** | True |
| **(f)** | True |

**PART B**

| | |
|---|---|
| **(a)** | **Calculate the correct Bank Balance in the General Ledger of AMA Stores on 30 September 20.9. Show detailed workings.** |

53 000 – 815 – 9 800 – 385 + 2 250 = R44 250

| | |
|---|---|
| **(b)** | **Use the relevant information provided above to prepare the Bank Reconciliation Statement of AMA Stores on 30 September 20.9.** |

**Bank Reconciliation Statement on 30 September 20.9.**

| | Debit | Credit |
|---|---|---|
| Balance as per bank account | 44 250 | |
| Outstanding deposit | | 47 200 |
| Outstanding deposit | | 4 200 |
| Outstanding cheques: No 980 | 4 700 | |
| No 991 | 14 250 | |
| Balance as per bank statement | | 11 800 |
| | **63 200** | **63 200** |

| | |
|---|---|
| **(c)** | **Refer to the outstanding deposit of R 47 200, dated 3rd September 20.9. Explain why the Internal Auditor should be concerned about this deposit. State 3 different points in your answer.** |

This deposit is very overdue and should have been reflected on the bank statement within a day.
R47 200 outstanding for such a long time could indicate that depositing is not happening and that the person who should be depositing this money is rolling cash or committing fraud.
R47 200 appears to be missing and will obviously have an effect on the cash flow and liquidity of the business.
Alternatively a possible error by the bank has taken place, e.g. bank has deposited this amount into the wrong account.
There is certainly cause for concern about how well the cash is being controlled and the internal control systems must be reviewed and adjusted if necessary.

## TASK 11.24 ⌘ Thom Traders: Bank Reconciliation

| | |
|---|---|
| **11.24.1** | **Explain why it is important for a business to prepare a Bank Reconciliation Statement on a monthly basis. Provide 2 different points in your answer.** |

For internal control purposes.
Allows for easy identification of errors and or fraud.
To identify the correct bank balance / update records.
Errors and dishonesty can be detected on a monthly basis.

| | |
|---|---|
| **11.24.2** | **Refer to the draft Bank Reconciliation Statement below.** |
| | **(a) Identify the cheque that has been treated incorrectly on this Bank Reconciliation Statement. Provide the cheque number of the cheque incorrectly treated.** |

Cheque No. 2641.

| | |
|---|---|
| | **(b) Explain why it should not have been included on this Bank Reconciliation Statement.** |

It is stale (more than 6 months old).

| | |
|---|---|
| | **(c) State the correct treatment of this cheque, i.e. what course of action should the bookkeeper have taken in dealing with this cheque?** |

This cheque should have been cancelled in the CRJ and should not appear on the Bank Reconciliation Statement as an outstanding cheque because it can no longer be presented to the bank for payment.

| | |
|---|---|
| **11.24.3** | **Calculate the correct bank balance in the General Ledger of Thom Traders once you have taken the correct action with regards to the cheque mentioned in 11.24.2 above.** |
| 25 620 + 5 200 + 3 080 = R 33 900<br>33 900 – 12 930 = R20 970 overdraft | |
| **11.24.4** | **When preparing the Financial Statements on 30 September 20.9 show the amount that would be reflected for Bank on the Balance Sheet of Thom Traders. Also provide a reason as to why the bookkeeper would need to make this balance sheet adjustment.** |
| Decrease the Bank overdraft with R5 200 (will be shown as R15 770) and increase creditors with R5 200 (Balance Sheet adjustment).<br>The R5 200 has not yet been drawn from the business' bank account and although a cheque has been given to the creditor this cheque cannot be deposited by the creditor until the 12th October 20.9 therefore the amount is still theoretically owing to the creditor and is still in the business' bank account. | |
| **11.24.5** | **The Internal Auditor notices that the deposit of R12 930 which appears on the draft Bank Reconciliation Statement below, is reflected on the October 20.9 Bank Statement (from MegaBank) as R2 930. After investigation it is found that MegaBank has recorded this correctly and the error is in the books of Thom Traders.** |
| | **(a) Explain why the Internal Auditor should be concerned about the R10 000 difference.** |
| This is a major error or it is possible that fraud may be taking place.<br>It certainly shows that there is a lack of internal control over cash. | |
| | **(b) What action should the Internal Auditor take with regard to this difference? Provide 3 different points in your answer.** |
| Check from the receipts to the deposit slip to identify if cash collected was all deposited.<br>Check if there is an error on the deposit slip.<br>Investigate if the cash has been stolen. Interview the cashier / bookkeeper.<br>Screen all employees for trustworthiness.<br>Establish proper internal control procedures – division of duties – so that one persons work serves as a check on another to avoid this problem in the future.<br>Owner to do the banking himself. | |

## TASK 11.25 Presentation: Reconciliation procedures

**Note to the Teacher:**
This Task could be included in the portfolio.

**Suggested rubric to assess this Task:**

| Criteria | Level 1 | Level 2 | Level 3 | Level 4 | Level 5 | TOTAL |
|---|---|---|---|---|---|---|
| Preparation and interview. | Little evidence of preparation or an interview with a business person. | Some evidence of preparation for the interview. | Evidence that the interview took place and reasonable preparation done for it. | Interview well planned. | Excellent planning for interview resulting in good information. | Max 5 marks |
| Description and benefits. | Little evidence of the benefits for the trader or customer. | Some indication of the benefits for either the trader or customer. | Evidence of some benefits for trader and customer. | Good evidence of benefits to trader and customer. | Excellent description of benefits to trader and customer showing good understanding of the topic. | Max 10 marks |
| Reconciliation procedure. | Little if any description of the procedure regarding credit sales. | Some discussion of procedure regarding credit sales. | Procedure for reconciliation of credit card sales given but it is incomplete. | Good description of procedure for credit card sales. | Excellent description of procedure for credit card sales showing good insight. | Max 20 marks |
| Identification of problem areas. | Some attempt to identify problem areas. | Some obvious problem areas identified. | Problem areas identified without any explanation or understanding. | Identification of problem areas with some insightful discussion. | Identified problem areas that are comprehend-sively discussed showing excellent insight and understanding. | Max 10 marks |
| Suggestions for improvement. | Some attempt to make suggestions. | Makes obvious suggestions for improvement but not relevant. | Makes suggestions for improvement with some discussion. | Makes relevant suggestions for improvement with good explanations. | Excellent suggestions showing clear understanding. | Max 5 marks |
| **TOTAL** | **50 marks** | | | | | |

The learner's marks can be related to the following assessment codes:

| Rank | 7 Outstanding | 6 Meritorious | 5 Substantial | 4 Adequate | 3 Moderate | 2 Elementary | 1 Not achieved |
|---|---|---|---|---|---|---|---|
| % | 80 – 100% | 70 – 79% | 60 – 69% | 50 – 59% | 40 – 49% | 30 – 39% | 0-29% |
| Mark | 17 - 20 | 15 - 16 | 13 – 14 | 11 - 12 | 9 - 10 | 7 - 8 | 0 - 6 |

Learners who achieve level 4 and below: indicate where they can improve and how. Allow them to re-write their report to improve their understanding and practice the skills of report writing.

Learners who achieve level 5 and 6, who are aiming for an A, also need to be given guidance on ways to improve either their understanding or skill in answering this type of question.

## TASK 11.26 Miguel & Simon: Case study

| 11.26.1 | Do you think Miguel keeps a proper set of books? Explain why. |
|---|---|
| No.<br>He does not reconcile his bank account with the bank statement – outstanding deposits, outstanding cheques, bank charges, etc., are not being considered. | |

| 11.26.2 | How do reconciliations help in internal control of finances? |
|---|---|
| Confirms the accuracy of all transactions recorded in the cash journals and the balance of the bank account.<br>Establishes why the bank statement balance differs from the bank account balance.<br>Keeps track of:<br>All cheques issued and those presented to the bank for payment.<br>All dishonoured cheques – may assist in screening debtors.<br>Direct deposits made into the trader's current account.<br>Debit/stop orders, etc.<br>Bank charges and interest on overdraft.<br>Errors and omissions made by the bank or business. | |

| 11.26.3 | What type of mistakes can banks make? |
|---|---|
| A bank may incorrectly credit his account with a deposit made by another person.<br>A bank may incorrectly debit his account with a cheque drawn by someone else.<br>It should be noted that errors made by a bank rarely occur.<br>The use of modern technology keeps errors to a minimum. | |

| 11.26.4 | Do you think that Simon is exaggerating when he states that 'If you are not careful your bank will take you for a ride'? Explain. |
|---|---|
| Open-ended.<br>All banks charge fees (service fees, cash deposit fees, etc.)<br>If an accountholder feels that he is being overcharged he should approach the bank manager and get information on the fee structure.<br>He should also compare with the fees charged by other banks. | |

| 11.26.5 | Miguel makes use of debit order facilities offered by banks. |
|---|---|
| | (a) State the main advantage of debit orders. |
| Payment is made automatically on the specified date.<br>The accountholder is assured that the account is paid on time.<br>This is a safe and convenient means of transferring funds. | |
| | (b) Are debit orders free? Explain. |
| Most banks charge a fee for each debit order instruction.<br>The fee may vary from one bank to another. | |
| | (c) List two examples of debit order payments. |
| Insurance premiums, rent, mobile phone charges, etc. | |

| 11.26.6 | Explain what bank charges are and its impact on Miguel's bank balance. |
|---|---|
| Service fees, cash deposit fees, levies, etc. which are charged by a bank.<br>Banks obtain their revenue from bank charges.<br>The amount charged varies from bank to bank.<br>The number of transactions processed during the period also has a bearing on the amount charged.<br>The amount of the bank charges only becomes known on receipt of the bank statement.<br>These charges would have to be recorded in the Cash Payments Journal as this is a business expense.<br>If the bank balance is favourable the bank balance would decrease.<br>If the account is overdrawn, the bank overdraft balance increases. | |

| 11.26.7 | **An important issue raised by Simon is that of cash flow. Explain what cash flow is and how bank reconciliation has a bearing on this.** |
|---|---|

Cash flow represents all the cash coming in and going out of the bank account.
Bank reconciliation ensures that the bank account balance is updated with the latest information on the bank statement.
Since the bank balance represents the correct balance at a given time, the trader is in a better position to manage his cash flow – payments to creditors, future planning, etc.

## TASK 11.27 Ms Cut Rite: Bank Reconciliations, Calculations

| 11.27.1 | **Calculate her bank balance in the General Ledger on 25 June 20.8.** |
|---|---|

| | |
|---|---|
| Bank statement balance (favourable) | R14 550 |
| Add outstanding deposit | 980 |
| Less outstanding cheque | [530] |
| Bank account balance (favourable) | **R15 000** |

| 11.27.2 | **Ms Cut Rite purchased equipment to the value of R14 000 on credit. Payment is due on 30 June 20.8.** |
|---|---|
| | **(a) Can she make this payment on the 30th bearing in mind that she has no over-draft facilities with her bank? What will her new bank balance be on 30 June? Indicate if it will be favourable or unfavourable.** |

Yes.
15 000 – 14 000 = R1 000 (favourable)

| | **(b) Assume that she has overdraft facilities with her bank subject to a maximum of R50 000. She makes the payment of R14 000 (above) and, in addition, she makes a cheque payment for more stock and equipment for R7 400. What will her new bank balance be on 30 June? Indicate if favourable or unfavourable.** |
|---|---|

1 000 – 7 400 = -R6 400 (unfavourable)

| | **(c) The same details in (b) apply except that the cheque for R7 400 is post-dated for 31 July 20.8. She also received a cheque for R1 300 dated 31 July 20.8 from Ms Xolani for redundant equipment sold to her. What will her new bank balance be according to her books on 30 June? Indicate if favourable or unfavourable.** |
|---|---|

-R6 400 (unfavourable)
**Note**: Post-dated cheques received are not recorded until the date on the cheque.

| 11.27.3 | **Briefly explain how the preparation of a Bank Reconciliation Statement can assist the trader in controlling her payments to creditors.** |
|---|---|

The trader is in a better position to plan payments to creditors as his records are updated with those of the bank – he knows exactly how much he has in his bank account.

## TASK 11.28 Terry Tickson: Electronic banking

| | |
|---|---|
| **11.28.1** | **Why does the bank recommend electronic payments rather than cheque payments?** |
| Safer, convenient, lower or no fees. | |
| **11.28.2** | **How does Terry benefit when his clients pay him electronically?** |
| Funds are deposited directly into his account; less charges. | |
| **11.28.3** | **How does Terry's clients benefit from paying him electronically?** |
| Accounts are settled almost immediately; less charges; not necessary to write out cheques which can be lost or stolen. | |
| **11.28.4** | **Terry has been advised to use his own bank's ATMs. Provide a reason for this.** |
| Charges are higher when another bank's ATM is used. | |
| **11.28.5** | **What happens when a person makes out cheques when he does not have sufficient funds in his account?** |
| Penalty fees for rejected payments are charged; credit rating with the bank is affected. | |
| **11.28.6** | **What arrangement can Terry make with his bank in order to avoid 'late payment charges'?** |
| He can arrange with the bank to deduct the minimum balance due automatically from his cheque account. | |
| **11.28.7** | **How can Terry avoid being penalised with 'over limit' charges?** |
| He must not exceed the limit allowed on his credit card. He needs to control and monitor his expenditure. | |

## TASK 11.29 Tommy Tools: Bank Reconciliation, Interpretation

| | |
|---|---|
| **11.29.1** | **Would you make an adjustment in the annual financial statements regarding the post-dated cheque received? Explain.** |
| No.<br>These cheques have not been recorded in the books and can only be presented to the bank once the date on the cheque arrives. | |
| **11.29.2** | **Would you make an adjustment in the annual financial statements regarding the post-dated cheque paid? State either yes or no and name this type of adjustment.** |
| Yes.<br>Balance Sheet Adjustment. | |
| **11.29.3** | **What GAAP principle is being applied with regard to the post-dated cheque paid?** |
| Prudence. | |
| **11.29.4** | **Calculate the bank balance to be shown on the balance sheet at year-end taking into account the post-dated cheques.** |
| 36 000 + 9 420 = R45 420 | |
| **11.29.5** | **What other account is involved with regard to the post-dated cheque paid? Does this account increase or decrease?** |
| Creditors control; Increase | |

| | |
|---|---|
| **11.29.6** | **State the procedure involved when:** |
| | **(a) The cheque for R5 000 is deposited on the 3 March 20.8.** |
| Dr Bank; Cr Debtors control | |
| | **(b) What entry would the bank make in its books? State either debit or credit.** |
| Credit | |
| | **(c) Does the bank balance of Tommy Tools increase or decrease?** |
| Increase | |
| **11.29.7** | **The supplier deposited the cheque for R9 420 on the stipulated date.** |
| | **(a) What entry would the supplier's bank make? State either debit or credit.** |
| Credit | |
| | **(b) What entry would Tommy Tools bank make? State either debit or credit.** |
| Debit | |
| | **(c) Does the balance of the bank account in the general ledger of Tommy Tools' change after this deposit is made on 12 March 20.8? State why.** |
| No.<br>The cheque was recorded in the CPJ on the date of issue.<br>It was also posted to the Bank account. | |
| | **(d) Calculate Tommy Tools bank account balance on 12 March 20.8 (i.e. after taking into consideration both the post-dated cheques).** |
| R36 000 + R5 000 = R41 000 | |

## TASK 11.30 ⌘ Ethics, Good business practice

| No. | Implications | Action to be taken |
|---|---|---|
| **1.** | The cheque can be cashed by anyone.<br>The cheque does not have to be deposited into a bank account – it can be cashed over the counter.<br>It seems that the owner does not want the payment to be reflected on the bank statement.<br>Unsafe – such a cheque can be cashed by anyone in possession of the cheque.<br>It is likely that the owner does not keep a proper set of books as he does not want the payment to be processed in the normal way via his cheque account. | The owner should be advised on the dangers of accepting cash cheques – they can so easily be cashed by the wrong person.<br>In order to ensure payment he may insist that his customers pay him electronically – safer and more convenient.<br>He may also insist on bank guaranteed cheques. |
| **2.** | The bank has made an error.<br>The trader's bank balance increases with this deposit and therefore the bank balance reflected is incorrect. | He should inform the bank immediately.<br>He should not keep quiet about it as the error will eventually be detected by the bank.<br>Furthermore, the person who made the deposit will also investigate as the deposit most likely does not appear on his bank statement. |
| **3.** | The books are not updated with entries in the bank statements, e.g. fees, debit orders, dishonoured cheques, electronic payments, etc. Therefore the business' bank account does not reflect the correct balance. | The bookkeeper needs to be reminded of the importance of bank reconciliation as an important tool for internal control.<br>The boss should ensure that this is done at least once a month. |

| No. | Implications | Action to be taken |
|---|---|---|
| **4.** | Legal action entails legal costs which are charged to the customer's bill.<br>The debtor is blacklisted.<br>The debtor is charged a penalty fee by his bank.<br>The threat of legal action ensures that debtors have sufficient funds in their accounts when making cheque payment. | Legal action is a drastic step – it should be used only as a last resort.<br>Defaulters should be approached and some arrangement be made to recover the money.<br>The defaulter is a customer of the business and his business is still needed.<br>Careful screening of debtors is necessary. |
| **5.** | Unsafe practice – money is safer in a bank than at home. Difficult to keep good control of cash when this happens. Money should be banked intact on a daily basis so CRT totals & deposit slips can be compared. | He should organise his banking times so that he does not have a large amount of cash at any given time.<br>He may invest in a safe at his business.<br>Carrying large sums of money home is definitely not advisable. |
| **6.** | The creditor may have lost the cheque.<br>He may have forgotten about the cheque.<br>The creditor may have relocated or his business may have closed down. | Contact the creditor and enquire about the cheque.<br>It may be necessary to cancel the lost cheque and then to write out a new cheque. |
| **7.** | The trader's bank balance decreases with this debit order.<br>It could be some type of scam organised by a crime syndicate to siphon off money from people's accounts. | He will need to know if the debit order was authorised by any of the staff members.<br>He must contact his bank immediately and arrange for the debit order instruction to be cancelled.<br>If need be a criminal case should be opened. |
| **8.** | The payment may not have been recorded in his account. Customer will have reason to be upset & we may lose him as a future customer. Also shows a lack of internal control in the business. | Investigate – check the receipt book and match with the deposit.<br>If correct the trader will have to apologise to the customer.<br>The person responsible for posting must be reprimanded. |
| **9.** | The cashier is withholding cash and using it for his own purposes.<br>Cash deposits are being understated. | An explanation would be required of the cashier.<br>His actions amount to fraud and he could be liable for prosecution. |
| **10.** | As above. | As above. |

## TASK 11.31 Emptron: Scenario

| **11.31.1** | **Could the above scenario lead to Emptron experiencing liquidity problems? Explain.** |
|---|---|
| Yes.<br>Debtors are not paying on time.<br>Furthermore Emptron is paying cash for stock while allowing debtors 30 days credit – this may result in liquidity problems. | |

| **11.31.2** | **Identify any 3 possible errors/ omissions made by Ms Blunt that may have resulted in the Debtors List not being in balance with the Debtors control.** |
|---|---|
| Wrong amounts posted from the journals to the Debtors Ledger.<br>Posting from journals may be incomplete.<br>Payments made by debtors may not be recorded in the CRJ.<br>R/d cheques may not have been considered. | |

| **11.31.3** | **Indicate ways to prevent the recurrence of the above errors/omissions in the future.** |
|---|---|
| Check receipts against deposit slips & entries in the CRJ.<br>Check invoices and credit notes against entries in the DJ and DAJ.<br>Check journal vouchers against entries in the GJ.<br>Check bank statements for r/d cheques.<br>Check posting to the Debtors Ledger. | |

| 11.31.4 | **Is it possible that Ms Blunt could be committing fraud? Explain fully.** |
|---|---|
| Either yes or no.<br>The fact that she is not monitoring debtors does not imply that she is committing fraud.<br>On the other hand debtors may be paying on time but she could be understating the amounts paid and keeping the difference. | |
| **11.31.5** | **Comment on the decision by Ms Blunt to send the email to all debtors. Was this the best way to solve the problem? Your answer must include moral/ethical issues, good business practice and any other views you may have.** |
| Any suitable opinion will apply.<br>Perhaps she could have checked with the owner before sending the email.<br>She sent the email to <u>all</u> the customers – there could be many clients who pay on time.<br>They may take exception to the email and may not want to do business with Emptron in the future.<br>Debtors are customers of the business – their business is needed.<br>Drastic action should only be taken as a last resort.<br>Any other suitable answer. | |

## TASK 11.32 ⌘ Buzi (Pty) Limited: Ethics & Internal control relating to Reconciliations

**Note to the Teacher:**
Alternative answers must be accepted provided they are logical and reasonable.

| No. | Does a problem exist? | Internal control or ethical matter or both? | How you would handle this case. |
|---|---|---|---|
| **11.32.1** | Yes | Internal control problem. | It appears that fictitious debtors have been created. Check how these debtors were originally set up. Debtors are not being screened properly. Check references and verify all details before we allow the customer to buy on credit. |
| **11.32.2** | Yes | Ethical problem and internal control problem. Someone in your business is creating false documents. | A complete audit needs to be done on all source documents to verify their authenticity. Possible ghost creditors have been created in the books. There should be a complete set of source documents to verify all transactions. Order forms, delivery notes, invoices should all tie up with each other. |
| **11.32.3** | Yes | Unethical behaviour from CEO. | If the management are going to break the rules then why should the rest of the staff not also do so? False reporting of business' financial position. Not following the Prudence Concept. Understating liabilities in the books. Effectively creditors will be paid a month later. This is likely to lead to a bad reputation. |
| **11.32.4** | Yes | Lack of internal control of cash. | Possible fraud and rolling of cash taking place. Large outstanding deposits for long periods of time should immediately ring alarm bells. Cashier might be using recent cash received to offset previous shortages. Deposits should be reflected on the next day on the bank statement when the deposit is processed by the bank. If it is not reflected this should be queried with the bank. |

| No. | Does a problem exist? | Internal control or ethical matter or both? | How you would handle this case. |
|---|---|---|---|
| **11.32.5** | No | At least the differences are being discovered so internal control system is working. | I might be concerned if so many errors occur and why they seem to continually happen. A system of rotation of duties could be implemented in order to see if the problem persists.<br>I would further suggest that a computerised accounting system is used in order to handle the large number of debtors and in order to help with more accurate recording of transactions. The manual system prone to error. By using a computerised system the reconciliation process will identify the differences which can be promptly rectified. |
| **11.32.6** | Yes | Unethical and lack of control of cash. | This solution will end up costing the business more money as they will be charged for cheques that are unpaid (bounce). Also it is unethical to issue cheques when you know that you have insufficient funds available. The business will also get a bad name both with the creditors and with the bank. This will affect their creditworthiness. |
| **11.32.7** | Yes and No | Neither unethical nor a lack of control but concerning. Over use of PDC's should be discouraged. | This suggests that the business has cash flow problems and that they are delaying payments as a result of this. Suppliers will not want to do business with us in the future and will affect creditworthiness. |
| **11.32.8** | NO | Good control of photocopying expense. | Good control of photocopy paper and photocopy costs. The process of placing requests for photocopies will ensure that staff cannot use the photocopier for their own / personal copies. It will also allow for the monitoring of how much paper is being used by each department / staff member. The fact that suppliers are being alternated is a good decision as it will minimise any fraudulent activities from the suppliers' side. These suppliers must however have been approved through the proper procurement policies of the business. |
| **11.32.9** | Yes | Internal control problem. | Cash cheques should seldom be made out as they can be cashed by anyone. There is a possibility that fraud is taking place as the bookkeeper does not want there to be an audit trail. Possible ghost creditors have been created in the books. There is also a possibility of fraud in the suppliers' office. Funds might also be diverted by their employees. Should check to see if valid receipts have been received from creditors and check to valid statements from creditors. |
| **11.32.10** | Yes | Lack of internal control. | There is no division of duties with regard to creditors. This allows Jennifer the opportunity to commit fraud as she has complete control of all parts of this accounting system relating to purchasing of goods and payment thereof. |

## TASK 11.33 Case study

| | |
|---|---|
| **11.33.1** | **In this article, how much money, in total, was stolen from the University of Cape Town?** |
| Almost R1.3 million | |
| **11.33.2** | **How do you think the theft of this money impacted on the running of the university?** |
| The university would have been short of R1.3 million in cash to meet their budget.<br>This means that the university could not be run as efficiently or effectively. | |
| **11.33.3** | **If you were a student at UCT and had to work in the holidays to help pay for your tuition fees, how do you think you would feel about all this money being stolen?** |
| Allow the learners to express their own opinion.<br>Discuss the different responses in the class. | |
| **11.33.4** | **List the sentences that were passed on the convicted employees?** |
| Criminal charges and a civil claim laid against one employee who was dismissed.<br>Two others were prosecuted successfully which means they were found guilty and now have criminal records and would have had to complete whatever sentence they were given.<br>Dismissal.<br>200 hours community service and house arrest.<br>Convicted employees lost property and pension money to repay the university. | |
| **11.33.5** | **Do you think these sentences are reasonable for the crimes committed? Explain.** |
| Allow learners to express their own opinion.<br>However, they must give valid, relevant reasons for their opinion. | |
| **11.33.6** | **Explain the term 'white collar crime'?** |
| All crime committed by office workers and involves theft of money in some form, etc. | |
| **11.33.7** | **How serious do you think the courts are about 'white collar crime'? Explain.** |
| Very serious.<br>The punishments in the above cases indicate that there is little leniency with 'white collar crime'. | |
| **11.33.8** | **Is it UCT's (and other businesses) own fault if employees get away with these crimes?** |
| Yes and no answers are applicable.<br>Allow learners to justify their opinion.<br>Yes, if the University did not have correct and proper internal control procedures in place.<br>No, as every employee should be responsible for his/her own actions and act. | |
| **11.33.9** | **Explain what is meant by the term; "Accountability".** |
| Every employee should take pride in their work and be prepared to take responsibility for their own actions. | |

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Preparation of Debtors and Creditors control accounts. | | | |
| Reconciliation of Debtors and Creditors control accounts with Debtors/Creditors Lists. | | | |
| Analysis and interpretation of Debtors and Creditors control and individual debtors and creditors accounts. | | | |
| Prepare a Debtors and Creditors Reconciliation Statement. | | | |
| Analyse a Debtors Age Analysis. | | | |
| Preparation of a Bank Reconciliation Statement. | | | |
| Analysis and interpretation of Bank Reconciliation Statements. | | | |
| Understanding of ethics and the implication of unethical behaviour in a business environment. | | | |
| Identify and suggest internal control measures. | | | |

# MODULE 12
# VALUE ADDED TAX

**Note to the Teacher**:

Learners should have been exposed to the concept of VAT in Grade 11 when the focus would have fallen on the calculations as well as the basic principle as to how VAT works. You will, however, need to spend time on the calculations and ensure that the learners can understand the difference when calculating VAT using an inclusive as against an exclusive price.

Please note that the VAT regulations changed in the financial year starting 1 March 2008, when the compulsory registration amount for businesses that must register for VAT was increased from R300 000 to R1 000 000. Teachers need to keep up to date with any further VAT changes as part of making this subject relevant and real is that we must keep abreast of latest developments.

There are different methods that are acceptable in the recording of claims back from Input and Output VAT. The method adopted in this textbook is that any claim back for VAT Output (e.g. debtor's allowances) is debited to the VAT Output account. This follows the basic principle that has been adopted in Accounting up to now, i.e. applying matching and cancelling the respective account. Likewise a claim back for VAT Input (e.g. creditors' allowance) is credited to the VAT Input account.

Another perfectly acceptable method is for any claims on VAT Output to be debited to the VAT Input account – this is because if goods are returned to us we have to claim this amount back from SARS. In the same way any cancellations on VAT Input can be credited to the VAT Output account. This method coincides with the SARS VAT 201 form in that SARS does not allow any negatives on the form. However, it can be confusing to the learners as it does not strictly follow the principles we have used up to this point in time.

Other claim backs that the learners need to be familiar with include:

- Cancellation of VAT on drawings of goods/equipment, etc.
- Cancellation of VAT on discount allowed and discount received.
- Cancellation of VAT on bad debts.
- Reversal of VAT cancelled on R/D cheques.

These are all covered in the textbook. We strongly urge you to adopt one method and to use that method throughout. Exposing learners to more than one method can become confusing.

You need to bear in mind that you only have one week to spend on this topic. Choose from the selected Tasks what you think is appropriate for your class. It is not necessary to do all the Tasks. Learners should also be practicing and therefore the extra Tasks can be used for homework or revision.

## TASK 12.1 ⌘ Baseline Assessment: Matching of columns

| COLUMN A | | COLUMN B | |
|---|---|---|---|
| **1.** | VAT inclusive | **H** | VAT is included in the marked price. |
| **2.** | VAT vendor | **F** | A business with an annual turnover of more than R1 000 000. |
| **3.** | Input tax | **G** | The VAT paid by a business for purchases. |
| **4.** | VAT invoice | **L** | Document issued by a registered vendor as proof of sale. |
| **5.** | VAT exclusive | **C** | VAT is excluded in the marked price. |
| **6.** | Zero rated supplies | **K** | Items which are charged at 0% VAT. |
| **7.** | Bi-monthly payments | **J** | Payments which are made every two months. |
| **8.** | Invoice basis | **E** | VAT is payable when the invoice is issued or the closest payment date. |
| **9.** | Output tax | **A** | The VAT received by a business from sales of goods or income earned. |
| **10.** | Receipts basis | **I** | VAT is payable only when payment is received either in full or part. |

## TASK 12.2 ⌘ Calculations

| NO. | VAT EXCLUSIVE AMOUNT | VAT AMOUNT | VAT INCLUSIVE AMOUNT |
|---|---|---|---|
| **1.** | R400.00 | **R56** | **R456** |
| **2.** | R700.00 | **R98** | **R798** |
| **3.** | R360.00 | **R50.40** | **R410.40** |
| **4.** | **R684.21** | **R95.79** | R780.00 |
| **5.** | **R1 087.72** | **R152.28** | R1 240.00 |
| **6.** | **R254.39** | **R35.61** | R290.00 |
| **7.** | **R317.14** | R44.40 | **R361.54** |
| **8.** | **R871.43** | R122.00 | **R993.43** |
| **9.** | **R1 500** | R210.00 | **R1 710** |

## TASK 12.3 ⌘ Helen's Health Shop: Calculation of amount owed to / by SARS

| No. | Details | Amounts | | | Owed to/by SARS | |
|---|---|---|---|---|---|---|
| | | Excluding VAT | VAT | Including VAT | VAT Input | VAT Output |
| **12.3.1** | Helen buys trading stock on credit from suppliers. | **R30 000** | **R4 200** | **R34 200** | **+ R4 200** | |
| **12.3.2** | Helen sells goods for cash. | **R20 000** | R2 800 | R22 800 | | + R2 800 |
| **12.3.3** | Helen sells goods on cred-it. | **R24 000** | R3 360 | R27 360 | | + R3 360 |
| **12.3.4** | Helen returns stock that she had bought on credit. | R1 600 | R224 | **R1 824** | – R224 | |
| **12.3.5** | Helen buys equipment for the business on credit. | R5 500 | **R770** | R6 270 | + R770 | |
| **12.3.6** | Debtors return goods which they did not order. | R1 200 | **R168** | R1 368 | | – R168 |
| **12.3.7** | Helen writes off bad debts. | **R600** | R84 | R684 | | – R84 |
| **12.3.8** | Helen draws trading stock for personal use. | R1 000 | **R140** | R1 140 | - R140 | |
| | | | | **TOTALS** | **R4 606** | **R5 908** |
| | | | | | **OWED TO SARS FOR VAT = R1 302** | |

**Note to Teachers**:
Learners should understand that a simple calculation can also be done to get the final answer,
E.g.: R2 800 + R3 360 – R168 – R84 + R140 – R 4 200 + R224 – R770 = R1 302.

## TASK 12.4 ⌘ Hari's Hardware Shop: Calculation of amount owed to / by SARS

| No. | Details | Amounts | | | Owed to/by SARS | |
|---|---|---|---|---|---|---|
| | | Excluding VAT | VAT | Including VAT | VAT Input | VAT Output |
| **12.4.1** | Amounts brought forward from previous month. | | | | **R2 394** | **R5 474** |
| **12.4.2** | Hari buys trading stock for cash from suppliers. | **R14 000** | R1 960 | R15 960 | + R1 960 | |
| **12.4.3** | Hari buys trading stock on credit from suppliers. | **R42 000** | R5 880 | R47 880 | + R5 880 | |
| **12.4.4** | Hari sells goods for cash. | **R18 000** | R2 520 | R20 520 | | + R2 520 |
| **12.4.5** | Hari sells goods on credit. | **R33 000** | R4 620 | R37 620 | | + R4 620 |
| **12.4.6** | Hari's creditors grant him trade discount on stock that he had earlier bought on credit. | R4 000 | R560 | **R4 560** | – R560 | |
| **12.4.7** | Hari buys stationery on credit for the business. | R1 500 | R210 | **R1 710** | +R210 | |
| **12.4.8** | Hari grants cash discount to debtors on settlement of their debts. | R1 700 | R238 | **R1 938** | | – R238 |
| **12.4.9** | Hari receives cash discount from creditors on settlement of his accounts. | R900 | R126 | **R1 026** | – R126 | |
| **12.4.10** | Hari reverses cash discount on a dishonoured cheque. | R250 | R35 | **R285** | | + R35 |
| **12.4.11** | Hari buys a delivery vehicle for the business by cheque. | R110 000 | **R15 400** | R125 400 | + R15 400 | |
| **12.4.12** | Debtors return goods which they did not order. | R2 800 | **R392** | R3 192 | | – R392 |
| **12.4.13** | Hari writes off bad debts. | R3 500 | **R490** | R3 990 | | – R490 |
| **12.4.14** | Hari draws trading stock for personal use. | R3 000 | **R420** | R3 420 | - R420 | |
| | | | | **TOTALS** | **R24 738** | **R11 529** |
| | | | | | **OWED BY SARS FOR VAT = R13 209** | |

**Note to Teachers**:
Learners should understand that a simple calculation can also be done to get the correct final answer, e.g.: R5 474 + R2 520 + R4 620 – R238 + R35 – R392 – R490 + R420 – R2 394 – R1 960 – R5 880 + R560 – R210 + R126 – R15 400 = –R13 209.

## TASK 12.5 ⌘ Muzi's Music: Entries directly in the VAT Control account

**GENERAL LEDGER OF MUZI'S MUSIC SHOP**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **VAT CONTROL** **B** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.8 Aug | 31 | Creditors control # | CJ | 1 960 | 20.8 Aug | 1 | Balance | b/d | 3 078 |
| | | Creditors control # | CJ | 133 | | 31 | Bank | CRJ | 1 848 |
| | | Debtors control | DAJ | 154 | | | Debtors control | DJ | 896 |
| | | Debtors control | GJ | 322 | | | Creditors control | CAJ | 252 |
| | | Balance | c/d | 3 729 | | | Drawings | GJ | 224 |
| | | | | **6 298** | | | | | **6 298** |
| | | | | | Sept | 1 | Balance | b/d | 3 729 |

# May be combined.

## TASK 12.6 ⌘⌘ Kally's Computer Shop: Entries directly in the VAT Control account

**GENERAL LEDGER OF KALLY'S COMPUTER SHOP**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **VAT CONTROL** **B** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.3 May | 31 | Bank | CPJ | 8 400 | 20.3 May | 1 | Balance | b/d | 6 270 |
| | | Creditors control | CJ | 11 480 | | 31 | Bank | CRJ | 15 400 |
| | | Bank | CPJ | 30 800 | | | Debtors control | DJ | 7 700 |
| | | Debtors control | DAJ | 1 120 | | | Creditors control | CAJ | 1 680 |
| | | Debtors control | CPJ | 210 | | | Debtors control | GJ | 84 |
| | | Debtors control | GJ | 980 | | | Drawings | GJ | 1 260 |
| | | | | | | | Balance | c/d | 20 596 |
| | | | | **52 990** | | | | | **52 990** |
| June | 1 | Balance | b/d | 20 596 | | | | | |

## TASK 12.7 ⌘⌘ Shaun's Shoe Shop: Entries directly in the VAT Control account

**GENERAL LEDGER OF SHAUN'S SHOE SHOP**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **VAT CONTROL** **B** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.4 April | 30 | Creditors control | CJ | 8 820 | 20.4 Apr | 1 | Balance | b/d | 15 600 |
| | | Bank | CPJ | 7 980 | | 30 | Creditors control | CAJ | 518 |
| | | Debtors control | DAJ | 784 | | | Creditors control | CPJ | 630 |
| | | Debtors control | CRJ | 588 | | | Bank | CRJ | 11 788 |
| | | Debtors control | GJ | 1 120 | | | Debtors control | DJ | 5 950 |
| | | Creditors control | CJ | 3 220 | | | Debtors control | GJ | 70 |
| | | Balance | c/d | 12 142 | | | Drawings | GJ | 98 |
| | | | | **34 654** | | | | | **34 654** |
| | | | | | May | 1 | Balance | b/d | 12 142 |

## TASK 12.8 ⌘ Fixx Furniture Shop: Entries directly in the VAT Control account

**GENERAL LEDGER OF SHAUN'S SHOE SHOP**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **VAT CONTROL** **B** **Cr**

| 20.6 | | | | | 20.6 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Oct | 31 | Bank # | CPJ | 11 480 | Oct | 1 | Balance | b/d | 17 100 |
| | | Bank # | CPJ | 39 200 | | 31 | Creditors control | CPJ | 952 |
| | | Debtors control | CRJ | 714 | | | Bank | CRJ | 17 220 |
| | | Creditors control ## | CJ | 14 700 | | | Creditors control | CAJ | 1 736 |
| | | Creditors control ## | CJ | 658 | | | Debtors control | DJ | 20 160 |
| | | Debtors control | DAJ | 1 820 | | | Debtors control | GJ | 7 |
| | | Debtors control | GJ | 770 | | | Drawings | GJ | 924 |
| | | | | | | | Balance | c/d | 11 243 |
| | | | | **69 342** | | | | | **69 342** |
| Nov | 1 | Balance | b/d | 11 243 | | | | | |

# May be combined.
## May be combined.

## TASK 12.9 Ekshay Fashions: Ledger accounts

**Note to the Teacher:**

We are following the method of cancelling VAT Input or Output by doing the opposite in the same account as the original transaction. In other words as the credit sales was entered on the Cr side of VAT Output, the debtors' allowances is Dr to the VAT Output account. This follows the method that the learners have always used in Accounting.

However, it would be equally correct if the entry for the Debtors allowances was debited to the VAT Input account. While this will change the individual balances on the VAT Input and Output accounts the final balance of what is owing to SARS will be the same.

**GENERAL LEDGER OF EKSHAY FASHIONS**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **VAT OUTPUT** **B** **Cr**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| July | 31 | Debtors control | DAJ | 152.04 | July | 1 | Balance | b/d | 4 320.00 |
| | | VAT control account | GJ | 12 495.01 | | 31 | Bank | CRJ | 3 430.00 |
| | | | | | | | Debtors control | DJ | 4 897.05 |
| | | | | **12 647.05** | | | | | **12 647.05** |

**VAT INPUT** **B**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| July | 1 | Balance | b/d | 2 300.00 | July | 31 | Creditors control | CAJ | 126.56 |
| | 31 | Bank (147.37 + 172.05) | CPJ | 319 42 | | | VAT control account | GJ | 5 329.68 |
| | | Petty cash | PCJ | 55.02 | | | | | |
| | | Creditors control | CJ | 2 781.80 | | | | | |
| | | | | **5 456.24** | | | | | **5 456.24** |

| Dr | | | | VAT CONTROL ACCOUNT | | | | | B | Cr |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.9 | | | | | 20.9 | | | | | |
| July | 31 | VAT Input | GJ | 5 329.68 | July | 31 | VAT Output | | GJ | 12 495.01 |
| | | Balance | c/d | 7 165.33 | | | | | | |
| | | | | **12 495.01** | | | | | | **12 495.01** |
| | | | | | Aug | 1 | Balance | | b/d | 7 165.33 |

**OR**

| Dr | | | | VAT CONTROL | | | | | B | Cr |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.9 | | | | | 20.9 | | | | | |
| July | 31 | Bank # | CPJ | 147.37 | July | 1 | Balance | | b/d | 2 020 |
| | | Bank # | CPJ | 172.05 | | 31 | Bank | | CRJ | 3 430 |
| | | Petty cash | PCJ | 55.02 | | | Creditors control | | CAJ | 126.56 |
| | | Creditors control | CJ | 2 781.80 | | | Debtors control | | DJ | 4 897.05 |
| | | Debtors control | DAJ | 152.04 | | | | | | |
| | | Balance | c/d | 7 165.33 | | | | | | |
| | | | | **10 473.61** | | | | | | **10 473.61** |
| | | | | | Aug | 1 | Balance | | b/d | 7 165.33 |

#may be combined

## TASK 12.10 Redberry Stores: Calculations, Journal entries, VAT control account

**Note to the Teacher:**

Before the learners start this Task you should revise which amounts are inclusive and which amounts are exclusive.

- Bank, Debtors control, Creditors control and Drawings will be **inclusive** amounts. This is because we have to pay or charge the full amount.
- Sales, Trading stock, Stationery, Equipment, etc. will all be **exclusive**. This is because in the business books they will record the actual cost of the items. The VAT amount together with these amounts adds up to the contra account, i.e. the inclusive amount.

**12.10.1**
**Cash Receipts Journal:**

| Bank | VAT Output | Sales | Cost of sales | Fee income | Sundry accounts |
|---|---|---|---|---|---|
| **91 200.00** | 11 200 | **63 400.00** | **47 550.00** | 16 600 | 0 |

**Note**: Both sales and fee income are subject to VAT.
**Calculations**:
11 200 ÷ 14/100 = Sales + Fee Income (80 000 – 16 600 = R63 400 for sales)
Bank: 11 200 + 63 400 + 16 600 = R91 200

**Cash Payments Journal:**

| Bank | VAT Input | Trading stock | Equip-ment | Station-ery | Creditors control | | Sundry accounts |
|---|---|---|---|---|---|---|---|
| | | | | | Payments | Discount received | |
| **84 189.00** | **7 679.00** | 43 180 | 8 090 | 2 480 | 19 860 | 0 | 2 900[1] |

**Calculations:**
(43 180 + 8 090 + 2 480 + 1 100) x 14% = R7 679
**Note:** There is no VAT Input on Drawings or payments to Creditors.

**Petty Cash Payments Journal:**

| Petty cash | VAT Input | Trading stock | Consum-ables | Casual wages | Sundry expenses | Sundry accounts |
|---|---|---|---|---|---|---|
| 2 840 | **170.80** | 900 | 180 | **1 449.20** | 140 | - |
| | B | | | | | |

**Calculations:**
900 + 180 + 140 = R1 220
1 220 x 14% = R170.80
2 840 – 170.80 – 900 – 180 – 140 = R1 449.20
**Note**: There is no VAT on wages.

**Debtors Journal:**

| Debtors control | VAT Output | Sales | Cost of sales |
|---|---|---|---|
| **56 817.60** | **6 977.60** | **49 840.00** | 37 380 |
| | B | | |

**Calculations:**
37 380 x $^{133.33}/_{100}$ = R49 840
49 840 x 14% = R6 977.60
49 840 + 6 977.60 = R56 817.60

**Debtors Allowances Journal:**

| Debtors control | VAT Output | Debtors allowances | Cost of sales |
|---|---|---|---|
| **5 586.00** | **686.00** | 4 900 | **3 675.00** |
| | B | | |

**Calculations:**
4 900 x $^{100}/_{133.33}$ = R3 675
4 900 x 14% = R686

**Creditors Journal:**

| Creditors control | VAT Input | Trading stock | Equipment | Consumables | Sundry accounts |
|---|---|---|---|---|---|
| 34 519 | **4 239.18** | **24 559.82** | 4 320 | 1 400 | 0 |
| | B | | | | |

**Calculations:**
34 519 x $^{14}/_{114}$ = R4 239.18
34 519 – 4 239.18 – 4 320 – 1 400 = R24 559.82

**Creditors Allowances Journal:**

| Creditors control | VAT Input | Trading stock | Equipment | Consumables | Sundry accounts |
|---|---|---|---|---|---|
| **2 052.00** | **252.00** | 1 800 | 0 | 0 | 0 |
| | B | | | | |

**Calculations:**
1 800 x 14% = R252

**12.10.2 General Journal entries:** **GJ**

| Doc | D | Details | Fol | Dr | Cr | Debtors control | | Creditors control | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Dr | Cr | Dr | Cr |
| 14 | 31 | Drawings | | 1 200 | | | | | |
| | | VAT Output | | | **147.37** | | | | |
| | | Trading stock | | | **1 052.63** | | | | |
| | | Stock taken by proprietor for private use | | | | | | | |
| 15 | | A. Straggler | | 124 | | 124 | | | |
| | | Interest on overdue a/c | | | 124 | | | | |
| | | Interest charged on overdue account | | | | | | | |
| 16 | | VAT Output | B | 21 838.97 | | | | | |
| | | VAT Control account | B | | 21 838.97 | | | | |
| | | Output VAT transferred to VAT control account | | | | | | | |
| 17 | | VAT Control account | B | 15 436.98 | | | | | |
| | | VAT Input | B | | 15 436.98 | | | | |
| | | Input VAT transferred to VAT control account | | | | | | | |

**Calculations:**
1 200 x $^{14}/_{114}$ = R147.37
1 200 – 147 = R1 052.63
**Note**: There is no VAT charged on Interest – this is VAT exempted.

**GENERAL LEDGER OF REDBERRY STORES**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **VAT OUTPUT** **B** **Cr**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Jan | 31 | Debtors control | DAJ | 686.00 | Jan | 1 | Balance | b/d | 4 200.00 |
| | | VAT Control account | GJ | 21 838.97 | | 31 | Bank | CRJ | 11 200.00 |
| | | | | | | | Debtors control | DJ | 6 977.60 |
| | | | | | | | Drawings # | GJ | 147.37 |
| | | | | **22 524.97** | | | | | **22 524.97** |

# Could be a credit to VAT Input

**VAT INPUT** **B**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Jan | 1 | Balance | b/d | 3 600.00 | Jan | 31 | Creditors control | CAJ | 252.00 |
| | 31 | Bank | CPJ | 7 679.00 | | | VAT Control account | GJ | 15 436.98 |
| | | Petty cash | PCJ | 170.80 | | | | | |
| | | Creditors control | CJ | 4 239.18 | | | | | |
| | | | | **15 688.98** | | | | | **15 688.98** |

**VAT CONTROL ACCOUNT** **B**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Jan | 31 | VAT Input | GJ | 15 436.98 | Jan | 31 | VAT Output | GJ | 21 838.97 |
| | | Balance | c/d | 6 401.99 | | | | | |
| | | | | **21 838.97** | | | | | **21 838.97** |
| | | | | | Feb | 1 | Balance | b/d | 6 401.99 |

**OR** **VAT CONTROL ACCOUNT** **B**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Jan | 31 | Debtors control | DAJ | 686.00 | Jan | 1 | Balance | b/d | 600.00 |
| | | Bank | CPJ | 7 679.00 | | 31 | Bank | CRJ | 11 200.00 |
| | | Petty cash | PCJ | 170.80 | | | Debtors control | GJ | 6 977.60 |
| | | Creditors control | CJ | 4 239.18 | | | Drawings | GJ | 147.37 |
| | | Balance | b/d | 6 401.99 | | | Creditors control | CAJ | 252.00 |
| | | | | **19 176.98** | | | | | **19 176.98** |
| | | | | | Feb | 1 | Balance | b/d | 6 401.99 |
| | | | | | | | | | |

## TASK 12.11 ⌘ Transaction analysis

| No. | Journal | General Ledger | | Amount |
|---|---|---|---|---|
| | | **Account debit** | **Account credit** | |
| **1.** | CPJ | VAT Control account | Bank | R3 000.00 |
| **2.** | CRJ | Bank | Sales | 1 078.95 |
| | | Bank | VAT Output | 151.05 |
| | | Cost of sales | Trading stock | 539.48* |
| **3.** | CRJ | Bank | Sales | 540.00 |
| | | Cost of sales | Trading stock | 450.00 |
| **4.** | GJ | Bad debts | Debtors control | 390.00 |
| | | VAT Output | Bad debts | 47.89 |
| **5.** | CJ | Trading stock | Creditors control | 3 029.82 |
| | | VAT Input | Creditors control | 424.18 |
| **6.** | CPJ | Creditors control | Bank | 3 281.30 |
| | | Creditors control | Discount received | 172.70 |
| | | Discount received | VAT Input | 21.21 |
| **7.** | CPJ | Utility bill | Bank | 1 370.18 |
| | | VAT Input | Bank | 191.82 |
| **8.** | CRJ | Bank | Debtors control | 900.00 |
| | | Discount allowed | Debtors control | 100.00 |
| | | VAT Output | Discount allowed | 12.28 |
| **9.** | GJ | VAT Output | Debtors control | 100.00 |
| **10.** | CRJ | Bank | Interest on fixed deposit | 1 400.00 |

*Cost of sales is calculated on the exclusive price.

## TASK 12.12 ⌘ Mary Traders: Interpretation, Theory

| **12.12.1** | **What does VAT stand for?** |
|---|---|
| Value Added Tax | |
| **12.12.2** | **Why does Mary Traders have to be registered for VAT?** |
| Their turnover is more than R1 million. | |
| **12.12.3** | **What is the difference between VAT Input and Output?** |
| **VAT Input:**<br>VAT paid on goods and services bought for the business.<br>**VAT Output:**<br>VAT charged (collected) on goods sold in the business. | |
| **12.12.4** | **Explain the meaning of each of the following:** |
| | • **Standard VAT** |
| 14% VAT that is charged on most goods and services in the country. | |

| | |
|---|---|
| | • **Zero-rated VAT** |
| Basic essential items on which the VAT rate is 0%. | |
| | • **VAT exempted** |
| Items that by law have no VAT levied on. | |

**12.12.5** **Use the information given below to calculate the amount owed to SARS or the amount owed by SARS. Indicate whether the business owes SARS or whether SARS owes the business.**

| VAT Input | VAT Output | Workings |
|---|---|---|
| 24 600 | 37 200 | Opening balance |
| | 112 000 | 912 000 x $^{14}/_{114}$ |
| 61 600 | | 440 000 x $^{14}/_{100}$ |
| 3 800 | | VAT amount given |
| | (3 200) | VAT amount given |
| | (70) | 570 x $^{14}/_{114}$ |
| | (574) | 4 674 x $^{14}/_{114}$ |
| (126) | | 900 x $^{14}/_{100}$ |
| **89 874** | **145 356** | |

145 356 – 89 874 = R55 482 owed to SARS

**NOTE:**

The negative amounts above can be inserted in the opposite column, as a positive. This will change the final totals but the amount owing to SARS will be the same.

**12.12.6** **The owner of Mary Traders has told the accountant to write off more bad debts than there actually are, each year.**

**(a) Why do you think the owner has suggested this course of action? Explain briefly.**

He can claim money back from SARS and thus reduce the amount paid.
Will mean more cash available to the business.

**(b) The accountant is not prepared to do this. Briefly explain why you think he feels like this by discussing two points.**

- It is unethical to cheat SARS – everybody needs to pay their correct VAT.
- The owner and the accountant could face fines and / or jail sentences if caught by SARS.

## TASK 12.13 Willow Traders: Interpretation, Theory

**12.13.1** **Willow Traders does not have to register as a VAT vendor in terms of the law. Briefly explain why you think the business has registered.**

The turnover is not over a R1 million, although it is close, but he does not have to register until his turnover exceeds the R1 million.

**Reason**:

He can claim back the VAT that he has paid on all goods and services used in the business.

| 12.13.2 | **Use the information below to calculate the amount of VAT owed to SARS or the amount owed by SARS. Indicate whether the business owes SARS or SARS owes the business.** |
|---|---|

| VAT Input | VAT Output | Explanation / Workings |
|---|---|---|
| 122 000 | 56 000 | Opening balances |
| | 107 800 | 770 000 x $^{14}/_{100}$ |
| 46 200 | | 376 200 x $^{14}/_{114}$ |
| 9 100 | | 65 000 x $^{14}/_{100}$ |
| | (70) | 570 – 500 |
| | (280) | VAT amount given |
| | (1 400) | VAT amount given |
| (224) | | 1 824 x $^{14}/_{114}$ (Note no VAT is charged on cash withdrawals) |
| **177 076** | **162 050** | |

162 050 – 177 076 = (R15 026) owed by SARS.

**NOTE:**

The minus amounts above can be inserted in the opposite column, as a positive. This will change the final totals but the amount owing to SARS will be the same.

| 12.13.3 | **SARS encourages all their VAT vendors to submit their VAT returns by e-filing.** |
|---|---|
| | **(a) What do you understand by e-filing?** |

Submitting VAT returns on line – via internet.

| | **(b) How can SARS guarantee security if using e-filing?** |
|---|---|

All businesses have pin numbers that they must use when entering the e-filing.

| | **(c) What is the advantage to the business for using e-filing?** |
|---|---|

It is quick and individuals do not have to go to the SARS office or depend on the post. Payments or refunds occur immediately.

**12.13.4**

| | STATEMENT | TRUE/ FALSE | REASON WHY FALSE |
|---|---|---|---|
| **1.** | VAT is levied at 10% p.a. | F | VAT is charged at 14%. |
| **2.** | It is compulsory by law that all businesses have to register as a VAT vendor. | F | Only businesses with a turnover of over R1 million have to register as a VAT vendor. |
| **3.** | VAT charged on services given is charged to VAT Input. | F | Charged to VAT Output. |
| **4.** | VAT paid on trading stock bought is charged to VAT Input. | T | |
| **5.** | Fresh fruit is exempted from VAT. | F | Fresh fruit is zero-rated. |
| **6.** | VAT is levied on petrol. | F | Petrol is exempted from VAT. |
| **7.** | Interest earned from the bank is subject to VAT. | F | Interest is VAT exempted. |
| **8.** | All VAT is collected by the Department of Labour. | F | VAT is collected by SARS. |
| **9.** | The VAT period is based on one month. | F | Based on a two month period. |
| **10.** | VAT Input and VAT Output accounts are closed off to the Trading account. | F | Closed off to the VAT control account. |
| **11.** | The receipt basis is the preferred method of VAT collection. | F | All businesses are subject to the **invoice basis**. Only businesses with permission can use the receipts basis. |

## TASK 12.14 ⌘ Ethics and control

| No. | Problem | Solution |
|---|---|---|
| **1.** | He is not a registered vendor. He is keeping the tax which he charges for his own benefit or to cover the cost of VAT Input which he may be paying to his suppliers. | A trader whose turnover is below R1 000 000 may register as a vendor. This is known as voluntary registration. He is then able to recover the VAT Input which he pays for supplies. |
| **2.** | She provides an educational service which is exempt from VAT. Although she pays VAT Input she cannot charge her customers with VAT. There is, therefore, no problem arising in this particular case. | - |
| **3.** | This constitutes fraud. She is claiming VAT Input in order to increase her VAT refund. | Every claim for VAT Input and Output must be supported with the correct documentation. Vendors are expected to keep records for 5 years. These should be made available to SARS auditors. Vendors are expected to provide accurate information to SARS. This is a serious offence – she could be charged double the amount of VAT evaded and in addition to this she may be fined or imprisoned. |
| **4.** | By law any business with a turnover of R1m or more must register as a vendor. Frankie is therefore breaking the law by not registering. | He will have to register with SARS. He would be required to provide financial records for the three years. SARS could conduct investigations. Usually the deciding factor is whether the intention was to evade VAT. He would most likely have to pay penalties plus interest. |
| **5.** | This constitutes fraud. By understating VAT Output he is benefiting at the expense of SARS. His customer might also benefit from this arrangement if he is VAT vendor as he might be using the invoice with the higher amount and claiming VAT Input on that invoice. | Vendors are expected to supply SARS with accurate information. Blarney is committing a fraudulent act which is punishable by law. SARS auditors may conduct a full-scale audit of his books and that of the customer. He will probably have to pay back the VAT plus penalties and interest. |
| **6.** | He is in direct contravention of the Tax Act which requires proper and full documentation for any tax claim. By submitting returns on time he is not being charged any penalties. | He should employ a bookkeeper or accountant to help him maintain a proper set of books. Vendors are expected to keep accurate records for a period of 5 years. As a registered vendor he is legally bound to comply with the requirements of the Tax Act. |
| **7.** | The accountant has done the right thing by reporting the error to the owner. Miranda's suggestion to overlook the mistake amounts to fraud. | The vendor's intention to evade tax is deliberate. This error can be picked up by SARS auditors and Miranda will have to account for the VAT plus penalties and interest. Vendors are expected to report errors on VAT returns so that the necessary adjustments can be made. It is up to the vendor to maintain a good relationship with SARS. |
| **8.** | Penalties and interest create an extra expense which impacts on profit. | Her cash flow problems can be alleviated if she arranges with SARS to submit her returns on a later date. The application must be in writing and should be fully motivated. |

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Understands how VAT works. | | | |
| Can calculate the amount of VAT if the price quoted is exclusive. | | | |
| Can calculate the amount of VAT if the price quoted is inclusive. | | | |
| Understands the difference between invoice and receipt base for the payment of VAT. | | | |
| Appreciates the penalties attached to fraud and evasion. | | | |
| Understands the need to adapt journals to accommodate VAT. | | | |
| Can record VAT transactions in the General Ledger. | | | |
| Understands the need for full disclosure and proper record keeping. | | | |
| Can discuss ethical issues relating to VAT. | | | |

# MODULE 13
# COST ACCOUNTING (MANUFACTURING)

**Note to the Teacher:**

In Grade 10 learners were exposed to cost concepts and then in Grade 11 they drew up manufacturing ledger accounts, calculated costs of manufacturing and were exposed to some ethical and internal control measures.

In Grade 12 the focus falls on the Production Cost Statement, costing and ethical and control measures. If you wish to revise the General Ledger accounts then we suggest you refer to the Grade 11 textbook. However, it is not necessary. At this stage you would be better off revising the different cost components and then lead them into the Production Cost Statement. Most learners find this statement a lot easier than the ledger accounts.

It is important to note that it has become the norm in examinations to test the two aspects, i.e. the Production Cost Statement and the costing in two different parts of a question. This is because of work-in-progress. If costing includes work-in-progress then the calculations are far more complicated as they are bringing in costs from the previous year. In the examination guideline document it states that for costing calculations there must be no work-in-progress at school level.

Further assumptions are also made around factory overheads and administration and selling and distribution costs. In terms of the school curriculum Factory overheads and Administration costs are regarded as fixed costs – in other words the costs remains the same irrespective of the number of units produced. However, Factory overheads will include some items that could be seen as variable, for example electricity. While electricity does have a fixed amount each month the balance will be variable – if you double your production then this will affect the electricity charges. The same can be said for other costs, e.g. consumable stores.

At school level we regard Factory overheads and Administration costs as fixed – the majority of the costs will be fixed. However, make learners aware of the fact that this is a bit of an assumption and that at tertiary level they will be involved in more complicated calculations when they will have to split these costs further in to what is fixed and what is variable.

## TASK 13.1 ⌘ Matching columns

| COLUMN A | | COLUMN B | |
|---|---|---|---|
| **COST CONCEPTS** | | **DEFINITION** | |
| **1.** | Direct materials | **J** | Material that forms a part of the item produced. |
| **2.** | Indirect materials | **F** | Materials that are used in the manufacturing process but do not form part of the item produced. |
| **3.** | Direct labour | **L** | Labour directly involved in the manufacture of the goods. |
| **4.** | Indirect labour | **A** | Labour used in the factory but are not involved in the manufacture of the goods. |
| **5.** | Prime cost | **H** | Total direct costs (raw materials + direct labour). |
| **6.** | Factory overheads | **B** | Other expenses incurred by the factory other than direct expenses. |
| **7.** | Fixed costs | **K** | Costs that remain constant irrespective of the amount produced. |
| **8.** | Variable costs | **D** | Costs that vary in proportion to the amount of goods produced. |
| **9.** | Total cost of production | **I** | Includes all costs involved in the production. |
| **10.** | Unit cost | **C** | Cost of one item produced. |
| **11.** | Mark-up | **G** | The profit made on the goods produced. |
| **12.** | Selling price | **E** | The price that the items are sold for. |

## TASK 13.2 ⌘ Ralley Bike Manufacturers: Production Cost Statement

**13.2.1 NAME OF MANUFACTURER: RALLEY BIKE MANUFACTURERS**
**PRODUCTION COST STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.8**

| | Note | |
|---|---|---|
| Direct / Prime costs | | 430 000 |
| Direct material costs | 1 | 330 000 |
| Direct labour costs | 2 | 100 000 |
| Factory overhead costs | 3 | 354 000 |
| Total manufacturing costs | | 784 000 |
| Work-in-process at beginning of the year | | 40 000 |
| | | 824 000 |
| Work-in-process at end of the year | | (44 000) |
| **Cost of production of finished goods** | | **780 000** |

**13.2.2 NOTES TO THE FINANCIAL STATEMENTS**

| | |
|---|---|
| **1. Direct material costs** | |
| Opening stock | 80 000 |
| Net purchases (200 000 + 60 000) | 260 000 |
| Carriage on purchases | 30 000 |
| | 370 000 |
| Closing stock | *(40 000) |
| **Direct material cost** | **330 000** |
| *Balancing figure | |
| **2. Direct labour costs** | |
| Factory wages (210 000 – 110 000) | 100 000 |
| **Direct labour cost** | **100 000** |
| **3. Factory overhead costs** | |
| Consumable stores (24 000 – 6 000) | 18 000 |
| Salaries and wages/indirect labour | 60 000 |
| Depreciation | 16 000 |
| Rent (200 000 x $^{3}/_{5}$) | 120 000 |
| Electricity | 120 000 |
| Sundry expenses (25 000 x 80%) | 20 000 |
| **Factory overhead costs** | **354 000** |
| **4. Selling and distribution costs** | |
| Depreciation | 7 000 |
| Rent (200 000 x $^{1}/_{5}$) | 40 000 |
| Electricity | 8 000 |
| Sundry expenses (25 000 x 15%) | 3 750 |
| Commission | 84 000 |
| **Selling and distribution costs** | **142 750** |

| **5. Administration costs** | |
|---|---|
| Salaries & wages (210 000 – 100 000 – 60 000) | 50 000 |
| Depreciation | 3 000 |
| Rent (200 000 x $^{1}/_{5}$) | 40 000 |
| Electricity | 8 000 |
| Sundry expenses (25 000 x 5%) | 1 250 |
| **Administration costs** | **102 250** |

## TASK 13.3 ⌘ Kwa-Mabula Manufacturers: Production Cost Statement, Income Statement

**13.3.1 NAME OF MANUFACTURER: KWA-MABULA MANUFACTURERS**
**PRODUCTION COST STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.8**

| | **Note** | |
|---|---|---|
| Direct / Prime costs | | 1 482 000 |
| Direct material costs | 1 | 1 302 000 |
| Direct labour costs | 2 | 180 000 |
| Factory overhead costs | 3 | 923 200 |
| Total manufacturing costs | | 2 405 200 |
| Work-in-process at beginning of the year | | 80 000 |
| | | 2 485 200 |
| Work-in-process at end of the year[2] | | (75 200) |
| **Cost of production of finished goods[1]** | | **2 410 000** |

[1] Refer to the finished goods stock note below to get this figure.
[2] Work-in-process is the balancing figure.

**INCOME STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.8**

| | **Note** | |
|---|---|---|
| Sales | | 3 600 000 |
| Cost of finished goods sold / Cost of sales | 6 | (2 400 000) |
| Gross profit | | **1 200 000** |
| Other costs | | (599 500) |
| Administration costs | 4 | (182 500) |
| Selling & distribution costs | 5 | (417 000) |
| **Net profit** | | **600 500** |

**13.3.3 NOTES TO THE FINANCIAL STATEMENTS**

| **1. Direct material costs** | |
|---|---|
| Opening stock | 180 000 |
| Net purchases (600 000 + 460 000 – 24 000) | 1 036 000 |
| Carriage on purchases | 150 000 |
| | 1 366 000 |
| Closing stock | (64 000) |
| **Direct material cost** | **1 302 000** |
| | |
| **2. Direct labour costs** | |
| Factory wages | 180 000 |
| **Direct labour cost** | **180 000** |

| | |
|---|---|
| **3. Factory overhead costs** | |
| Consumables stores (14 000 + 44 000 – 6 000) | 52 000 |
| Salaries and wages (indirect labour) (360 000 – 180 000 – 80 000) | 100 000 |
| Depreciation [(1 000 000 – 240 000) x 12%] | 91 200 |
| Rent (500 000 x 60%) | 300 000 |
| Electricity | 320 000 |
| Sundry expenses (90 000 x $^{4}/_{6}$) | 60 000 |
| **Factory overhead costs** | **923 200** |
| | |
| **4. Selling and distribution costs** | |
| Depreciation – sales vehicles | 11 000 |
| Rent (500 000 x 25%) | 125 000 |
| Electricity (344 000 – 320 000 – 10 000) | 14 000 |
| Sales vehicle running expenses | 72 000 |
| Sundry expenses (90 000 x $^{1}/_{6}$) | 15 000 |
| Commission (3 600 000 x 5%) | 180 000 |
| **Selling and distribution costs** | **417 000** |
| | |
| **5. Administration costs** | |
| Salaries | 80 000 |
| Depreciation – office equipment | 2 500 |
| Rent (500 000 x 15%) | 75 000 |
| Electricity | 10 000 |
| Sundry expenses (90 000 x $^{1}/_{6}$) | 15 000 |
| **Administration costs** | **182 500** |
| | |
| **6. Cost of finished goods sold / Finished Goods** | |
| Opening stock of finished goods | 70 000 |
| Cost of finished goods produced during the year | 2 410 000 |
| | 2 480 000 |
| Closing stock of finished goods | (80 000) |
| **Cost of finished goods sold / Cost of sales** | **2 400 000** |

**Note**:
Procedure to complete the Finished goods note:

- The opening balance of R70 000 was given.
- The closing balance of R80 000 was given.
- The cost of sales can be calculated as you have the sales figure and the mark-up: 3 600 000 x $^{100}/_{150}$ = R2 400 000
- The cost of finished goods produced becomes the balancing figure.

## TASK 13.4 Centipede Manufacturers: Production Cost Statement, Income Statement, Calculations

**13.4.1 NAME OF MANUFACTURER: CENTIPEDE MANUFACTURERS**
**PRODUCTION COST STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.8**

| | Note | |
|---|---|---|
| Direct / Prime costs | | 506 400 |
| Direct material costs | 1 | 246 000 |
| Direct labour costs | 2 | 260 400 |
| Factory overhead costs | 3 | 208 200 |
| Total manufacturing costs | | 714 600 |
| Work-in-process at beginning of the year | | 120 000 |
| | | 834 600 |
| Work-in-process at end of the year | | (41 000) |
| **Cost of production of finished goods** | | **793 600** |

**13.4.2 INCOME STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.8**

| | Note | |
|---|---|---|
| Sales | | 1 500 000 |
| Cost of finished goods sold / Cost of sales | 4 | (1 049 840) |
| Gross profit | | **450 160** |
| Other costs | | (207 160) |
| Administration costs | | (82 040) |
| Selling & distribution costs | | (125 120) |
| **Net profit** | | **243 000** |

**NOTES TO THE FINANCIAL STATEMENTS**

| | |
|---|---|
| **1. Direct material costs** | |
| Opening stock | 60 000 |
| Net purchases (210 000 + 62 000)[1] | 272 000 |
| Carriage on purchases (19 500 + 9 920)[2] | 29 420 |
| Import duties[3] | 6 200 |
| | 367 620 |
| Closing stock | (121 620) |
| **Direct material cost** | **246 000** |
| [1]£5 000 x 12.40 | |
| [2]£800 x 12.40 | |
| [3]62 000 x 10% | |
| **2. Direct labour costs** | |
| Factory wages (198 000 + 19 800) | 217 800 |
| Medical Aid contributions (39 000 + 3 600) | 42 600 |
| **Direct labour cost** | **260 400** |
| **3. Factory overhead costs** | |
| Consumables stores (15 000 + 45 000 – 6 000) | 54 000 |
| Factory electricity (9 000 + 3 000) | 12 000 |
| Maintenance on factory equipment | 24 000 |
| Factory rent [72 000 + 1 200 (600 x 2)] | 73 200 |
| Depreciation | 45 000 |
| **Factory overhead costs** | **208 200** |

| **4. Cost of finished goods sold / Finished Goods** | |
|---|---|
| Opening stock of finished goods | 308 040 |
| Cost of finished goods produced during the year | 793 600 |
| | 1 101 640 |
| Closing stock of finished goods | (51 800) |
| **Cost of finished goods sold / Cost of sales** | **1 049 840** |

| **13.4.3** | **Calculate the following:** |
|---|---|
| | **(a) The unit cost of production of each pool filter.** |
| 793 600 ÷ 3 280 = **R241.95** | |
| | **(b) The selling price of each pool filter.** |
| 1 500 000 ÷ 4 000 = **R375** | |
| | **(c) The mark-up % on each pool filter.** |
| $^{133.05}/_{241.95}$ x 100 = **55%** | |

## TASK 13.5 Vilakazi Shoe Factory: Production Cost Statement, Income Statement, Calculations

**13.5.1 NAME OF MANUFACTURER: VILAKAZI SHOE FACTORY**
**PRODUCTION COST STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.8**

| | **Note** | |
|---|---|---|
| Direct / Prime costs | | 775 150 |
| Direct material costs | 1 | 427 150 |
| Direct labour costs | 2 | 348 000 |
| Factory overhead costs | 3 | 212 500 |
| Total manufacturing costs | | 987 650 |
| Work-in-process at beginning of the year | | 70 000 |
| | | 1 057 650 |
| Work-in-process at end of the year | | (124 700) |
| **Cost of production of finished goods** | | **932 950** |

**13.5.2 INCOME STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.8**

| | **Note** | |
|---|---|---|
| Sales | | 1 080 000 |
| Cost of finished goods sold / Cost of sales | 6 | (720 000) |
| Gross profit | | 360 000 |
| Other costs | | (252 655) |
| Selling & distribution costs | 4 | (125 383) |
| Administration costs | 5 | (127 272) |
| **Net profit** | | **107 345** |

**NOTES TO THE FINANCIAL STATEMENTS**

| | |
|---|---|
| **1. Direct material costs** | |
| Opening stock | 160 000 |
| Net purchases (280 000 + 70 000) | 350 000 |
| Carriage on purchases | 4 700 |
| | 514 700 |
| Closing stock (balancing figure) | (87 550) |
| **Direct material cost** | **427 150** |
| | |
| **2. Direct labour costs** | |
| Factory wages | 348 000 |
| **Direct labour cost** | **348 000** |
| | |
| **3. Factory overhead costs** | |
| Consumable stores [(9 400 + 19 800 – 3 900) x 75%] | 18 975 |
| Indirect labour | 39 600 |
| Salary: Foreman (96 240 + 5 000 + 400 + 50) | 101 690 |
| Depreciation | 6 000 |
| Maintenance | 12 155 |
| Insurance | 12 480 |
| Rent (21 800 – 2 000 + 1 800) | 21 600 |
| **Factory overhead costs** | **212 500** |
| | |
| **4. Selling and distribution costs** | |
| Salaries | 76 000 |
| Depreciation | 34 300 |
| Bad debts | 1 120 |
| Commission on sales (1 122 + 9 678) (1 080 000 x 1%) | 10 800 |
| Consumable stores | 3 163 |
| **Selling and distribution costs** | **125 383** |
| | |
| **5. Administration costs** | |
| Salaries | 56 100 |
| Depreciation | 4 800 |
| Insurance: Administration offices (22 440 – 4 000) | 18 440 |
| Sundry administration expenses | 33 110 |
| Rent | 11 660 |
| Consumable stores (6 325 ÷ 2) | 3 162 |
| **Administration costs** | **127 272** |
| | |
| **6. Cost of finished goods sold / Finished Goods** | |
| Opening stock of finished goods | 55 800 |
| Cost of finished goods produced during the year | 932 950 |
| | 988 750 |
| Closing stock of finished goods | (268 750) |
| **Cost of finished goods sold** (1 080 000 x $^{100}/_{150}$) | **720 000** |

| **13.5.3** | **Calculate the unit cost of producing the shoes.** |
|---|---|
| 932 950 ÷ 23 324 = R40 | |
| **13.5.4** | **Calculate how many shoes were sold.** |
| 40 + 50% = R60<br>1 080 000 ÷ R60 = 18 000 pairs | |

## TASK 13.6 ⌘ Tugela Water Bottle Manufacturers: Production Cost Statement, Income Statement, Unit costs

**13.6.1/3 NAME OF MANUFACTURER: TUGELA WATER BOTTLE MANUFACTURERS**
**PRODUCTION COST STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.8**

| | Note | Total | Unit cost |
|---|---|---|---|
| Direct / Prime costs | | 708 000 | R8.74 |
| Direct material costs | 1 | 330 000 | R4.07 |
| Direct labour costs | 2 | 1 038 000 | R12.81 |
| Factory overhead costs | 3 | 582 000 | R7.19 |
| Total manufacturing costs | | 1 620 000 | R20.00 |
| Work-in-process at beginning of the year | | 0 | |
| | | 1 620 000 | |
| Work-in-process at end of the year | | 0 | |
| **Cost of production of finished goods** | | **1 620 000** | **R20.00** |

**13.6.2/3 INCOME STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.8**

| | Note | Total | Unit cost |
|---|---|---|---|
| Sales [1 620 000 x $^{180}/_{100}$] | | 2 916 000 | R36.00 |
| Cost of finished goods sold / Cost of sales | 6 | (1 620 000) | R20.00 |
| Gross profit | | 1 296 000 | R16.00 |
| Other costs | | (660 700) | (R8.16) |
| Selling & distribution costs | 4 | (465 500) | (R2.41) |
| Administration costs | 5 | (195 200) | (R5.75) |
| Operating profit | | 635 300 | |
| Interest income [66 000 – 60 000] | | 6 000 | |
| Operating profit before interest expense | | 641 300 | |
| Interest expense [200 000 x 18%] | | (36 000) | |
| **Net profit** | | **605 300** | |

**NOTES TO THE FINANCIAL STATEMENTS**

| | |
|---|---|
| **1. Direct material costs** | |
| Opening stock | 105 000 |
| Purchases [240 000 + 370 000] | 610 000 |
| Carriage on purchases | 35 000 |
| | 750 000 |
| Closing stock | (42 000) |
| **Direct material cost** | **708 000** |
| **2. Direct labour costs** | |
| Factory wages | 330 000 |
| **Direct labour cost** | **330 000** |
| **3. Factory overhead costs** | |
| Wages: Cleaner [42 000 x $^{4}/_{6}$] | 28 000 |
| Salary: Foreman | 129 000 |
| Cleaning materials [(3 000 + 38 000 – 5 000) x $^{4}/_{6}$] | 24 000 |
| Rent expense [432 000 x $^{800}/_{1\,200}$] | 288 000 |
| Insurance [36 000 x $^{800}/_{1\,200}$] | 24 000 |
| Electricity & water [31 000 + 4 000 – 10 000] | 25 000 |
| Depreciation [(500 000 – 180 000) x 20%] | 64 000 |
| **Factory overhead costs** | **582 000** |

| | |
|---|---|
| **4. Selling and distribution costs** | |
| Wages: Cleaner [42 000 x $^{1}/_{6}$] | 7 000 |
| Sales commission [(2 880 000 – 78 000) x 5%] | 140 100 |
| Cleaning materials [(3 000 + 38 000 – 5 000) x $^{1}/_{6}$] | 6 000 |
| Rent expense [432 000 x $^{220}/_{1\,200}$] | 79 200 |
| Insurance [36 000 x $^{220}/_{1\,200}$] | 6 600 |
| Electricity & water [(31 000 + 4 000 - 25 000) ÷ 2] | 5 000 |
| Packing materials [52 000 x 80%] | 41 600 |
| Bad debts | 78 000 |
| Cell-phone allowances | 12 000 |
| Sales vehicle expenses | 30 000 |
| Depreciation [240 000 x 25%] | 60 000 |
| **Selling and distribution costs** | **465 500** |
| | |
| **5. Administration costs** | |
| Wages: Cleaner [42 000 x $^{1}/_{6}$] | 7 000 |
| Salary: Office workers | 84 000 |
| Cleaning materials [(3 000 + 38 000 – 5 000) x $^{1}/_{6}$] | 6 000 |
| Rent expense [432 000 x $^{180}/_{1\,200}$] | 64 800 |
| Insurance [36 000 x $^{180}/_{1\,200}$] | 5 400 |
| Electricity & water [(31 000 + 4 000 - 25 000) ÷ 2] | 5 000 |
| Bank charges | 9 000 |
| Sundry administration expenses | 10 000 |
| Depreciation [(50 000 – 30 000) x 20%] | 4 000 |
| **Administration costs** | **195 200** |

## TASK 13.7 ⌘💧💧 Break-even point: Calculations

| Selling price per item | Variable cost per item | Profit per item | Fixed costs (in total) | Break-even point (no. of items) |
|---|---|---|---|---|
| R10 | R8 | R2 | R60 | 30 |
| R24 | R16 | **R8** | R160 | **20** |
| R50 | R30 | **R20** | R1 000 | **50** |
| R75 | R45 | **R30** | R900 | **30** |
| R40 | **R25** | R15 | R750 | **50** |
| **R80** | R68 | R12 | R144 | **12** |
| R80 | R54 | **R26** | **R624** | 24 |

## TASK 13.8 ⌘💧 Tau Factory: Calculations

| | |
|---|---|
| **1.** | **Direct material cost per unit.** |
| 100 000 ÷ 10 000 = **R10** | |
| **2.** | **Direct labour cost per unit.** |
| 150 000 ÷ 10 000 = **R15** | |
| **3.** | **Total direct cost per unit.** |
| 250 000 ÷ 10 000 = **R25** | |
| **4.** | **Factory overhead cost per unit.** |
| 200 000 ÷ 10 000 = **R20** | |

| 5. | **Cost of production of finished goods per unit.** |
|---|---|
| 450 000 ÷ 10 000 = **R45** | |
| **6.** | **Selling & distribution costs per unit.** |
| 50 000 ÷ 10 000 = **R5** | |
| **7.** | **Administration costs per unit.** |
| 70 000 ÷ 10 000 = **R7** | |
| **8.** | **Variable costs per unit.** |
| Direct material cost (DMC) per unit + Direct labour cost (DLC) per unit + Selling & distribution cost (SDC) per unit<br>R10 + R15 + R5 = **R30** | |
| **9.** | **Fixed costs per unit.** |
| Factory overhead cost per unit (FOHC) + Administration cost (AC) per unit<br>R20 + R7 = **R27** | |
| **10.** | **Contribution per unit.** |
| Selling price per unit *less* Variable costs per unit<br>R60 – R30 = **R30** | |
| **11.** | **Break-even point (i.e. the point at which no profit or loss is earned).** |
| Fixed costs ÷ Contribution per unit<br>270 000 ÷ 30 = **9 000 units** | |

**Proof of break-even point:**

| | | |
|---|---|---|
| 9 000 units sold at R60 each | = | R540 000 |
| Variable costs [9 000 x R30] | = | R270 000 |
| Fixed costs | | R270 000 |
| Profit / Loss | = | NIL |

## TASK 13.9 Icicles Factory: Production Cost Statement, Income Statement

**NAME OF MANUFACTURER: ICICLES FACTORY**
**PRODUCTION COST STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.8**

| | Note | R | Per unit |
|---|---|---|---|
| Direct / Prime costs | | **60 000** | **R0.50** |
| Direct material costs | | **36 000** | **R0.30** |
| Direct labour costs | | 24 000 | **R0.20** |
| Factory overhead costs | | **96 000** | R0.80 |
| Total manufacturing costs | | **156 000** | **R1.30** |
| Work-in-process at beginning of the year | | 0 | |
| | | **156 000** | |
| Work-in-process at end of the year | | 0 | |
| **Cost of production of finished goods** | | **156 000** | **R1.30** |

**INCOME STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.8**

| | Note | R | Per unit |
|---|---|---|---|
| Sales | | **360 000** | **R3.00** |
| Cost of finished goods sold / Cost of sales | | **(156 000)** | R1.30 |
| Gross profit | | **204 000** | **R1.70** |
| Other costs | | **(114 000)** | **(R0.95)** |
| Selling & distribution costs | | **(36 000)** | (R0.30) |
| Administration costs | | **(78 000)** | **(R0.65)** |
| **Net profit** | | **90 000** | R0.75 |

## TASK 13.10 ⌘ Ground Leather Manufacturers: Analysis and interpretation

| | |
|---|---|
| **13.10.1** | **Give 2 reasons why the direct material cost has decreased.** |
| Cheaper quality material being used.<br>They may have found a cheaper supplier.<br>May have found a supplier that was closer so transport costs are reduced. | |
| **13.10.2** | **Give 2 reasons why the direct labour cost has increased.** |
| Employed more labour without increasing production, workers were given an increase in salaries /wages, labour is not as productive. | |
| **13.10.3** | **Discuss the increase in the cost of production and explain what effect this will have on the profits of the business.** |
| The costs of production have increased from R42 to R50 (R8 increase) but the selling price has remained the same which means less profits for the business. | |
| **13.10.4** | **Explain why selling and distribution expenses have increased by R7 but admin costs only by R1.** |
| Various reasons:<br>Perhaps they did more advertising and employed more sales people plus the normal increase for inflation while admin expenses have only increased due to inflation – increased costs. | |
| **13.10.5** | **What does the increase in the break-even point mean to the business? Explain fully.** |
| The business has to make an extra 30 items before they make a profit. | |
| **13.10.6** | **Do you think Groundcover made the correct decision in not increasing the selling price of the belts? Why?** |
| Learners to debate – costs have increased so they need to increase the sales price to make the same profit but sales have already decreased so maybe the demand for the product has decreased.<br>If there was more advertising (increased selling and distribution expenses) this has not really paid off. | |
| **13.10.7** | **Give the owners advice on what they need to do to improve the situation for the next year.** |
| Learners to give their own opinions.<br>Possible answers:<br>Look for another supplier.<br>Cut back on labour.<br>Reduce overhead costs.<br>Do more advertising.<br>Reward increased productivity, etc. | |

## TASK 13.11⌘ Tick-Tock Lollies: Calculations, Analysis and interpretation

**13.11.1 Complete the unit cost table by calculating the missing figures marked with (a) – (e).**

| No. | Working | Answer |
|---|---|---|
| (a) | 200 000 ÷ 40 000 | R5 |
| (b) | 40 000 ÷ 40 000 | R1 |
| (c) | R5 + R1 | R6 |
| (d) | 40 000 x R6 (or R200 000 + R40 000) | R240 000 |
| (e) | 40 000 x R1.50 | R60 000 |

**13.11.2 Calculate the unit cost of each lolly made during the year.**

R5 + R1 + R2 = R8
OR (200 000 + 40 000 + 80 000) ÷ 40 000 = **R8**

**13.11.3 Calculate the mark-up achieved by the business.**

Gross profit: 12 – 8 = R4
$^{4}/_{8}$ x 100 = **50%**

**13.11.4 What is the difference between a fixed and a variable cost? Give one explain of each.**

**Fixed cost:**
The costs remain the same within a period of time irrespective of the number of units produced, e.g. Factory overheads, rent, etc.
**Variable cost:**
The costs vary in direct proportion to the number of units produced, e.g. raw materials, direct labour.

**13.11.5 Calculate the break-even point in 20.8.**

$$\frac{80\,000 + 160\,000}{12 - (5 + 1 + 1.50)}$$

$$\frac{240\,000}{4.50}$$

**53 334 units**

**13.11.6 Should the owner be happy with the performance of the business in terms of the break-even? Take into account that the break-even last year was 25 000.**

No.
He is selling 40 000 and the break-even is 53 334 which means he is making a loss on 13 334 units.
His break-even has increased from 25 000 to 53 334.

**13.11.7 (a) Give two possible reasons why the direct material cost per unit has increased.**

- Increase in the price of the goods.
- Increase in transport of the goods.
- More wastage.
- Any other viable reason.

**(b) What effect has this increase had on the profits of the business?**

Decreased the profits.

**(c) Briefly discuss two suggestions the owner could consider to reduce this cost.**

- Find an alternative supplier.
- Find a closer source so that the transport costs are reduced.
- Control the wastage.

Any other viable reason.

| 13.11.8 | **Factory overheads have decreased as a result of "economies of scale". Briefly explain what is meant by this term.** |
|---|---|
| Factory overheads are fixed so the more you produce the total amount of the costs is divided by a larger number so the costs per unit come down. | |
| **13.11.9** | **Do you agree with the owner keeping the selling price of the lollies the same for 20.7 and 20.8? Why? Explain briefly.** |
| No.<br>The cost of manufacturing each lolly in 20.7 was R6.30 but in 20.8 this increased to R8, therefore they are making less profit.<br>OR Yes.<br>Their sales have increased from 25 000 to 40 000 and in view of the economic climate if they increase the selling price they might not sell as much. | |

## TASK 13.12 Barney's Toy Manufacturers (1): Internal control

The purpose of this Task is for the learners to engage with the figures and real-life scenarios. There is no right or wrong answer but the discussion is what is important. However, it is important that the students can substantiate any statements made.

**Suggested marking rubric:**

| Criteria | Level 1 | Level 2 | Level 3 | Level 4 |
|---|---|---|---|---|
| **Possible reasons for the stock being used up** | Fails to identify possible reasons why the stock has been used up. | Identifies some reasons why the stock has been used up. | A good discussion on possibilities. | An excellent discussion showing great insight. |
| **Control measures** | Poor suggestions made for control measures. | Some control measures discussed. | Good discussion on control measures that are feasible. | Excellent discussion on control measures to take. |
| **Advice** | Poor advice that does not address the issue. | Aspects of the advice are feasible. | Good advice given that is feasible. | Excellent advice that shows great understanding. |

**Possible answers:**

| | |
|---|---|
| **Possible reasons for the stock being used up** | Staff stealing material, wastage, cutting out wrong pieces that need to be recut, errors, etc. |
| **Control measures** | Material issued must be strictly controlled, make people answerable, people to check up on each other, make people responsible for damages and losses, reward for targets met, etc. |
| **Advice** | Various answers: Yes – so that there is no stoppage in production, needs strict control<br>No – as this puts temptation in people's way. |

## TASK 13.13 Barney's Toy Manufacturers (2): Ethics

The focus of this Task is the ethical issues at stake. Learners need to realise that there are consequences to all actions and that they cannot take decisions into your own hand. Even though Annie has got a problem just taking the off-cuts is not ethically correct. She should rather talk to the management in an attempt to solve her problem. If Barney is to just forget the issue he is opening himself up to further issues in future but he cannot discriminate and take action against some and not others.

Give the learners time to discuss this Task. You might decide that they do not need to write a report on the Task. Often assessment stunts people from expressing their views so it could therefore be done as a discussion or a debate.

**Suggested marking rubric:**

| Criteria | Level 1 | Level 2 | Level 3 | Level 4 |
|---|---|---|---|---|
| **Ethical issues** | Poor discussion on the ethical issues at stake. | Some ethical issues raised. | Good discussion on the ethical issues. | Excellent discussion on the ethical issues. |
| **Reasons for and against just 'forgetting it'** | Poor discussion. | Some valid reasons posed. | Good discussion for and against why to just 'forget it'. | Excellent discussion for and against why to just 'forget it'. |
| **Advice** | Poor advice given. | Some advice is acceptable. | Good advice based on prior discussions. | Excellent advice based on discussion. |

**Note to the Teacher:**
Many of the Tasks that follow are integrated with inventory valuations. These two topics can very easily be integrated in a final examination, so you are urged to allow the learners to do some of these tasks.

## TASK 13.14 ⌘ Hopkins Manufacturers: Production Cost Statement, Analysis and interpretation

**13.14.1 NAME OF MANUFACTURER: HOPKINS MANUFACTURERS**
**PRODUCTION COST STATEMENT FOR THE PERIOD ENDED 28 FEBRUARY 20.2**

| | Note | |
|---|---|---|
| Direct / Prime costs | | 678 384 |
| Direct material costs | 1 | 223 884 |
| Direct labour costs [450 000 + 4 500] | | 454 500 |
| Factory overhead costs | | 411 616 |
| Total manufacturing costs | | 1 090 000 |
| Work-in-process at beginning of the year | | 110 000 |
| | | 1 200 000 |
| Work-in-process at end of the year | | (150 000) |
| **Cost of production of finished goods** | | **1 050 000** |

**NOTES**

| | |
|---|---|
| **1. Direct material costs** | |
| Opening stock | 15 400 |
| Purchases plus carriage | 226 340 |
| | 241 740 |
| Closing stock* | (17 856) |
| **Raw materials issued to production** | **223 884** |
| | |
| **2. Cost of finished goods sold / Finished Goods** | |
| Opening stock of finished goods | 112 000 |
| Goods from manufacturing department (balancing figure) | 1 050 000 |
| | 1 162 000 |
| Closing stock of finished goods | (62 000) |
| Cost of sales (1 760 000 x $^{100}/_{160}$) | **1 100 000** |

*__CALCULATION OF CLOSING STOCK__
15 400 + 226 340 = R241 740
= (96 x 241 740) ÷ (100 + 1 200)
= 23 207 040 ÷ 1 300 = R17 852

Due to rounding off the learners can get different amounts. Take this into consideration in the Production Cost Statement.

| 13.14.2 | **Briefly explain why you think Hopkins Manufacturers chose the weighted average method to value the bags of polystyrene. Discuss two reasons.** |
|---|---|

- Cannot separate different bags of polystyrene.
- Value is low.

| 13.14.3 | **Discuss two possible reasons for the change in direct material cost per unit in 20.2.** |
|---|---|

- Found cheaper material.
- Found a supplier that is closer so reduced transport costs.
- Found alternative supplier.

| 13.14.4 | **Discuss two possible reasons for the change in direct labour cost per unit in 20.2.** |
|---|---|

- Increase in wage rate.
- Staff are not as productive.
- Staff worked overtime.

Do not accept increased labour force as this is a unit cost.

| 13.14.5 | **Should the owners be happy with the break-even for 20.2? Why? Explain briefly quoting figures to substantiate your answer.** |
|---|---|

Yes / No.
They have sold 3 520 units and break-even point is 3 240 so they are making a profit.
The break-even has increased from last year.

## TASK 13.15 Maria: Calculations, Production Cost Statement, Analysis and interpretation

**13.15.1 Raw material / Direct material issued to the production process.**

| | |
|---|---|
| Opening stock | 20 992 |
| Purchases | 436 300 |
| Carriage on purchases [755 x R6] | 4 530 |
| | 461 822 |
| Closing stock [62 x R578]* | (35 836) |
| **Raw materials issued to production** | **R425 986** |

*__Working__:
(461 822 ÷ 755) - 44 = R578

**13.15.2 NAME OF MANUFACTURER: MARIA**
**PRODUCTION COST STATEMENT FOR THE PERIOD ENDED 31 AUGUST 20.1**

| | Note | |
|---|---|---|
| Direct / Prime costs | | 749 986 |
| Direct material costs | | 425 986 |
| Direct labour costs (1 500 x 216) | | 324 000 |
| Factory overhead costs (1 500 x 166.67) | | 250 005 |
| Total manufacturing costs | | 999 991 |
| Work-in-process at beginning of the year | | 50 009 |
| | | 1 050 000 |
| Work-in-process at end of the year | | (60 000) |
| **Cost of production of finished goods** | | **990 000** |

| 13.15.3 | Calculate the unit cost of production for the year ended 31 August 20.1. |
|---|---|
| 990 000 ÷ 1 500 = **R660** | |
| **13.15.4** | **(a) Give a possible reason, other than price changes, for the change in each of the unit costs provided above.** |
| **Raw materials:** More wastage.<br>**Direct labour:** Better productivity.<br>**Factory overheads:** Economies of scale. | |
| | **(b) Explain whether Maria should be concerned about the break-even point. Quote figures to support your answer.** |
| No.<br>The break-even point has reduced from last year and she is producing more.<br>Her sales are 1 464 so she is making a profit. | |
| | **(c) Maria sells most of her travel bags to overseas tourists. In view of this she has decided to increase her mark-up to 150%. Do you agree with her? Discuss with full explanation.** |
| Yes / No.<br>No as the mark-up is too high and it is unethical to exploit overseas visitors.<br>Yes if people are prepared to pay there is no reason why she cannot increase the cost. | |

## TASK 13.16 Clay Potters and Cwele Ltd: Production Cost Statement, Stock valuations, Analysis and interpretation

**PART A: CLAY POTTERS**

**13.16.1 NAME OF MANUFACTURER: CLAY POTTERS**

**PRODUCTION COST STATEMENT FOR THE PERIOD ENDED 31 JULY 20.1**

| | Note | |
|---|---|---|
| Direct / Prime costs | | 527 880 |
| Direct material costs [(240 000 + 40 000) x 80%] | | 303 880 |
| Direct labour costs | | 224 000 |
| Factory overhead costs | | 302 120 |
| Total manufacturing costs | | 830 000 |
| Work-in-process at beginning of the year | | 28 000 |
| | | 858 000 |
| Work-in-process at end of the year | | (21 000) |
| **Cost of production of finished goods** | | 837 000 |

**13.16.2**

- **CALCULATION OF DIRECT OR (RAW) MATERIALS COST**

| | |
|---|---|
| Opening stock | 28 960 |
| Purchases | 269 350 |
| Carriage on purchases | 28 290 |
| | 326 600 |
| Closing stock* | (22 720) |
| **Direct material cost** | 303 880 |

***Calculation of Closing stock:**

326 600 ÷ 230 = 1 420

1 420 x 16 = R22 720

- **CALCULATION OF FACTORY OVERHEAD COST**

| | |
|---|---|
| Consumable stores | 40 000 |
| Rent [180 000 x $^{60}/_{100}$] | 108 000 |
| Water and electricity | 50 000 |
| Depreciation | 26 000 |
| Indirect labour [280 000 – 224 000] | 56 000 |
| Sundry expenses | 22 120 |
| **Factory overhead cost** | 302 120 |

- **CALCULATION OF FINISHED GOODS STOCK**

| | |
|---|---|
| Opening stock | **52 000** |
| Cost of goods manufactured (balancing figure) | 837 000 |
| | 889 000 |
| Less Closing stock | **(29 000)** |
| Cost of sales [1 376 000 x $^{100}/_{160}$] | 860 000 |

| | |
|---|---|
| **13.16.3** | **The owners of Clay Potters have instructed the accountant to switch between the Weighted average and FIFO method when valuing the raw materials.** |
| | • **Why do you think the owners would give this instruction?** |
| To show higher or lower profits depending on what he is trying to achieve. | |
| | • **Do you agree with the owners? Why?** |
| No.<br>It is unethical to switch – businesses have to stick to one method in the interest of comparison. | |

**PART B: CWELE LTD**
**UNIT COSTS: (Note that this is a separate question to Part A)**
**13.16.4**

| **COSTS** | **TOTAL** | **UNIT COST 20.10** | **UNIT COST 20.9** |
|---|---|---|---|
| Direct / raw materials | R250 000 | **R10** | R12 |
| Direct labour cost | **375 000** | **R15** | R11 |
| Prime cost | **625 000** | R25 | R23 |
| Factory overheads | R200 000 | R8 | R10 |
| Administration costs | R75 000 | R3 | R3 |
| Selling & distribution costs | R100 000 | R4 | R2 |

| | |
|---|---|
| **13.16.5** | **Define the following concepts and give an example of each:** |
| | • **Fixed costs** |
| Remains constant irrespective of the number of goods produced.<br>Example: Rent, etc. | |
| | • **Variable costs** |
| Varies in direct proportion to the number of units produced.<br>Example: Raw materials. | |
| **13.16.6** | **Calculate the unit cost of production for 20.10.** |
| 825 000 ÷ 25 000 = **R33** | |
| **13.16.7** | **Discuss 2 possible reasons for the change in the following costs from 20.9 to 20.10:** |
| | • **Direct / raw materials cost** |
| Cheaper source of material / supplier.<br>Less wastage. | |

| | |
|---|---|
| | • **Direct labour cost** |
| Increase in wage rate.<br>Employed more labourers. | |
| | • **Factory overheads** |
| Economies of scale.<br>Costs, e.g. rent, have decreased. | |
| **13.16.8** | **Calculate the break-even point for 20.10.** |
| 200 000 + 75 000<br>60 – 29<br>= 275 000<br>31<br>= **8 871 units** | |
| **13.16.9** | **The owner of Cwele Ltd is very pleased regarding the trend in the break-even point from 2.09 to 20.10. Do you agree? Why?** |
| Yes.<br>Because the break-even is less than 20.9 so more profit is being made. | |

## TASK 13.17 Rani Manufacturers: Calculations, Stock valuations, Analysis and interpretation

| | |
|---|---|
| **13.17.1** | **The owner (Rani) is of the opinion that the FIFO method is the best method to use in the manufacturing of raincoats. Briefly explain why you think he is of this opinion.** |
| The stock is valued at the current prices and in times when prices are increasing (as it has during the past year) this will give a more realistic value of the stock. | |
| **13.17.2** | **Calculate the following: (Refer to information note no. 2 below.)** |
| | **(a) The value of the raw (direct) materials on hand on 28 February 20.9 using the FIFO method of stock valuation.** |
| (2 200 x 48) + (4 300 – 2 200 x 42)<br>= 105 600 + 88 200 = **R193 800** | |
| | **(b) Calculate the value of the raw (direct) material cost that would appear in the Production Cost Statement for the year ended 28 February 20.9.** |
| (700 x 30) + 490 600 – 193 800<br>= 21 000 + 490 600 – 193 800<br>= **R317 800** | |
| **13.17.3** | **Rani has asked you to investigate the control over the raw materials:** |
| | **(a) Calculate the number of metres of raw material fabric that appears to be missing.** |
| 9 100 (issued to factory) – 4 000 x 1.8 (no. of raincoats x 1.8 metres each)<br>= 9 100 – 7 200<br>= **1 900 metres missing** | |
| | **(b) Apart from theft state one possible reason for this shortage. Briefly offer Rani advice on what she could do to prevent this shortage. Discuss one point.** |
| Wastage of material.<br>Unskilled labour that are not cutting the material properly.<br>Any other valid reason.<br>Proper supervision.<br>Training of staff.<br>Any other valid reason. | |

| | | |
|---|---|---|
| **13.17.4** | **(a)** | **Calculate the value of the direct labour cost (including contributions) that would appear in the Production Cost Statement for the year ended 28 February 20.9 (Refer to information 3 below).** |

Basic: 5 x R5 000 x 12 = R300 000 (note the R5 000 is monthly but you are working for a year)
Overtime: 180 x 5 x 70 = R63 000
Pension: R300 000 x 10% = R30 000
UIF: R300 000 x 1% = R3 000
Total = 300 000 + 63 000 + 30 000 + 3 000 = **R296 000**

| | | |
|---|---|---|
| | **(b)** | **Rani is concerned about the number of hours that the workers have worked overtime. She has had the same number of employees in the factory this year as last and the overtime has increased by double.** |
| | | • **Why do you think she should be concerned?** |

Last year they produced 4 500 raincoats and this year this number was reduced to 4 000 but the same number of workers that worked double the time.
This will increase the costs of manufacturing and thus result in lower profits.

| | |
|---|---|
| | • **Suggest two measures that Rani could introduce to try and cut back on the overtime.** |

- The norm time to make a raincoat must be worked out so that staff will know what is expected of them in normal working hours.
- There needs to be constant supervision.
- Staff needs to be given extra training.
- Any other feasible suggestion.

| | | |
|---|---|---|
| **13.17.5** | **Calculate the following:** | |
| | **(a)** | **The total cost of production of finished goods.** |

R317 800 + R396 000 + (4 000 x 67.55)
= 317 800 + 396 000 + 270 200
= **R984 000**

| | | |
|---|---|---|
| | **(b)** | **The unit cost of production of each raincoat.** |

R984 000 ÷ 4 000 = **R246**

| | | |
|---|---|---|
| | **(c)** | **Calculate the break-even point for the year ended 28 February 20.9.** |

350 200
350 – 215.95
350 200
134.05
**2 613 raincoats** (2 612.5) (Remember break-even must always be rounded up)

| | | |
|---|---|---|
| | **(d)** | **The break-even point for the year ended 28 February 20.8 was 2 273 units. Should Rani be happy with the break-even point for 20.9? Explain briefly.** |

Yes.
The business has produced 4 000 raincoats which is above the break-even point (they are making a profit on 1 387 units).
OR No.
The break-even point is higher than it was in 20.8 (340 units). Therefore they have to manufacture more in 20.9 before they can make a profit.

| 13.17.6 | **Discuss two possible reasons why the selling and distribution costs per unit have decreased. In your opinion has this been beneficial to the business? Discuss briefly.** |
|---|---|

**Two possible reasons:**
The salesman's commission on sales has been reduced as they have sold fewer raincoats.
Less advertising.
Deliveries have been reduced.
Any other feasible reason.
**Has this been beneficial to the business?**
No.
The number of raincoats sold has decreased and therefore less profit will be made.

## TASK 13.18 BB Bakery: Production Cost Statement, Stock valuations, Analysis and interpretation

**13.18.1 NAME OF MANUFACTURER: BB BAKERY**
**PRODUCTION COST STATEMENT FOR MARCH 20.8.**

| | **APRIL 20.8** | **MARCH 20.8** |
|---|---|---|
| Direct / Prime costs | **120 000** | * |
| Direct material costs | **78 000** | 57 600 |
| Direct labour costs [30 000 x 1.40] | **42 000** | 33 600 |
| Factory overhead costs | **48 000** | * |
| **Total manufacturing costs of finished loaves of bread** | 168 000 | 120 000 |

**Raw material / Direct material cost**

| | |
|---|---|
| Opening stock | 7 000 |
| Purchases [52 000 + 25 000] | 77 000 |
| Carriage on purchases | 2 000 |
| Raw materials available for production | 86 000 |
| Closing stock | (8 000) |
| **Raw materials issued to the manufacturing process** | 78 000 |

| 13.18.2 | **Calculate the unit cost of each loaf of bread in April 20.8.** |
|---|---|

168 000 ÷ 30 000 = R5.60

| 13.18.3 | **Give 2 possible reasons why the raw materials cost have increased.** |
|---|---|

- Due to inflation.
- Increase in transport costs.
- Different supplier.
- Any other reasonable reason.

| 13.18.4 | **Name 2 items that could possibly be included in factory overhead costs.** |
|---|---|

- Rent.
- Electricity.
- Factory manager / supervisor.
- Cleaning and / or maintenance staff.
- Etc.

| 13.18.5 | **Calculate the break-even point in April 20.8.** |
|---|---|

$$\frac{48\,000 + 10\,500}{7 - (2.60 + 1.40 + 0.50)}$$

$$\frac{58\,500}{2.50}$$

**23 400 units**

| | |
|---|---|
| **13.18.6** | **The owner of BB Bakery is very happy that the number of loaves of bread has increased by 6 000 since last month. He has therefore decided to take a holiday overseas in view of the increased profit he believes he is making. Is the owner correct in his assumption? Explain using figures to substantiate your answer.** |

Calculation of profit:

| | MARCH | APRIL |
|---|---|---|
| Sales (24 000 x R7) (30 000 x R7) | 168 000 | 210 000 |
| Cost of manufacturing | (120 000) | (168 000) |
| Administration cost | (10 000) | (10 500) |
| Selling and distribution costs | (10 000) | (15 000) |
| **Net profit** | **R28 000** | **R16 500** |

No.
Although the number of loaves has increased he has made less profit in April than March due to increased costs.

| | |
|---|---|
| **13.18.7** | **On investigation the owner has discovered that the sales figure for the month of April 20.8 was actually R8 000 less than what was expected but no bread has been left over.** |
| | • **Give 2 reasons why the sales are lower than budgeted.** |

- Loaves of bread have been stolen.
- There has been wastage of bread.
- Any other feasible reason.

| | |
|---|---|
| | • **Discuss 2 measures that the owner could take to prevent this situation in future.** |

- Introduce security measures to prevent theft.
- Division of duties – somebody needs to be checking up so that there isn't wastage or bread been badly made that cannot be sold.
- Any other feasible reason.

| | |
|---|---|
| **13.18.8** | **In order to improve the profitability the owner has made the following proposal and has requested your comment. The standard loaf of bread weighs 700g. He is proposing reducing each loaf of bread to 680g although it will still be marked on the packet as 700g. He does not, however, intend reducing the selling price of each loaf of bread. Do you agree with his suggestion? Why? Discuss at least 2 points in your discussion to qualify your decision.** |

No.
- This is unethical – he needs to tell the customers if he is reducing the weight of the bread.
- The business will get a bad reputation and they will lose customers and this will have more of an effect on the profit of the business.

| | |
|---|---|
| **13.18.9** | **The stock controller has recently left the bakery and the owner is not sure what method he was using in the calculation of the value of the closing stock. The owner is aware that there are two basic methods used in business, i.e. the FIFO and weighted average method. He has come to you for assistance as to which method he should use. Briefly explain which method you believe will be the most appropriate for a bakery business.** |

Weighted average method:
- The ingredients used in baking bread cannot be separated from each other – e.g. it would be impossible to separate a bin of flour in to separate purchases.
- The amount of ingredients would also be large (R78 000 of raw materials were used in April).
- Therefore the weighted average method would be the most appropriate.

OR FIFO (This method would not be the most appropriate):
- FIFO makes use of the most current prices
- Therefore the stock valuation is the most realistic value.

## TASK 13.19 Article

| | |
|---|---|
| **13.19.1** | **A friend of yours has read the article but does not understand certain terms. Explain to her what the terms in bold in the text mean.** |

Rising input costs – cost incurred in the manufacturing process, i.e. raw materials, labour and factor overheads.
As these are increasing it is pushing the cost price of the articles up.

| | |
|---|---|
| **13.19.2** | **Explain to your friend, why in terms of the article, food prices are expected to increase.** |

Costs have increased.
Shortages of raw materials through droughts.
Crop failures.

| | |
|---|---|
| **13.19.3** | **Why do you think it is cheaper to import some products than manufacture them locally?** |

South Africa's input costs are often high.
For example our labour costs are much higher than in many other countries of the world.
Electricity tariffs have increased considerably over the last few years.
Shortages of raw materials produced locally.

| | |
|---|---|
| **13.19.4** | **Why is the poultry industry expected to be hard hit? Explain briefly.** |

The poultry are fed on maize and related feeds.

| | |
|---|---|
| **13.19.5** | **You have been tasked by the board of a mill to make a presentation at the next board meeting around strategies that the business should be adopting in the new year to ensure the sustainability of the mill. Give a brief report in which you discuss at least five possible strategies that the board could look at.** |

- Economise on costs, e.g. overheads.
- Source cheaper supplier of raw materials.
- Introduce incentive schemes so that labour becomes more productive.
- Set up the mills near the source of labour and / or raw materials to cut down on transport.
- Seek alternative products to manufacture.

## TASK 13.20 Ethics and Internal control

| NO. | PROBLEM | INTERNAL CONTROL / ETHICAL PROBLEM | SUGGESTIONS |
|---|---|---|---|
| **13.20.1** | Yes | Ethical problem | If the company is going to reduce the quantity they need to inform the customers. |
| **13.20.2** | Yes | Ethical problem | If products are used that could be potentially dangerous then they must be clearly stated on the packaging. |
| **13.20.3** | Yes / No | Ethical problem | Depends on their contracts. If this was a condition of service then management cannot just take it away. However, if it has been a privilege then they can remove it. It could have a very demotivating effect on the workers. |
| **13.20.4** | Yes | Ethical<br><br>Internal control | Under the regulations of the country all workers working more than the prescribed minimum have to be paid overtime.<br>If management is of the opinion that staff is wasting time in order to earn overtime, then this is an internal control problem. |

| NO. | PROBLEM | INTERNAL CONTROL / ETHICAL PROBLEM | SUGGESTIONS |
|---|---|---|---|
| **13.20.5** | Yes or No | Ethical | Ethically if the costs are reduced these should be passed on to the customer. However, according or market forces, if customers are prepared to pay a price the seller can charge what he wants. |
| **13.20.6** | Yes | Ethical | This is breaking the law. |
| **13.20.7** | Yes | Internal control | Management are not controlling the packaging and the quality that is been produced. Needs stricter control measures. |
| **13.20.8** | Yes | Internal control | The matter needs to be investigated and the relevant people who have made up the ghost employees need to face a disciplinary meeting. |
| **13.20.9** | Yes | Internal control | Staff must be eating more than their allowance or they are taking cereal home. |
| **13.20.10** | Yes | Unethical | If individuals are been paid to say something it must be true. Playing on the physiological impact of advertising. |

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Define and explain concepts relating to a manufacturing enterprise. | | | |
| Prepare a Production Cost Statement together with relevant notes. | | | |
| Prepare a short form Income Statement together with relevant notes. | | | |
| Calculation of relevant costs. | | | |
| Comment on costs. | | | |
| Discuss ethical issues relating to Cost Accounting. | | | |
| Discuss internal audit and control measures relating to a manufacturing business. | | | |

# MODULE 14
# BUDGETING

**Note to Teacher:**

Learners have already studied budgets extensively in Grade 10 and 11 so this year the focus is on the analysis and interpretation. However, learners will not be able to complete this task successful without the prior knowledge that involves preparation of the cash budget and projected income statement. Therefore we will start with some baseline assessments and you are urged to do the necessary revision where necessary.

## TASK 14.1 Health Nut Bakery: Cash budget

This first Task is purely to give the learners a chance to engage with a budget and external factors that influence the completion of a budget. In most cases there is no right or wrong answer but the importance is that the learners can justify their decisions and these must be based on sound accounting principles.

14.1.1 Learners to express their own opinions but the accountant should be concerned as an increase in the wheat price together with a weakening of the rand will have an effect on the business.
14.1.2 Report.

**Suggested marking rubric for the report:**

| Criteria | Level 1 | Level 2 | Level 3 |
|---|---|---|---|
| Can discuss the effect on the wheat price. | Poor attempt at the discussion. | Aspects of the discussion are complete but there are gaps. | A good discussion showing insight. |
| Can discuss the effect on the other payments. | Poor attempt at the discussion. | Aspects of the discussion are complete but there are gaps. | A good discussion showing insight. |
| Can discuss the effect on the other income. | Poor attempt at the discussion. | Aspects of the discussion are complete but there are gaps. | A good discussion showing insight. |
| Can discuss the effect on the selling price. | Poor attempt at the discussion. | Aspects of the discussion are complete but there are gaps. | A good discussion showing insight. |

## TASK 14.2 ⌘ Tabco Ltd: Cash budget

**14.2.1 CASH BUDGET OF TABCO LTD FOR THE 3 MONTHS ENDED 30 SEPTEMBER 20.8**

| **CASH RECEIPTS** | **JULY** | **AUGUST** | **SEPTEMBER** |
|---|---|---|---|
| Cash sales | 45 000 | 51 000 | 48 000 |
| Cash from debtors | 125 250 | 135 300 | 146 700 |
| Ordinary shares | | | 104 000 |
| **Total receipts** | **170 250** | **186 300** | **298 700** |
| **CASH PAYMENTS** | | | |
| Cash purchases of trading stock | 12 000 | 13 600 | 12 800 |
| Payments to creditors | 96 900 | 102 600 | 116 280 |
| Operating expenses | 50 000 | 51 000 | 52 020 |
| Dividends | 60 000 | | |
| SARS | 16 000 | | |
| Loan | | 20 000 | |
| **Total payments** | **234 900** | **187 200** | **181 100** |
| Surplus (Deficit) | (64 650) | (900) | 117 600 |
| Opening bank balance | 54 000 | (10 650) | (11 550) |
| Closing bank balance | **(10 650)** | **(11 550)** | **106 050** |

**14.2.3 DEBTORS COLLECTION SCHEDULE**

| | | **July** | **August** | **September** |
|---|---|---|---|---|
| May | [112 500] | 9 000 | | |
| June | [127 500] | 89 250 | 10 200 | |
| July | [135 000] | 27 000 | 94 500 | 10 800 |
| August | [153 000] | - | 30 600 | 107 100 |
| September | [144 000] | - | - | 28 800 |
| **Debtors Collections** | | **125 250** | **135 300** | **146 700** |

**CREDITORS PAYMENTS SCHEDULE**

| | **May** | **June** | **July** | **August** | **Sept** |
|---|---|---|---|---|---|
| Sales | 150 000 | 170 000 | 180 000 | 204 000 | 192 000 |
| Cost of sales | 100 000 | 113 333 | 120 000 | 136 000 | 128 000 |
| Credit purchases | 90 000 | 102 000 | 108 000 | 122 400 | 115 200 |
| **Payments to Creditors** | | | ***96 900** | **102 600** | **116 280** |

*R102 000 x 0.95 = R96 900

## TASK 14.3 ⌘ Benraj Trading Ltd: Income Forecast, Cash budget, Debtors Collection Schedule

**BENRAJ TRADING LTD**
**MONTHLY INCOME FORECAST FOR THE 6 MONTHS ENDED 30 JUNE 20.8**

| | Jan | Feb | March | April | May | June |
|---|---|---|---|---|---|---|
| Sales | 144 000 | 140 000 | 152 000 | 164 000 | 156 000 | 140 000 |
| Cost of sales | 96 000 | 93 333 | 101 333 | 10 9333 | 104 000 | 93 333 |
| Gross profit | **48 000** | **46 667** | **50 667** | **54 667** | **52 000** | **46 667** |
| Operating expenses | (55 177) | (55335) | (55 941) | (59 607) | (59 275) | (59 151) |
| Bad debts | 4 050 | 4 320 | 4 590 | 3 888 | 3 780 | 4 104 |
| Discount allowed | 2 592 | 2 520 | 2 736 | 2 952 | 2 808 | 2 520 |
| Advertising and selling | 1 440 | 1 400 | 1 520 | 1 640 | 1 560 | 1 400 |
| Salaries and wages | 33 600 | 33 600 | 33 600 | 37 632 | 37 632 | 37 632 |
| Fixed other expenses | 11 200 | 11 200 | 11 200 | 11 200 | 11 200 | 11 200 |
| Depreciation | 2 295 | 2 295 | 2 295 | 2 295 | 2 295 | 2 295 |
| Net loss before interest expense | (7 177) | (8 668) | (5 274) | (4 940) | (7 275) | (12 484) |
| Interest expense | (2 800) | (2 800) | (2 800) | (2 800) | (2 800) | (2 800) |
| Net loss before tax | (9 977) | (11468) | (8 074) | (7 740) | (10 075) | (15 284) |
| Income tax | | | | | | (55 368) |
| Net loss after tax | **(9 977)** | **(11 468)** | **(8 074)** | **(7 740)** | **(10 075)** | **(70 652)** |

**CASH BUDGET FOR THE 6 MONTHS ENDED 30 JUNE 20.8**

| **CASH RECEIPTS** | **Jan** | **Feb** | **March** | **April** | **May** | **June** |
|---|---|---|---|---|---|---|
| Cash sales | 14 400 | 14 000 | 15 200 | 16 400 | 15 600 | 14 000 |
| Cash from debtors | 135 828 | 123 390 | 124 056 | 133 308 | 136 728 | 128 412 |
| **Total receipts** | **150 228** | **137 390** | **139 256** | **149 708** | **152 328** | **142 412** |
| **CASH PAYMENTS** | | | | | | |
| Cash purchases of stock | 19 200 | 18 667 | 20 267 | 21 867 | 20 800 | 18 667 |
| Payments to creditors | 80 000 | 85 334 | 90 667 | 76 800 | 74 666 | 81 066 |
| Advertising and selling | 1 440 | 1 400 | 1 520 | 1 640 | 1 560 | 1 400 |
| Salaries and wages | 33 600 | 33 600 | 33 600 | 37 632 | 37 632 | 37 632 |
| Fixed other expenses | 11 200 | 11 200 | 11 200 | 11 200 | 11 200 | 11 200 |
| Tax | 12 700 | | | | | 55 368 |
| Dividends | 40 000 | | | | | 40 000 |
| Interest on mortgage | 2 800 | 2 800 | 2 800 | 2 800 | 2 800 | 2 800 |
| **Total payments** | **200 940** | **153 000** | **160 054** | **151 939** | **148 658** | **248133** |
| Surplus (Deficit) | (50 712) | (15 610) | (20 798) | (2 231) | 3 670 | (105 721) |
| Opening bank balance | 13 144 | (37 568) | (53 178) | (73 976) | (76 207) | (72 537) |
| Closing bank balance | **(37 568)** | **(53 178)** | **(73 976)** | **(76 207)** | **(72 537)** | **(178 258)** |

**DEBTORS COLLECTION SCHEDULE**

| | | Jan | Feb | March | April | May | June |
|---|---|---|---|---|---|---|---|
| November | 144 000 | 10 080 | | | | | |
| December | 153 000 | 76 500 | 10 710 | | | | |
| January | 129 600 | 49 248 | 64 800 | 9 072 | | | |
| February | 126 000 | - | 47 880 | 63 000 | 8 820 | | |
| March | 136 800 | - | - | 51 984 | 68 400 | 9 576 | |
| April | 147 600 | - | - | - | 56 088 | 73 800 | 10 332 |
| May | 140 400 | - | - | - | - | 53 352 | 70 200 |
| June | 126 000 | - | - | - | - | - | 47 880 |
| **TOTAL** | | **135 828** | **123 390** | **124 056** | **133 308** | **136 728** | **128 412** |

| | Oct | Nov | Dec | Jan | Feb | March | April | May | June |
|---|---|---|---|---|---|---|---|---|---|
| Sales | 150 000 | 160 000 | 170 000 | 144 000 | 140 000 | 152 000 | 164 000 | 156 000 | 140 000 |
| Cost of sales | 100 000 | 106 667 | 113 333 | 96 000 | 93 333 | 101 333 | 109 333 | 104 000 | 93 333 |

## TASK 14.4 ⌘ Wopper Trading Store: Analysis and interpretation of Cash budget

| | |
|---|---|
| **14.4.1** | **Do you think it is a good decision to budget for the payment of the loan of R40 000 in January?** |

Learners to give their own opinions.
No as the paying of the loan means the business goes into an overdraft and generally the interest on an overdraft is higher than that of a loan.

| | |
|---|---|
| **14.4.2** | **Would you be happy with the budgeted results if the loan payment was not made in January? Explain.** |

If the loan was not paid back then the business would have a favourable bank balance over the 3 months. However, not making the loan repayment would mean additional interest.

| | |
|---|---|
| **14.4.3** | **Comment on the owner's drawings? Do you think these are feasible in terms of the cash situation of the business?** |

Learners to express their own opinions on whether they think R7 000 is high or not.

| | |
|---|---|
| **14.4.4** | **Comment on the turnover figures over the budgeted period. Discuss 2 possible reasons for the expected decrease in turnover over the next 3 months.** |

Learners to give their own opinions.
The turnover is decreasing on a monthly basis by R5 000.
Possible reasons: sales, trade discounts, customers not supporting the business, etc.

| | |
|---|---|
| **14.4.5** | **What percentage of turnover is being spent on advertising and selling expenses? Do you think their policy is going to be successful? Why?** |

$^{1\,800}$ / $_{90\,000}$ x 100 = 2%
Not successful as sales are continually expected to drop each month.

| | |
|---|---|
| **14.4.6** | **Is this business expected to maintain a fixed mark-up % over the forecast period? Quote figures to support your answer.**<br>**<u>Note</u>: A fixed stock base is maintained by Wopper Trading Store.** |

The mark-up has decreased monthly.

| | | | |
|---|---|---|---|
| January | Sales | 90 000 | 47% |
| | COS | 61 200 | |
| | GP | 28 800 | |
| February | Sales | 85 000 | 36% |
| | COS | 62 424 | |
| | GP | 22 576 | |
| March | Sales | 80 000 | 26% |
| | COS | 63 672 | |
| | GP | 16 328 | |

| | |
|---|---|
| **14.4.7** | **What would you say are the 2 main expected causes of the expected decline in the cash surplus for the business?** |

Reducing sales, lower mark-up, repayment of the loan.

## TASK 14.5 ⌘ Regina Traders: Analysis and interpretation of Cash budget

| 14.5.1 | **Do you think that the management should be happy with the expected sales trend over the next 6 months? Why?** |
|---|---|
| Learners to give their own opinion.<br>Sales are expected to increase by R4 000 per month.<br>This shows positive growth in the customer base of the business and is pleasing. | |
| **14.5.2** | **Calculate the expected mark-up % to be used by Regina Traders during the forecast period.** |
| $\frac{72\,000}{72\,000} \times \frac{100}{1} =$ **100%**<br>(Learner could use any month to calculate this as the mark-up% is expected to be constant over the budget period). | |
| **14.5.3** | **Calculate what the Debtors control balance was in the books of Regina Traders at the end of December 20.7 considering that no discounts are expected to be granted to debtors for early settlement of their accounts.** |
| R84 000.<br>Debtors are paying in 30 days – January sales were R144 000 and the cash sales R57 600.<br>This leaves R86 400 which was received in February.<br>Cash from debtors in January represents the Debtors control balance at the end of December. | |
| **14.5.4** | **Calculate the forecasted credit sales for the 6 months period.** |
| Cash sales are 40% ($^{57\,600}/_{144\,000}$ x 100).<br>Total sales = R924 000 so credit sales (60%) is **R554 400**. | |
| **14.5.5** | **Calculate what the Debtors control balance is expected to be on the 30 June 20.8.** |
| 164 000 – 65 600 = **R98 400**<br>(or 60% of R164 000) | |
| **14.5.6** | **Calculate the expected credit purchases for January 20.8.** |
| 72 000 – 14 400 = **R57 600**<br>(Fixed stock base means that COS = Total purchases) | |
| **14.5.7** | **Calculate what the Creditors control balance was on 31 December 20.7.** |
| 52 800 + 54 400 + 56 000 = **R163 200** | |
| **14.5.8** | **Calculate what the Creditors control balance is expected to be on 30 June 20.8.** |
| Credit purchases are 80%:<br>62 400 + 64 000 + 65 600 = **R192 000** (or *R240 000 x 80%)<br>(Creditors are paid in 3 months)<br>*R240 000 = 78 000 + 80 000 + 82 000 | |
| **14.5.9** | **State the credit terms that this business is expecting to use for credit purchase over the budget period.** |
| 90 days. | |
| **14.5.10** | **Name 3 expenses that could be included in "Fixed cash expenses".** |
| Salaries, rent, rates, etc. | |

| 14.5.11 | **What is your opinion on the expected cash flow of this business over the next 6 month?** |
|---|---|
| Learners to offer their own opinions but they must substantiate all comments.<br>Possible answers:<br>The cash balance has increased, the turnover has increased, gross profit has increased, and Fixed cash expenses have remained constant. | |

## TASK 14.6 Kup Traders Ltd: Analysis and Interpretation of Cash budget & Income Statement

| 14.6.1 | **What % of sales is expected to be sold on credit?** |
|---|---|
| Cash sales: $^{40\,000}/_{160\,000}$ x 100 = 25%; therefore credit sales are 75%. | |
| **14.6.2** | **What mark-up % is the business expected to use?** |
| $^{80\,000}/_{80\,000}$ x 100 = **100%** | |
| **14.6.3** | **Name 2 expenses that specifically relate to a company that could be included in the other operating expenses.** |
| Printing of financial statements, AGM expenses, prospectus costs, etc. | |
| **14.6.4** | **What % increase is expected to be given in wages and salaries and on what date is this increase expected to be given?** |
| July: $^{2\,880}/_{36\,000}$ x 100 = **8%** | |
| **14.6.5** | **Discuss 2 possible reasons why the wages and salaries are expected to increase.** |
| Annual increase, performance increases, trade union actions. | |
| **14.6.6** | **Calculate the amount of the loan on 1 March 20.8.** |
| 2 880 x 12 = R34 560<br>34 560 ÷ 0.18 = **R192 000** | |
| **14.6.7** | **Assuming depreciation is to be written off at 20% p.a. on cost. Calculate the cost of the equipment on 1 March 20.8.** |
| 3 000 x 12 = $^{36\,000}/_{20}$ x 100 = **R180 000** | |
| **14.6.8** | **In which month is the March credit sales expected to be received? No discounts are expected to be granted to debtors.** |
| April | |
| **14.6.9** | **What are the credit terms to debtors?** |
| 30 days | |
| **14.6.10** | **What was the Debtors control account balance on 28 February 20.8?** |
| R80 000 | |
| **14.6.11** | **What is the expected Debtors control account balance on 31 August 20.8?** |
| 204 206 – 51 052 = **R153 154** | |
| **14.6.12** | **What % of the expected March purchases of trading stock is to be on credit? Assuming that a fixed base stock level is maintained.** |
| Cash purchases: $^{32\,000}/_{80\,000}$ = 40% therefore credit purchases is 60% for March.<br>Changed policy to 20% for April to August. | |

| 14.6.13 | **What do the expected tax payments of R8 000 and R90 000 in March and August 20.8 represent?** |
|---|---|
| R8 000 is the amount owing to SARS at the end of the previous financial year.<br>R90 000 is the expected 1st provisional tax payment of the next financial year. | |
| **14.6.14** | **Explain what the dividend payment in March represents.** |
| Probably what was owing to the shareholders from the previous financial year.<br>Final dividend declared but not paid last year. | |
| **14.6.15** | **Do you think that the expected loan repayment of R48 000 during June is affordable? Explain?** |
| Learners to express their own opinions – the interest on the loan will decrease and so will the risk for the business.<br>Need to look at gearing to make an accurate decision.<br>Have the necessary cash reserves to pay back the loan. | |
| **14.6.16** | **Explain why the interest on the loan has been treated differently in the cash budget and on the Forecast Income Statement for July and August.** |
| The income statement shows the expense for each month while the budget shows the actual cash payments – the business is obviously intending to pay 2 months interest in July. | |
| **14.6.17** | **Explain why the Cash Budget shows an expected cash surplus of R118 838 for the 6 month period but the Forecast Income Statement shows an expected net income of R216 554.** |
| The cash budget shows the actual cash balance – the difference between cash inflows and cash outflows.<br>The Income Statement however, shows the profit which is a calculated by finding the difference between the income and expenses.<br>It is essential that learners understand that CASH and PROFIT are two very different concepts. | |

## TASK 14.7 ⌘💧💧💧 Multicon Ltd: Analysis and Interpretation of Cash budget

| 14.7.1 | **What is the planned interim dividend <u>per share</u> and why do you think the company has promised this to the shareholders?** |
|---|---|
| R400 000 ÷ R2 = 200 000 shares<br>28 000 ÷ 200 000 = 14 cents<br>Learners to come up with their own reasons but was probably an incentive to get them to buy shares in the new company. | |
| **14.7.2** | **Why is the company expecting to pay provisional tax if there is an expected cash deficit at various times during the budget period?** |
| Tax is calculated on profit and not the cash balance. (Cash and profit are two very different concepts). | |
| **14.7.3** | **When the company was formed it incurred preliminary (start-up) expenses of R48 000. Give 2 examples of what this figure could include.** |
| Promotion, prospectus printing, registration costs, legal costs, etc. | |
| **14.7.4** | **One of the directors is of the opinion that the bank overdraft could be totally avoided if all the stock is bought on credit. Do you agree?** |
| Learners to come up with their own opinions.<br>Buying on credit will delay payments which will assist with the overdraft initially but eventually these amounts will have to be paid and unless they have managed to acquire extra income they will still be back in the overdraft situation. | |

| 14.7.5 | **The directors are obviously relying on a large loan in September and they have planned to solve the overdraft problem by issue more shares in December. Do you agree with this strategy? Give reasons for your answers.** |
|---|---|

Learners to give their own opinions.
Selling shares does not result in extra costs as there is no interest or repayments so this will help the cash situation.
The interest on the loan and the overdraft need to be compared to determine which is the best option.

| 14.7.6 | **Calculate the expected credit sales for October.** |
|---|---|

Business maintains a fixed stock base of R180 000 and this is what is expected to be purchased each month if you look at the payments section.
Sales for October: COS + 50% = Total sales = 180 000 + 50% = R270 000
Total sales – Cash sales = Credit sales = 270 000 – 67 500 = **R202 500**

| 14.7.7 | **Are the expected collections from debtors satisfactory? Explain.** |
|---|---|

Only R101 250 was received in November of the Credit sales in October – debtors are taking longer than 30 days to pay their accounts.
Only 50% of the debtors are paying within 30 days.

| 14.7.8 | **Explain the directors' plans with regard to advertising over the forecast period.** |
|---|---|

They advertised extensively in September when they opened and then again in December for the festive / holiday season.
The other months were maintained at a constant rate to ensure that the customers are constantly reminded about the business and their products.

| 14.7.9 | **The employees are expecting an increase in wages at some time. When will this be and what is the expected % increase?** |
|---|---|

Wage increase in December: $^{4\,920}/_{41\,000}$ x 100 = **12%**

| 14.7.10 | **Give the directors advice on how they can improve the cash flow situation of the business.** |
|---|---|

Learners to give their own opinions.
Possible answers:
Encourage debtors to pay quicker, buy more on credit and less for cash, control the overheads, pay the fixed assets off over a number of months rather than spending R280 000 in one month, etc.

## TASK 14.8 Golden Boy General Dealers: Interpretation and problem solving

| 14.8.1 | **Calculate the missing figures (a) – (g) on the Cash Budget. Show workings for part marks.**<br>**Note: You are NOT required to calculate the missing figures shown by means of a '?'.** |
|---|---|

| | Workings | Answer |
|---|---|---|
| (a) | 336 000 – (a) = 22 000 | R314 000 |
| (b) | 22 000 + 8 800 = (b) | R30 800 |
| (c) | | R8 800 |
| (d) | -84 200 + 8 800 = (d)<br>See (c) above | -R75 400 |
| (e) | (e) = (b)<br>See (b) | R30 800 |
| (f) | (f) + 30 800 = 16 500<br>See (e) above | -R14 300 |
| (g) | (g) – 75 400 = -25 000 | R50 400 |

| 14.8.2 | **Briefly explain why it is important for a business to prepare a budget and what is the main purpose of a budget.** |
|---|---|

It is important for a business to prepare a budget as it is essential that the business plans and forecasts with regards to its liquidity and future cash flow.
A budget helps management to access what its expected bank balance will be and to see if it is expected to have liquidity / cash flow problems.
*Alternative answers possible*.
**Do not accept:** "Internal control"

| 14.8.3 | **Answer the following questions based on the information provided above:** |
|---|---|
| | **It is evident when comparing the amount budgeted for and the amount actually spent in November for "Repairs to Delivery Vehicles" that there were some unexpected repairs and, therefore, a large overspend.** |
| | **(a) Calculate the amount of the overspend on repairs to delivery vehicles.** |

53 000 – 1 000 = R52 000

**(b) State 3 strategies that the managerial accountant <u>used</u> in December to deal with this overspend. Also state any expected consequences for the business as a result of each of these decisions. You must quote relevant figures and or provide meaningful calculations to support your 3 suggestions.**

| | **Managerial Accountant's Strategy** | **Expected consequence(s) of this strategy.** |
|---|---|---|
| **Strategy 1** | Management halved the amount spent on the staff Christmas party.<br><br>Budgeted R 40 000 but only spent R20 000. | Staff may be de-motivated as they may feel that they are being punished for something that was out of their control and not their fault. |
| **Strategy 2** | Took out a loan from Help bank to assist with the shortage of cash and help pay for the unexpected repairs: R45 000 @ 12% p.a. | There will be interest on the loan that will need to be paid from January 20.3.<br>45 000 x $^{12}/_{100}$ x $^{1}/_{12}$<br>= R450 p.m. |
| **Strategy 3** | Delayed payments to creditors in December 20.2.<br><br>Nov credit purchases = R60 000;<br>i.e. 145 000 – 85 000 = R60 000<br><br>Amount that should have been paid to creditors in Dec 20.2:<br>60 000 x 0.95 = R57 000<br><br>Only paid half the amount that should have been paid to creditors in Dec 20.2:<br><br>57 000 ÷ 2 = R28 500 | Creditors will charge us interest on our overdue accounts.<br><br>We may have harmed our reputation with our suppliers as we have not complied with their credit terms. This may result in problems in the future when we want to order goods from our suppliers. |

| 14.8.4 | **Refer to the budget to determine:**<br>**(a) One expense that seems to have been well controlled.** |
|---|---|

Telephone account

| | |
|---|---|
| | **(b) One expense that concerns you and that needs some intervention by management. Also explain an <u>internal control measure</u> that you feel could be implemented in order to bring this budget line item under control in the future.** |
| Stationery and printing costs.<br>An internal control measure that you could implement in order to bring this budget line item under control.<br>All stationery orders and requests for stationery must be controlled by someone in authority.<br>Staff must sign for stationery they are issued and the amount of stationery issued to each staff member must be controlled and monitored.<br>Each staff member should be issued with a secret code for the photocopy machine so that management can monitor how many copies each person is making and in this way stop people using the photocopier for their own use.<br>*Alternative answers possible.* | |
| **14.8.5** | **Provide a possible explanation, (other than a general salary increase to staff), for each of the following:** |
| | **(a) Why the wages and salaries are expected to increase from R65 000 to R72 000 over the forecast period?** |
| Christmas bonuses awarded to staff.<br>Or overtime required as store needed to be open for longer hours during the Christmas season.<br>*Alternative answers possible.* | |
| | **(b) What could be the reason why there was an overspend on this budget line in December?** |
| Extra staff was required to help with Christmas rush period. Etc.<br>*Alternative answers possible.* | |
| | **(c) Calculate the % overspend that occurred for salaries and wages.** |
| $\frac{6\,120}{72\,000} \times \frac{100}{1} = 8\frac{1}{2}\%$ | |

## TASK 14.9 ⌘ The Trendy Store: Interpretation, Problem solving, Calculations

**PART A**

| | |
|---|---|
| **14.9.1** | **Explain why it is essential for the managerial accountant to prepare a Cash Budget. You must provide at least 3 different reasons in your answer.** |
| Budgets are used for planning purposes. Forecasting of expected cash flow of a business.<br>Assess future liquidity situation and determines whether the business will have enough cash available before committing itself to contracts and payment deadlines that they may not be able to honour.<br>Also useful in determining whether it may be necessary to arrange or apply for an additional overdraft facility from the bank. | |
| **14.9.2** | **Study the incomplete Budget provided below as well as the Additional information 1-4 below and calculate the missing figures (a) – (g) on the Cash Budget.<br>Do NOT calculate all the missing figures shown by means of a '?' on the Cash Budget.** |
| **(a)** 185 000 x 0.8 = R148 000 | |
| **(b)** 144 000 x 0.35 = R50 400 | |
| **(c)** 180 000 x 0.2 = 36 000<br>36 000 x 0.6 = 21 600<br>200 000 x 0.2 x 38% = 15 200<br>21 600 + 15 200 = R36 800 | |
| **(d)** 160 000 x 0.65 = 104 000<br>104 000 x 0.975 = R101 920 | |

| | | | |
|---|---|---|---|
| **(e)** | 500 x 12 months | = | R6 000 p.a. |
| | 6 000 ÷ 0.12 | = | R50 000 |
| | 50 000 – 20 000 | = | R30 000 |
| | 30 000 x $^{12}/_{100}$ x $^{1}/_{12}$ | = | R300 |
| **(f)** | 13 680 ÷ 1.14 | = | R12 000 |
| **(g)** | 14 495 - 15 730 | = | (R1 235) Overdraft |

| | |
|---|---|
| **14.9.3** | **According to the Cash Budget. The sales assistant of The Trendy Store is due for a salary increase on 1 August 20.9.** |
| | **(a) Do you think that she is likely to be satisfied with the proposed salary increase? Provide two different reasons to support your opinion.** |

Her salary only expected to increase by 5½% (this is below the current CPI) while manager's salary is expected to increase by 14%.
*Any valid point mentioned.*

| | |
|---|---|
| | **(b) Comment on what you think was the reason management decided on this particular salary increase. (i.e. why did they not decide on a different % increase?)** |

Sales have been decreasing over the past months (stated in question) and business is experiencing difficulties at present as a result of the weakening economy.
Sales assistant has underperformed and business does not expect to have cash available to pay higher salary.
*Any valid point mentioned.*

| | |
|---|---|
| **14.9.4** | **Refer to the Cash Budget and briefly explain what the plan is with regard to the Fixed Deposit on 1 August 20.9.** |

*Any valid explanation.*
A Fixed deposit of R20 000 will mature on 1 August 20.9.
The money will be deposited into the businesses current banking account.
Interest will be reduced accordingly.

| | |
|---|---|
| **14.9.5** | **It is evident from the proposed budget that The Trendy Stores plan to purchase additional computer equipment during the budget period.** |
| | **(a) Calculate the total expected cost price of this new computer equipment.** |

5 000 + (7 000 x 5) = 5 000 + 35 000 = R40 000

| | |
|---|---|
| | **(b) Calculate what % deposit of the total cost is required to be paid in July.** |

$^{5\,000}/_{40\,000}$ x 100 = 12½%

| | |
|---|---|
| **14.9.6** | **Briefly explain why the Cash Budget shows that equipment will be bought in the next few months. The accountant has not included depreciation as a line item on the Cash Budget for July and August.** |

Depreciation is not a flow of cash and therefore does not appear on the Cash Budget as it does not have any effect on the future Bank balance of the business.
Depreciation would appear on the Forecast Income Statement as an expense but not as a payment on the Cash Budget.

**PART B**

**At the end of July 20.9 you as the internal auditor do a comparison between the figures that were budgeted for and the actual figures.**
**Provide a point of advice to Mrs Mchunu in respect of each of the following:**

- **Change in Consumable stores and Stationery figures:**

The internal auditor needs to ensure that internal control procedures are put into place in order to ensure that there is less wastage of consumable stores / stationery.
He also needs to determine whether the staff are taking any of these items home for their own use.
A record should be kept of what stationery / consumable stores are being taken by each staff member.
By monitoring this closely it will be possible to see why there was such a large over spend on this budget line. (R 5 000 overspend in one month) (45% overspend).

- **Change in Advertising figures:**

*Possible answers:*
- R 4000 was budgeted but only R 1 600 was spent.
- This could have been why the total sales decreased in July.
- Continuous advertising is important for continuous sales.

## TASK 14.10 Sue's Cultural Dress Shop: Interpretation, Problem solving, Calculations

| | |
|---|---|
| **14.10.1** | **Is Sue's Cultural Dress Shop in a good or bad liquidity position on 28 February 20.9? Comment by quoting appropriate liquidity ratios in your answer.** |

Current ratio = [170 000 + 60 000 + 62 000] : [58 182 + 100 000] = 1.8 : 1
Acid test ratio = [60 000 + 62 000] : [58 182 + 100 000] = 0.8 : 1
Current ratio is almost twice current liabilities; the acid test ratio is almost equal to current liabilities.
She should not experience any serious liquidity problems.

| | |
|---|---|
| **14.10.2** | **Calculate the following as at 28 February 20.9.** |
| | **(a) Period of stock on hand (in days).** |

$$\frac{170\,000}{768\,000} \times \frac{365}{1} = \underline{\textbf{81 days}}$$

| | |
|---|---|
| | **(b) Average payment period by debtors (in days).** |

$$\frac{\frac{1}{2}[60\,000 + 76\,000]}{576\,000} \times \frac{365}{1} = \underline{\textbf{43 days}}$$

| | |
|---|---|
| | **(c) Average creditors payment period (in days).** |

$$\frac{\frac{1}{2}[58\,182 + 78\,182]}{768\,000} \times \frac{365}{1} = \underline{\textbf{32 days}}$$

| | |
|---|---|
| **14.10.3** | **Comment briefly on your calculations in 2 above. Are these periods appropriate for Sue's Dress Shop?** |

Stock levels are reasonable – it seems that Sue has taken changes in fashions into account when ordering stock.
Debtors are slow in paying –they are exceeding the 30 day limit offered to them.
Corrective action is necessary – e.g. charging interest on overdue accounts, sending reminders, offering incentives for early settlement, etc.
Creditors are being paid too soon – she should take advantage of the 60 days allowed by creditors – this would impact favourably on working capital.

**14.10.4 SUE'S CULUTRAL DRESS SHOP**
**CASH BUDGET FOR THE THREE MONTHS ENDED 31 MAY 20.9**

| **CASH RECEIPTS [A]** | **March** | **April** | **May** | **TOTAL** |
|---|---|---|---|---|
| Cash sales | 105 600[1] | 48 000[2] | 48 000[2] | 201 600 |
| Debtors collection | 30 000 | 90 192 | 65 376 | 185 568 |
| **Total Receipts** | **135 600** | **138 192** | **113 376** | **387 168** |
| **CASH PAYMENTS [B]** | | | | |
| Payments to creditors | 58 182 | 140 800 | 64 000 | 262 982 |
| Other fixed operating expenses: | | | | |
| Overhead expenses [180 000 ÷ 12] | 15 000 | 15 000 | 15 000 | 45 000 |
| Other payments: | | | | |
| Interest on loan | 2 800[3] | 2 800[3] | 1 466[4] | 7 066 |
| Drawings | 12 000 | 12 000 | 12 000 | 36 000 |
| Loan repayment | | | 100 000 | 100 000 |
| Relocation of premises | | 30 000 | | 30 000 |
| **Total Payments** | **87 982** | **200 600** | **192 466** | **481 048** |
| Cash surplus [A – B] | 47 618 | [62 408] | [79 090] | [93 880] |
| Bank: opening balance | 56 000 | 103 618 | 41 210 | 56 000 |
| Bank: closing balance | **103 618** | **41 210** | **37 880** | **37 880** |

[1] 1 152 000 + 10% x $^{1}/_{6}$ ÷ 2
[2] 1 152 000 + 10% x $^{5}/_{6}$ ÷ 11 ÷ 2
[3] 100 000 + 110 000 x 16% ÷ 12
[4] 110 000 x 16% ÷ 12

**Working:**
**DEBTORS COLLECTION SCHEDULE: MARCH – MAY 20.9**

| | **March** | **April** | **May** |
|---|---|---|---|
| February [50% x 60 000] | 30 000 | 30 000 | |
| March [60% x 52 800 – 5%; 36% x 52 800] | | 60 192 | 38 016 |
| April [60% x 24 000 – 5%] | | | 27 360 |
| **Receipts from debtors** | **30 000** | **90 192** | **65 376** |

**PAYMENT TO CREDITORS: MARCH – MAY 20.9**

| | **March** | **April** | **May** |
|---|---|---|---|
| Cost of sales for February | 58 182 | | |
| Cost of sales for March [105 600 x 2 x $^{100}/_{150}$] | | 140 800 | |
| Cost of sales for April [48 000 x 2 x $^{100}/_{150}$] | | | 64 000 |
| **Payments to creditors** | **58 182** | **140 800** | **64 000** |

| **14.10.5** | **Quote from the Cash Budget in answering the following questions:** |
|---|---|
| | **(a) Is Sue's Cultural Dress Shop likely to experience liquidity problems within the next 3 months? Explain.** |
| Learners to express their own opinions.<br>The cash balance is expected to decrease continually and the bank is expected to move into an overdraft. | |
| | **(b) Sue is hoping to place a full-page colour advertisement in the local press for the entire month of March and she is hoping to open a second shop in Harrismith in June. In your opinion, should she continue to pursue her plans? What advice would you offer to solve her cash flow problems?** |
| Learners to give their own advice. | |

## TASK 14.11 The Berea Hockey Club: Report, Analysis & Interpretation

**Suggested marking rubric:**

| Criteria | Level 1 | Level 2 | Level 3 | Level 4 |
|---|---|---|---|---|
| **Discussion on problem areas under receipts.** | Poor identification of problem areas. | Some problem areas are identified. | Good identification and discussion of problem areas. | Excellent identification and discussion of problem areas showing great insight. |
| **Discussion on problem areas under payments.** | Poor identification of problem areas. | Some problem areas are identified. | Good identification and discussion of problem areas. | Excellent identification and discussion of problem areas showing great insight. |
| **Advice.** | Poor advice given. | Some advice not relevant to discussion on problem areas. | Good advice based on discussion of problem areas. | Excellent advice based on discussion of problem areas. |

## TASK 14.12 Internal audit and control

| 14.12.1 | **Compare the projected and actual figures. Identify three items that you are most concerned about. State the items and the figures and suggest ways to improve the situation.** |
|---|---|

**Telephone:**
Overspent in both months: R1 650 in November and R1 710 in December.
Although some of this overspend may be as a result of the additional sales and therefore additional calls to customers and clients it may also be as a result of staff making personal calls.
Tighter control needs to be exercised over this expense.
If staff are using the business phone for private calls they must pay for these calls.

**Trading stock deficit:**
Actual figures are much higher in both months: R5 400 in November and R8 550.
Only half the amount budgeted for security during November and December was actually spent.
This has resulted in customers / staff shoplifting and this resulted in large trading stock deficits.
The additional amounts in both months are greater than what would have been spent on additional security.

**Bad debts:**
Bad debts are much higher in both months than what were expected.
It appears that the increase in sales over the budgeted period has resulted in more credit customers defaulting.
Better screening of debtors needs to be done before customers are allowed to buy on credit.

**Note**:
Although the actual Advertising expense is much higher than the budgeted amount, this is not really a problem because the extra advertising has resulted in much higher sales and therefore it has been effective.
The additional amount spent on advertising, R27 000 has brought in R37 000 additional sales over the budgeted period.

| 14.12.2 | **List two expenses that appear to have been over-budgeted for and provide advice with regard to this.** |
|---|---|

**<u>Sundry Operating Expenses</u>:**
In both months there has been a large under spend suggesting that too much was budgeted for this line item.
Would advise that this line item be broken down into more specific line items so that more accurate budgeting can be done.
The under spend over these two months should be reallocated over the next forecast period to line items that have been over spend during November and December in order to "balance the budget".
E.g. Telephone, motor vehicle expenses, etc.

**<u>Training of staff</u>:**
Training of staff has also been over budgeted for.
It probably was not a good idea to budget for training of sales staff in December as the store was much too busy over this period (extra sales) to have sales staff going off for training over this period.
This is possibly why no training took place in December.
This budget line was also over budgeted for in November suggesting that too much is being budget for this line item.

| 14.12.3 | **Provide two reasons as to why you think the sales assistant is likely to be dissatisfied over this forecast period. Provide figures to support your answer.** |
|---|---|

- Sales assistant is likely to be dissatisfied over this forecast period because his / her Christmas bonus is only 3% of his / her salary whereas the Store manager is receiving a Christmas bonus of 18% of his / her salary. Why is there such a big difference between the bonuses being granted?
- The sales assistant would have been the person who had helped make the additional sales over this budget period but he / she does not seem to be recognised for their additional efforts. The sales assistant's additional efforts do not seem to be appreciated by management. This is likely to de-motivate the sales assistant.

## TASK 14.13 Assignment (Group and Individual Aspects)

This activity can be completed as part of the learners' assignment / project for CASS.

**Suggested marking rubric:**

| Criteria | Level 1 | Level 2 | Level 3 | Level 4 |
|---|---|---|---|---|
| **Knowledge of concepts.** | Poor knowledge of concepts. | Some concepts are understood. | Good knowledge of concepts. | Excellent knowledge of concepts showing insight. |
| **Preparation of proposal.** | Poor proposal made. | Some aspects of the proposal were acceptable. | Good proposal made. | Excellent proposal made. |
| **Preparation of budget.** | Poor budget presented. | Aspects of the budget acceptable. | Good budget presented. | Excellent budget presented. |
| **Handling of different scenarios.** | Has little knowledge of how the scenarios will affect the budget. | Shows some understanding but lacks depth. | Good understanding of the different scenarios shown. | Excellent understanding shown, showing great insight. |
| **Research of government budget.** | Poor research and presentation. | Aspects adequately covered. | Good research and presentation. | Excellent research and presentation. |

**CHECKLIST:**

| Skills | Yes – proficient | Requires more attention | Complete |
|---|---|---|---|
| Can complete a Cash Budget. | | | |
| Can complete the Debtors Collection Schedule. | | | |
| Can complete the Creditors Payment Schedule. | | | |
| Can complete the Projected Income Statement. | | | |
| Can analyse and interpret a Cash Budget. | | | |
| Can analyse and interpret the Debtors Collection Schedule. | | | |
| Can analyse and interpret the Creditors Payment Schedule. | | | |
| Can analyse and interpret the Projected Income Statement. | | | |
| Discuss control measures. | | | |
| Ability to use budgets for effective control over expenses. | | | |

# MODULE 15
# REVISION

## COMPANIES

## TASK 15.1 ⌘ Jozini Limited: Balance Sheet, Interpretation

**15.1.1 JOZINI LIMITED**
**BALANCE SHEET AS AT 30 JUNE 20.8**

| **ASSETS** | **Note** | |
|---|---|---|
| NON-CURRENT ASSETS | | 2 022 100 |
| Fixed assets | | 1 847 100 |
| Investments [240 000 – 65 000] | | 175 000 |
| CURRENT ASSETS | | 1 830 900 |
| Inventories (all Trading stock) | | 1 298 900 |
| Trade & other receivables [434 000 + 4 000 + 27 000] | | 465 000 |
| Cash & cash equivalents [2 000 + 65 000] | | 67 000 |
| **TOTAL ASSETS** | | **3 853 000** |
| **EQUITY & LIABILITIES** | | |
| ORDINARY SHAREHOLDERS EQUITY [380 000 x R6.60] | | 2 508 000 |
| Ordinary share capital [380 000 x R5] | | 1 900 000 |
| Retained income | | 608 000 |
| NON-CURRENT LIABILITIES | | 734 700 |
| Loan from Ulundi Mortgages [687 600 + 89 100 – 42 000] | | 734 700 |
| CURRENT LIABILITIES | | 610 300 |
| Trade & other payables [285 300 + 36 000] | | 321 300 |
| Bank overdraft | | 37 000 |
| Current portion of loan | | 42 000 |
| Shareholders for dividends | | 210 000 |
| **TOTAL EQUITY & LIABILITIES** | | **3 853 000** |

| **15.1.2** | **The audit report forms an important part of the annual report of a company. Briefly explain:** |
|---|---|
| | • **The role played by the independent auditor.** |
| The independent auditor is acting for the shareholders who are not involved in controlling the business.<br>He expresses an opinion to them on the fair presentation of the financial statements.<br>He does checks on a test basis in order to express this opinion. | |
| | • **Why would you want to see an unqualified audit report for this company?** |
| An unqualified report would indicate that no irregularities were revealed by his tests. | |
| **15.1.3** | **Calculate the following financial indicators (comparative figures for the previous year are shown in brackets):** |
| | • **Acid-test ratio** **20.7 (0.7 : 1)** |
| 532 000 : 610 300 = **0.9 : 1** | |
| | • **Turnover rate of stock (6 times)** |
| 5200 000 ÷ 1 298 900 = **4 times** | |

| | |
|---|---|
| | • **Debt / equity ratio (0.4 : 1)** |
| 734 700 : 2 508 000 = **0.3 : 1** | |
| | • **Earnings per share (150 cents)** |
| Net profit after tax = 177 000 x $^{100}/_{30}$<br>590 000 ÷ 380 000 = **155.3 cents** | |
| | • **Return on shareholders equity (16%)** |
| $\frac{413\,000}{\frac{1}{2}(2\,508\,000 + 1\,752\,000)} \times \frac{100}{1}$<br>$\frac{413\,000}{2\,130\,000} \times \frac{100}{1}$<br>= **19.4%** | |
| **15.1.4** | **Comment on the liquidity of the company. Should the directors be satisfied with the situation? Explain briefly, quoting financial indicators from the question.** |
| They should not be entirely satisfied with the liquidity.<br>Current ratio is quite high at 3 : 1.<br>Acid-test ratio is acceptable at 0.9 : 1 and this has improved slightly from 0.7 : 1 although the lack of available cash is a concern (the R65 000 will be available only in 6 months' time).<br>The low rate of stock turnover is a concern.<br>This has declined.<br>The company appears to be overstocked. | |
| **15.1.5** | **Comment on the debt / equity ratio. Should the directors make use of loans or should they use another method to raise funds? Explain briefly, quoting financial indicators from the question.** |
| They should be satisfied with the debt / equity ratio.<br>There is low risk with a ratio of 0.3 : 1 (this has declined from 0.4 : 1).<br>ROTCE of 27% exceeds the rate of interest on loans which leads to positive gearing. | |
| **15.1.6** | **Should the shareholders be satisfied with the results for 20.8? Consider returns, earnings, dividends and share price? Explain briefly, quoting financial indicators from the question.** |
| ROSHE has improved from 16% to 19.4%.<br>This exceeds the returns on alternative investments.<br>EPS has improved slightly from 150c to 155.3c.<br>The company paid out more than half their earnings in the form of dividends (110 c).<br>The shareholders should be satisfied with the results, although earnings have been diluted by the new shares issued.<br>They should aim at even better EPS next year by using the proceeds of the new shares effectively.<br>The net asset value of the share is 660c which represents a significant improvement from the previous year $^{1\,572\,000}/_{300\,000}$ x 100 = 524c).<br>The share price is currently lower than the NAV. The reasons for this should be investigated.<br>The market obviously is not aware of the potential of the company.<br>The shares should be valued at more than 660c on the JSE. | |

## TASK 15.2 ⌘ Report on a public company

**RUBRIC FOR REPORT:**

**Grade 12** **NAME OF LEARNER: _____** **CLASS:_____**

| Criteria | 0 Marks | 1 Mark | 2 Marks | 3 Marks | 4 Marks | 5 Marks | Weight | Total |
|---|---|---|---|---|---|---|---|---|
| Shareholders' returns: Comparison on EPS or DPS to Equity Value (NAV). | No valid explanation on any % return or its extent. | Poor explanation on **one** % return and does not identify the extent. | Adequate explanation on **one** % return and its extent in comparison to NAV. | Satisfactory explanation on **both** % returns & their extent in comparison to NAV. | Good & complete explanation on **both** % returns and their extent in comparison to NAV. (EPS 50% of NAV & DPS 25% of NAV). | Excellent & complete explanation on **both** % returns and their extent in comparison to NAV. (EPS 50% of NAV & DPS 25% of NAV). | X2 | |
| Retained income: Comparison of DPS to EPS. | No valid explanation on Retained income. | Poor comment on retention of income. Does not identify how this affects the company, or does not compare DPS & EPS. | Adequate comment on retention of income. Does not identify how this affects the Company. Compares DPS to EPS without pay-out rate. | Satisfactory comment on retention of income. Does not identify how this affects the Company, or does not compare DPS & EPS. | Good comment on retention of income & how this affects the company. Compares DPS to EPS & identifies consistent pay-out without its extent. | Excellent comment on retention of income & how this affects the company. Compares DPS to EPS & identifies consistent pay-out and its extent. (60%). | X2 | |
| Productivity: Comparison of increase in EPS to increase in sales and number of employees. | No valid comment on productivity. | Poor comment on productivity. | Adequate comment on productivity. Increase in sales identified. | Satisfactory comment on productivity. Increase in sales identified but not well related to other factors. | Good comment on productivity. Increase in sales compared to increase in work-force or increase in profits (EPS). | Excellent comment on productivity. Increase in sales compared to increase in work-force or increase in profits (EPS). | X2 | |

| Criteria | 0 Marks | 1 Mark | 2 Marks | 3 Marks | 4 Marks | 5 Marks | Weight | Total |
|---|---|---|---|---|---|---|---|---|
| Share performance: Comparison of NAV to share price. | No valid comment on share performance. | Comment on market price of shares but **not compared to NAV. Poor** identification of demand for the shares. | Comment on market price of shares but **not compared to NAV. Adequate** identification of demand for the shares. | Comparison of market price of shares to NAV, but only **satisfactory** identification either of demand for the shares **or** a valid reason for the difference. | Comparison of market price of shares to NAV, & **accurate** identification either of demand for the shares **or** a valid reason for the difference. | Comparison of market price of shares to NAV, but only **satisfactory** identification either of demand for the shares **and** a valid reason for the difference. | X2 | |
| Conciseness and integration of comments. | No valid comments provided. | Few comments provided which are concise or relevant | Some comments provided but not always concise or relevant. | Comments generally concise and relevant, with some exceptions. | Most comments concise and relevant. | All comments concise and relevant. | X1 | |
| Command of interest of the reader – headline and communication style. | Not interesting at all. | Valid comments provided but lacks logic. Difficult to understand | Logical comments. Interesting some of the time. Adequate construction. | Generally interesting and logical. Satisfactory construction. | Enjoyed reading this – logical and creative. Good construction | Captivated my interest at all times – logical and very creative. Excellent construction. | X1 | |
| | | | | | | | **Total** | **/50** |

## TASK 15.3 ⌘ Formosa Ltd: Company entries & Accounting Equation

**15.3.1**

| No. | General Ledger | | Amount | Effect on Accounting Equation | | |
|---|---|---|---|---|---|---|
| | Account debited | Account credited | | Assets | Equity | Liabilities |
| **E.g.** | Stationery | Creditors control | R700 | 0 | – | + |
| **1.** | Bank | SARS (Income tax) | R56 000 | ± | 0 | 0 |
| **2.** | Shareholders for dividends | Bank | R660 000 | – | 0 | – |
| **3.** | Dividends on ord. shares | Bank | R450 000 | – | – | 0 |
| **4.** | Bank | Ordinary share capital | R3 640 000 | + | + | 0 |
| **5.** | SARS (Income tax) | Bank | R1 020 000 | ± | 0 | 0 |
| **6.** | Directors fees | Bank | R3 630 000 | – | – | 0 |
| | Directors fees | Expenses payable | R330 000 | 0 | – | + |
| **7.** | Dividends on ord. shares | Shareholders for dividends | R1 330 000 | 0 | – | + |
| **8.** | Income tax | SARS (Income tax) | R1 056 000 | 0 | – | + |

| **15.3.2** | **Provide the amounts that would be shown in the Cash Flow Statement for:** |
|---|---|
| | • **Dividends paid** |
| 660 000 + 450 000 = **R1 110 000** | |
| | • **Income tax paid** |
| 1 020 000 – 56 000 = **R964 000** | |

**15.3.3**

**GENERAL LEDGER OF FORMOSA LTD**
**FINAL ACCOUNTS SECTION**

**Dr** **Appropriation** **F3** **Cr**

| 20.7 | | | | | 20.7 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| April | 30 | Div. on ord. shares | | 1 780 000 | April | 30 | Profit & loss | | 3 300 000 |
| | | Income tax | | 1 056 000 | | | | | |
| | | Retained income | | 464 000 | | | | | |
| | | | | **3 300 000** | | | | | **3 300 000** |

| **15.3.4** | **Net asset value per share:** |
|---|---|
| | • **Calculate the net asset value per share on 30 April 20.7.** |
| Shares at issued price: 3 000 000 shares of R4.00 each = R12 000 000<br>Additional shares issued: 800 000 shares at R4.55 each = R3 640 000<br>Retained income = R884 000<br>Shareholders equity = 12 000 000 + 3 640 000 + 884 000 = R16 524 000<br>No. of shares = 3 800 000<br>Net asset value per share = $\frac{16\,524\,000}{3\,800\,000}$ x 100c = **434.8 cents** | |
| | • **You are one of the new shareholders who bought shares on 1 November 20.7. Would you be happy with the price you paid? Explain briefly, providing two points. Quote figures from the question to support your answer.** |
| Yes / No.<br>Compare NAV to 455 cents paid for the share.<br>Consider the final dividend earned this year of 35 cents per share.<br>Consider effect on share price – increase from 390 cents to 441 cents. | |

| 15.3.5 | **Directors fees:** |
|---|---|
| | • **Do you feel that the directors deserve the fees they are earning? Explain briefly. Quote figures from the question to support your answer.** |
| Yes / No.<br>Total directors fees are R3 960 000.<br>Net profit is R3 300 000.<br>Directors are earning more than half the net profit ($^{3\ 960}/_{7\ 260}$ x 100 = 54%). | |
| | • **Provide two suggestions for setting directors fees each year, and provide a reason for each suggestion.** |
| Form a remuneration committee – to ensure transparency.<br>Link to profit earned – to ensure the directors are paid for achievements.<br>Compare to directors fees of other similar companies – to ensure fairness. | |

## TASK 15.4⌘ MH Ltd.: Calculations, Interpretation

| 15.4.1 | **What final dividends would you recommend in order to satisfy the shareholders and the company management?** |
|---|---|
| • Net profit after tax: R960 000; 960c per share.<br>• Interim dividends already paid: R500 000; 500c per share.<br>• Maximum dividends should be: R460 000; 460c per share.<br>• But cash on hand: R200 000 – possibly negotiate an overdraft.<br>• Dividends are lower than previous year (R750 000); this will have a further negative effect on share price.<br>Learner may express opinion, e.g. ensure final dividends are at least 250c or 450c per share. | |
| **15.4.2** | **Is the negative attitude of the shareholders towards your re-appointment justified? Provide certain figures/ratios/percentages to support your answer.** |
| • Low return on OSE: 9.6%.<br>• Probably a low return on total capital employed as interest is very high, and probably a higher debt/equity ratio which increases financial risk.<br>• Sales have increased 20% yet final profit has dropped 21%.<br>• Extra loans raised – this increases risk.<br>• Directors fees have increased by 66% - now exceed normal salaries (up 5%). | |
| **15.4.3** | **How would you as CEO solve the problems regarding your re-appointment and the share price? Provide three recommendations.** |
| • Apply principles of King Code – transparency, accountability, etc.<br>• Establish a remuneration committee to assess directors' fees, salary & wage increases.<br>• Three-year plan to get the company back to previous profitability – plan to reduce loans and interest.<br>• Increased sales imply sustainability.<br>Various other valid suggestions also acceptable. | |

## TASK 15.5 Corporate investment problem & decision

**Note to Teacher:**

A wide variety of responses is expected. The object of this task is to for learners to understand that investment decisions such as this are not an exact science. The final decision might depend on attitudes to risk, profitability, etc. The following rubric will assist in marking.

| Criteria | Expected responses | Level 1<br>1 mark | Level 2<br>2 marks | Level 3<br>3 marks | Level 4<br>4 marks | Level 5<br>5 marks | Weight | Score |
|---|---|---|---|---|---|---|---|---|
| Mark-up% | A high mark-up % does not necessarily generate the highest gross profit. This depends on response of customers to prices. It appears Eagle is the most successful in this regard. | | | | | | | /5 |
| Operating effectiveness | Sparrow appears to be controlling operating expenses the best (9% on sales), which leads to the highest net profit % on sales. However, remember that Sparrow has the highest sales, so these figures could be misleading when comparing one company to another. | | | | | | | /5 |
| Control of working capital (liquidity) | High liquidity ratios are not necessarily better than low ratios. High ratios could mean too much money tied up in stock, debtors and cash which is not earning a return for the company. Very low ratios could lead to liquidity problems. Mynah could be regarded as the most effective in this regard. | | | | | | X2 | /10 |
| Effectiveness of gearing | Eagle has the most risky debt/equity ratio, but because the ROTCE is greater than the interest rate on loans, they are gearing up net profits (refer to the module on ratio analysis for more information on this if necessary). Should ROTCE be less than the interest rate on loans, then Eagle will have a problem. However, this is not a problem at present. | | | | | | X2 | /10 |
| Returns to shareholders | Eagle has the best % return due to the gearing effect. Also their earnings are almost half the par value of the share, and they are paying out more than 70% of their earnings in the form of dividends at present. They also have a very good NAV which affects the market value of the share. Sparrow has a relatively low % return, although it is still good (22%). Their dividends are low. | | | | | | X2 | /10 |
| Number of shares that can be bought for R200 000 | Eagle: R200 000 ÷ 450c = approx. 44 400 shares, i.e. 11% shareholding<br>Sparrow: R200 000 ÷ 420c = approx. 47 600 shares, i.e. 24% shareholding<br>Mynah: R200 000 ÷ 175c = approx. 114 200 shares, i.e. 13% shareholding | | | | | | | /5 |
| **FINAL CHOICE** | Depends on which criteria are most highly rated by the learners. It will be interesting to compare choices of different students after completing this Task. This category is for the final decision and overall impression. | | | | | | | /5 |
| | **FINAL MARK** | **/50** | | | | | | |

# TASK 15.6 Sandile & Shakira: Company vs Partnership

**15.6.1** **GENERAL LEDGER OF SANDILE & SHAKIRA**
**FINAL ACCOUNTS SECTION**

**Dr** **Appropriation** **F3** **Cr**

| 20.6 | | | | | 20.6 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Partners salaries | | 200 000 | Feb | 28 | Profit & loss a/c | | 334 000 |
| | | Interest on capital | | 54 000 | | | | | |
| | | Current a/c: Sandile | | 48 000 | | | | | |
| | | Current a/c: Shakira | | 32 000 | | | | | |
| | | | | **334 000** | | | | | **334 000** |

**15.6.2** **Calculate the % return earned by the partnership as a whole.**

334 000 x 100 = **33.4%**
1 000 000 1

**15.6.3** **Calculate the amount earned and drawn by Sandile during the year ended 28 February 20.6.**

Amount earned by Sandile = 100 000 + 32 400 + 48 000 = R180 400
Drawings = **R180 400**

**15.6.4** **Calculate and comment briefly on the return earned by Sandile for the year ended 28 February 20.6.**

180 400 x 100 = **30.6%**
590 000 1
A good return compared to alternatives, but it is before tax and it includes salary.

**15.6.5** **GENERAL LEDGER OF SANDILE & SHAKIRA**
**FINAL ACCOUNTS SECTION**

**Dr** **Appropriation** **F3** **Cr**

| 20.6 | | | | | 20.6 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Income tax | | 72 000 | Feb | 28 | Profit & loss | | 240 000 |
| | | Div. on ord. shares | | 100 800 | | | | | |
| | | Retained income | | 67 200 | | | | | |
| | | | | **240 000** | | | | | **240 000** |

**15.6.6** **Calculate and comment on the % return earned by the company in its first year.**

168 000 x 100 = **14%**
1 200 000 1
An above average return compared to alternatives

**15.6.7** **Calculate the Earnings per share (EPS) and Dividends per share (DPS) for the year ended 28 February 20.7.**

EPS:
168 000 x 100c = **70c**
240 000

DPS:
100 800 x 100c = **42c**
240 000

| 15.6.8 | **Calculate the Net asset value per share on 28 February 20.7.** |
|---|---|
| 1 200 000 + 67 200 x 100c = **528c**<br>240 000 | |

| 15.6.9 | **Calculate the amount earned by Sandile from the company during the year ended 28 February 20.7.** |
|---|---|
| 120 000 + (42c x 118 000 shares = 49 560) = **R169 560** | |

| 15.6.10 | **In your opinion, has Sandile made the right decision by converting the business which he had formed, into a company? Explain, quoting evidence from the question.** |
|---|---|
| Opinion: Probably YES.<br>He now needs to pay tax on directors fees – 35% of R120 000 = R42 000 (dividends are also taxable but there are tax concessions).<br>His earnings from the partnership still need to be taxed, i.e. after tax he would have earned R180 400 less 35% = R117 260.<br>He is earning on the capital appreciation of his shares: NAV of shares is now R5.28 – gain is tax-free.<br>Also – consider sharing profits with a 3rd person – he now has a 49% share (previously 60%) in the business ($^{118\ 000}/_{240\ 000}$ x 100) – loss of control. | |

## TASK 15.7 Booma Ltd: Dividends, Tax and buy-back of shares

**GENERAL LEDGER OF BOOMA LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **ORDINARY SHARE CAPITAL** **B1** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.5 | | | | | 20.4 | | | | | |
| Aug | 31 | Bank | CPJ | 1 530 000 | Sep | 1 | Balance | b/d | 750 000 |
| | | [90 000 x 17.00] | | | 20.5 | | | | |
| | | Balance | c/d | 920 000 | Mar | 1 | Bank | CRJ | 1 700 000 |
| | | | | **2 450 000** | | | | | **2 450 000** |
| | | | | | 20.5 | | | | |
| | | | | | Sep | 1 | Balance | b/d | 920 000 |

**RETAINED INCOME** **B2**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.5 | | | | | 20.4 | | | | |
| Aug | 31 | Bank | CPJ | 675 000 | Sep | 1 | Balance | b/d | 2 630 000 |
| | | [90 000 x 7.50] | | | | | | | |
| 20.4 | | | | | | | | | |
| Oct | 31 | Appropriation | GJ | 145 500 | | | | | |
| | | Balance | c/d | 1 809 500 | | | | | |
| | | | | **2 630 000** | | | | | **2 630 000** |
| | | | | | 20.5 | | | | |
| | | | | | Sep | 1 | Balance | b/d | 1 809 500 |

**SARS – INCOME TAX** **B4**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.4 | | | | |
| Sep | 15 | Bank | CPJ | 35 000 | Sep | 1 | Balance | b/d | 35 000 |
| 20.5 | | | | | 20.5 | | | | |
| Feb | 28 | Bank | CPJ | 210 000 | Aug | 31 | Income tax | GJ | 438 000 |
| Aug | 31 | Bank | CPJ | 250 000 | | | Balance | c/d | 22 000 |
| | | | | **495 000** | | | | | **495 000** |
| 20.5 | | | | | | | | | |
| Sep | 1 | Balance | b/d | 22 000 | | | | | |

**NOMINAL ACCOUNTS SECTION**

**Dr** **DIVIDENDS ON ORDINARY SHARES** **N11** **Cr**

| 20.5 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Bank | CPJ | 187 500 | Oct | 31 | Appropriation | GJ | 1 167 500 |
| | | [250 000 x 75c] | | | | | | | |
| Oct | 31 | Shareholders for dividends | GJ | 980 000 | | | | | |
| | | [350 000 x 280c] | | | | | | | |
| | | | | **1 167 500** | | | | | **1 167 500** |

**FINAL ACCOUNTS SECTION**

**APPROPRIATION ACCOUNT** **F3**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Oct | 31 | Income tax | GJ | 438 000 | Oct | 31 | Profit and loss | GJ | 1 460 000 |
| | | Dividends on ordinary shares | GJ | 1 167 500 | | | Retained income | GJ | 145 500 |
| | | | | **1 605 500** | | | | | **1 605 500** |

## TASK 15.8 Glenco Limited: Income Statement, Fixed assets, Share capital & Retained income

**15.8.1** **GENERAL LEDGER OF GLENCO LIMITED**

**NOMINAL ACCOUNTS SECTION**

**Dr** **Asset Disposal** **N** **Cr**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Equipment | GJ | 44 000 | June | 30 | Acc dep on equipment [11 000 + 3 300] | GJ | 14 300 |
| | | | | | | | Bank | CRJ | 3 200 |
| | | | | | | | Loss on disposal of asset | GJ | 26 500 |
| | | | | **44 000** | | | | | **44 000** |

**15.8.2 GLENCO LTD**
**INCOME STATEMENT (STATEMENT OF COMPREHENSIVE INCOME)**
**FOR YEAR ENDED 30 SEPTEMBER 20.9**

| | |
|---|---|
| Sales (10 880 000 – 24 800 – 38 400) | 10 816 800 |
| Cost of sales (5 240 000 – 25 600) | (5 214 400) |
| **Gross profit** | 5 602 400 |
| **Other operating income** | 591 040 |
| Fee income (454 220 – 3 000) | 451 220 |
| Rent income (138 920 – 20 240) | 118 680 |
| Bad debts recovered | 2 400 |
| Provision for bad debts adjustment (5 700 – 5 360) | 340 |
| Trading stock surplus [1 960 000 – (1 916 000 + 25 600)] | 340 |
| **Gross operating income** | 6 193 440 |
| **Operating expenses** | (5 039 540) |
| Salaries and wages | 655 340 |
| Discount allowed | 3 600 |
| Insurance | 44 000 |
| Sundry expenses (157 000 – 12 800 – 83 000) | 61 200 |
| Directors fees (1 560 000 + 1 560 000 + 650 000) | 3 770 000 |
| Audit fees | 214 800 |
| Consumable stores | 96 000 |
| Depreciation (3 300 + 71 600 + 83 200 + 10 000) | 168 100 |
| Loss on sale of asset | 26 500 |
| **Operating profit** | 1 161 240 |
| Interest income | 8 100 |
| **Profit before interest expense** | 1 162 000 |
| Interest expense | (72 000) |
| **Profit before tax** | 1 090 000 |
| Income tax | (305 200) |
| **Net profit after tax** | **784 800** |

**WORKINGS:**
**Rent:**
3y + (12 x 1.1y) = 138 920; 3y + 12.1y = 138 920; 15.1y = 138 920; y = 9 200; 1.1y = 10 120
**Provision for bad debts:**
Debtors = 146 200 + 2 400 + 41 400 = R190 000; 5% = R9 500
**Trading stock surplus:**
1 916 000 + 25 600 - 1 960 000 = R18 400

**15.8.3 NOTES TO THE FINANCIAL STATEMENTS**

- **Fixed/Tangible Assets**

| | Land and Buildings | Vehicles | Equipment |
|---|---|---|---|
| Carrying value at beginning of year | 7 011 000 | 416 000 | 612 000 |
| Cost | 7 011 000 | 580 000 | 760 000 |
| Accumulated depreciation | - | (164 000) | (148 000) |
| **Movements** | 983 000 | (96 400) | (104 600) |
| Additions at cost | 983 000 | 300 000 | - |
| Disposals at carrying value | - | - | (29 700) |
| Depreciation | - | (93 200) | (74 900) |
| Carrying value at end of year | **7 994 000** | **622 800** | **507 400** |
| Cost | 7 994 000 | 880 000 | 716 000 |
| Accumulated depreciation | - | (257 200) | (208 600) |

- **ORDINARY SHARE CAPITAL**

| | |
|---|---|
| **Authorised:** | |
| 1 500 000 ordinary shares | |
| **Issued:** | |
| 1 000 000 ordinary shares in issue at the beginning of the year | 5 000 000 |
| 250 000 ordinary shares issued during the year at 700 cents each | 1 750 000 |
| 30 000 shares repurchased on 30 Sept 20.9 (average price 540 cents) | (162 000) |
| 1 220 000 ordinary shares in issue at the end of the year | **6 588 000** |

- **RETAINED INCOME**

| | |
|---|---|
| Retained income at beginning of year | 1 380 000 |
| Net profit after tax | 784 800 |
| Repurchase of 30 000 shares (300 cents above average price) | (90 000) |
| Dividends for the year | (741 000) |
| Interim | 375 000 |
| Final | 366 000 |
| Retained income at end of year | **1 333 800** |

**15.8.4 Questions:**

| | |
|---|---|
| **(a)** | **Calculate the following financial indicators for the year ended 30 September 20.9:** |
| | • **% Return on average equity** |
| $\frac{784\,000}{\frac{1}{2}(6\,380\,000 + 7\,921\,800)} \times \frac{100}{1}$<br>$\frac{784\,000}{7\,150\,900} \times \frac{100}{1}$<br>**10.97%** or **11%** | |
| | • **Net asset value per share** |
| $\frac{7\,921\,800}{1\,220\,000}$ x 100 cents<br>**649.3 cents** | |
| **(b)** | **You are told that the current market price of the shares on the JSE is 580 cents. You have identified the following figures from the 20.8 financial statements:**<br>• **Sales R8.3m**<br>• **Audit fees R100 000**<br>• **Directors fees R1.2m**<br>• **Net profit before tax R1.1m**<br>**What questions would you raise at the AGM about the performance of the directors?** |
| Any appropriate answer, e.g.:<br>Higher turnover resulted in the almost the same net profit before tax in the current year. With higher sales, why was there no significant increase in net profit?<br>Substantial increase in directors' fees. Has the remunerations committee done its job properly?<br>Audit fees have more than doubled. Has there been a problem with internal control causing audit fees to increase? | |

## TASK 15.9 Basic concepts relating to companies

| | | |
|---|---|---|
| **15.9.1** | **You have R200 000 to invest in either company. How many shares could you buy in each company? Show workings.** | **(6)** |
| **Bingo Ltd:** R200 000✓ ÷ R13.00✓ = 15 384✓ shares (or 15 300 if sold in lots of 100)<br>**Umlozi Ltd:** R200 000✓ ÷ R16.50✓ = 12 121✓ shares (or 12 100 if sold in lots of 100) | | |
| **15.9.2** | **Which company is making more use of loans? Explain whether or not it was a good idea for that company to make use of loans. Quote financial indicators to support your opinion.** | **(6)** |
| Bingo Ltd is making more use of loans. ✓<br>Their debt / equity ratio is 2.4 : 1✓ compared to Umlozi Ltd of 0.2 : 1. ✓<br>It was not a good idea for them to make so much use of loans as their return on total capital employed (before tax) of 12.9% (before tax) or 10.5% (after tax) is lower than the interest rate of 14%.✓✓<br>There is negative gearing.✓ | | |
| **15.9.3** | **Which company is handling its working capital more effectively? Explain and quote four financial indicators to support your opinion.** | **(9)** |
| Bingo Ltd is more effective. Umlozi Ltd has too much funds tied up in working capital.✓✓<br>Current ratio of Bingo is 1.6 : 1 compared to 7.0 : 1 of Umlozi Ltd.✓<br>Acid-test ratio of Bingo is 0.8 : 1 compared to 3.1 : 1 of Umlozi Ltd.✓<br>Stock turnover rate of Bingo is 4.8 times compared to 2 times of Umlozi Ltd.✓<br>Stock holding period of Bingo is 75 days compared to 180 days of Umlozi Ltd.✓<br>Debtors collection period of Bingo is 21 days compared to 58 days of Umlozi Ltd.✓<br>Umlozi Ltd is paying their creditors in 45 days which is less than their debtors collection period of 58 days.✓<br>Bingo Ltd is paying their creditors in 60 days which is more than their debtors collection period of 21 days.✓ | | |
| **15.9.4** | **The two companies have different policies with regard to the amount of retained income that they maintain. Comment on this, quoting financial indicators to support your opinion.** | **(8)** |
| Umlozi Ltd is retaining more income✓:<br>EPS is 738 cents✓, DPS is 432 cents✓, Dividend pay-out rate is 58.5%.✓<br>Bingo Ltd is not retaining any income✓:<br>EPS is 320 cents✓, DPS is 345 cents✓, Dividend pay-out rate is 107.8%.✓ | | |
| **15.9.5** | **Which company has the better % return and earnings? Explain, quoting financial indicators for each company.** | **(8)** |
| % ROSHE for Umlozi Ltd of 25.5% is much higher than that of Bingo Ltd (13.4%).✓✓<br>EPS for Umlozi Ltd is 738 cents compared to 320 cents of Bingo Ltd.✓✓<br>EPS of Umlozi Ltd is 44.7% of the market price of the share of R16.50.✓✓<br>EPS of Bingo Ltd is 24.6% of the market price of the share of R13.00.✓✓ | | |
| **15.9.6** | **Comment on the current market value of the shares of the two companies. Quote financial indicators/figures to support your answer.** | **(8)** |
| **Umlozi Ltd**:<br>Market price of R16.50✓ is higher than NAV of R10.95✓ which indicates that public demand for the share is good.✓✓<br>**Bingo Ltd:**<br>Market price of R13.00✓ is lower than NAV of R14.60✓ which indicates that public demand for the share is not good.✓✓ | | |

| 15.9.7 | **Which company would you decide to invest in? Explain.** | **(5)** |
|---|---|---|

Either company, with valid reasons. Overall impression: ✓✓✓✓✓

**Reasons for Umlozi Ltd:**

Better % return, better EPS, better gearing. If inefficiencies in working capital can be rectified, returns will be even higher.

**Reasons for Bingo Ltd:**

Share price under-valued, can get shares at lower price than they are worth, but reasons for low demand from public must be rectified first.

**TOTAL MARKS = 50**

## TASK 15.10 Tentilo Ltd: Cash Flow Statement & indicators

### 15.10.1 NOTES TO THE BALANCE SHEET ON 31 MARCH 20.6

| | | |
|---|---|---|
| **1.** | **ORDINARY SHARE CAPITAL** | |
| | Authorised: | |
| | 5 000 000 ordinary shares | |
| | Issued: | |
| | 2 880 000 ordinary shares in issue at beginning of year | ✓1 440 000 |
| | 144 000 ordinary shares repurchased on 31 May 20.5 (average price 50c) | ✓ (72 000) |
| | 934 400 ordinary shares issued on 1 September 20.5 | ✓1 168 000 |
| | 3 670 400 ordinary shares in issue at end of year | **☑2 536 000** |
| | Number of shares: ☑☑ | **(6)** |
| **2.** | **RETAINED INCOME** | |
| | Retained income at beginning of year | ✓823 680 |
| | Net profit after tax (2 400 000 – 672 000) | ✓✓1 728 000 |
| | Repurchase of 144 000 shares (at 60 cents each) | ✓✓ (86 400) |
| | Dividends paid and declared (273 600 + 734 080) | ✓✓☑ (1 007 680) |
| | Retained income at end of year | **☑1 457 600** |
| | | **(9)** |

### 15.10.2 TENTILO LTD
### CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 20.6

| | **Note** | |
|---|---|---|
| **Cash flows from operating activities** | | ☑1 130 320 |
| Cash generation from operations | 1 | ☑2 878 240 |
| Interest paid | | ✓✓ (172 320) |
| Dividends paid | 3 | ☑ (705 600) |
| Tax paid | 4 | ☑ (870 000) |
| **Cash flows from investing activities** | | ☑ (1 704 000) |
| Purchase of non-current assets[(1)] | | ☑✓✓ (1 428 000) |
| Proceeds from disposal of non-current assets [216 000 – 132 000] | | ✓84 000 |
| Financial assets (investment) | | ✓✓ (360 000) |
| **Cash flows from financing activities** | | ☑853 600 |
| Proceeds from issue of share capital | | ✓✓1 168 000 |
| Repurchase of shares [72 000 + 86 400] | | ✓✓☑ (158 400) |
| Payment of capital portion of long-term borrowings[2] | | ✓✓ (156 000) |
| **Net change in cash equivalents** | 2 | ☑279 920 |
| Cash and cash equivalents – beginning of year | 2 | ☑209 600 |
| Cash and cash equivalents – end of year | 2 | **☑489 600** |
| | | **(24)** |

**[1]Purchase of Non-current assets:**

| | |
|---|---|
| Book value at beginning | 2 532 000 |
| Additions | **1 428 000** |
| Disposals | [84 000] |
| Depreciation | [324 000] |
| Book value at end | 3 552 000 |

**[2]Loan:**

| | |
|---|---|
| Start | 960 000 |
| **Interest** | **172 320** |
| Repaid (12 x 27 360) | [328 320] |
| End | 804 000 |

**NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 20.6**

| | |
|---|---|
| **1. Reconciliation between profit before taxation and cash generated from operations** | |
| Profit before taxation [1 728 000 + 672 000] | ✓✓2 400 000 |
| Adjustments in respect of: | |
| Depreciation | ✓324 000 |
| Interest expense | ✓172 320 |
| Operating profit before changes in working capital | ☑2 896 320 |
| Changes in working capital: | ☑(18 080) |
| Decrease in inventory | ✓✓297 600 |
| Decrease in debtors | ✓✓198 000 |
| Decrease in creditors | ✓✓(513 680) |
| Cash generated from operations | **☑2 878 240** |
| | **(13)** |

| **2. Cash and cash equivalents** | **Net change** | **20.6** | **20.5** |
|---|---|---|---|
| Bank | ✓340 800 | 393 600 | 52 800 |
| Cash float | ✓48 000 | 84 000 | 36 000 |
| Petty cash | ✓12 000 | 12 000 | - |
| | **☑400 800** | **489 600** | **88 800** |

**(4)**

| | |
|---|---|
| **3. Dividends paid** | |
| Amount owing at the end of the previous year | ✓432 000 |
| Total dividends for the year [273 600 + 734 080] | ✓✓1 007 680 |
| Amount owing at the end of the current year | ✓(734 080) |
| Amount paid | **☑705 600** |
| | **(5)** |
| **4. Taxation paid** | |
| Amount owing at the end of the previous year | ✓168 000 |
| Income Statement amount | ✓672 000 |
| Amount owing at the end of the current year | ✓30 000 |
| Amount paid | **☑870 000** |
| | **(4)** |

**Note to Teachers – To extend capable learners:**

**Calculation of weighted average number of shares:**

2 880 000 shares in existence x 2 months = 8 640 000
2 736 000 shares in existence x 3 months = 8 208 000
3 670 400 shares in existence x 7 months = 25 692 800
42 540 800 ÷ 12 = **3 545 067 shares**

**15.10.3 CALCULATION OF FINANCIAL INDICATORS**

| Indicator | | Working | Answer |
|---|---|---|---|
| **(a)** | Mark-up % | $\frac{5\ 200\ 000}{11\ 600\ 000} \times \frac{100}{1}$ | **44.9%**✓✓ |
| **(b)** | Operating profit on sales | $\frac{2\ 450\ 000}{16\ 800\ 000} \times \frac{100}{1}$ | **14.6%**✓✓ |
| **(c)** | Net profit after tax on sales | $\frac{1\ 728\ 000}{16\ 800\ 000} \times \frac{100}{1}$ | **10.3%**✓✓ |
| **(d)** | Earnings per share | $\frac{1\ 728\ 000✓}{3\ 545\ 067*✓} \times \frac{100}{1}$<br>*Weighted average | **48.7 cents**☑ |
| **(e)** | Dividends per share | Interim:<br>R273 600 ÷ 2 736 000 shares = 10 cents✓✓<br>Final:<br>R734 080 ÷ 3 670 400 = 20 cents✓✓ | **30 cents**☑ |
| **(f)** | % Return on equity | $\frac{1\ 728\ 000✓}{3\ 068\ 000✓} \times \frac{100}{1}$ | **56.3%**☑ |
| **(g)** | % Return on total capital employed | $\frac{(2\ 400\ 000 + 172\ 300)✓}{(3\ 128\ 640 + 882\ 000)✓} \times \frac{100}{1}$ | **64.1%**☑ |
| **(h)** | Net asset value per share | 3 993 600✓ ÷ 3 670 400✓ shares | **108.8 cents**☑ |
| **(i)** | Debt/equity ratio | 804 000✓ : 3 993 600✓ | **0.2 : 1**☑ |
| **(j)** | Current ratio | 1 740 000✓ : 1 082 400✓ | **1.6 : 1**☑ |
| **(k)** | Acid-test ratio | 645 000✓ : 1 082 400✓ | **0.6 : 1**☑ |
| **(l)** | Stock turnover rate | 11 600 000✓ ÷ 1 243 200✓ | **9.3 times**☑ |

**(35)**

**TOTAL: 100 marks**

## TASK 15.11 Westville Deliveries: Calculations, Asset disposal, Fixed asset note, Internal control

| **15.11.1** | **Calculate the depreciation on equipment for the year.** |
|---|---|

On new equipment: 60 000 x 20% x $^{3}/_{12}$ = R3 000
On old equipment: 230 000 x 20% = R46 000
Total = 3 000 + 46 000 = **R49 000**

**15.11.2 NOTE TO THE FINANCIAL STATEMENTS ON 28 FEBRUARY 20.7**
**FIXED/TANGIBLE ASSETS**

| | Land and Buildings | Equipment | Vehicles |
|---|---|---|---|
| Carrying value at beginning of year | 740 000 | 230 000 | **970 000** |
| Cost | 740 000 | 350 000 | **1 500 000** |
| Accumulated depreciation | - | (120 000) | **(530 000)** |
| **Movements** | 62 000 | 11 000 | **(465 000)** |
| Additions at cost | 62 000 | 60 000 | **-** |
| Disposals at carrying value | - | - | **(110 000)** |
| Depreciation | - | (49 000) | **(355 000)** |
| Carrying value at end of year | 802 000 | 241 000 | **505 000** |
| Cost | 802 000 | 410 000 | **1 340 000** |
| Accumulated depreciation | - | (169 000) | **(835 000)** |

**15.11.3 GENERAL LEDGER OF WESTVILLE DELIVERIES**
**NOMINAL ACCOUNTS SECTION**

**Dr** **Asset disposal** **N** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.5 | | | | | 20.5 | | | | |
| Nov | 1 | Vehicles | | 160 000 | Nov | 1 | Acc. dep. on vehicles | | 50 000 |
| | | | | | | | Bank | | 70 000 |
| | | | | | | | Loss on disposal of asset | | 40 000 |
| | | | | **160 000** | | | | | **160 000** |

| **15.11.4** | **The owner is concerned that internal control over fixed assets is poor and that the figures for fixed assets in the books and financial statements are unreliable. You have been appointed as the internal auditor. Provide three suggestions to solve this potential problem.** |
|---|---|

Check cost price of items of equipment to invoices.
Check each purchased and disposal is properly authorised – check signatures.
Physical check of each item to the Fixed Assets Register.

## TASK 15.12 Kloof Hardware: Problem solving

**Identify and explain ONE major problem relating to each delivery vehicle or its driver. Quote figures from the information to support your answer. Provide a valid solution to each problem.**

**Delivery vehicle 1:** Any valid problem identified ✓ Quoting of relevant figure. ✓
*Possible responses:*
- The driver has been lazy/not working too hard – only did 280 deliveries in the year.
- The driver is absent from work too often – 50 days away from work.
- The vehicle is not being utilised enough – only did 10% of the trips yet it has the lowest running costs (R1.95).
- The driver is being paid the same salary as other drivers despite only doing 10% of the work.
- Lack of internal control/This vehicle is running at a loss – income R105 000 less expenses R132 600 = R27 600 loss.

Any valid solution related to the problem identified above✓
*Possible responses:*
- Pay drivers per delivery – this will encourage them to work harder.
- Allocate this vehicle to the busiest driver.

**Delivery vehicle 2:** Any valid problem identified ✓ Quoting of relevant figure. ✓
*Possible responses:*
- The driver has been working too hard – did 8 deliveries per day (2 100 / 260).
- This vehicle is old / has a high running cost (R3.08) yet it is used for 2 100 out of 3 680 deliveries.

Any valid solution related to the problem identified above✓
*Possible responses:*
- Allocate this vehicle to the least busy driver.
- Restrict usage of this vehicle.

**Delivery vehicle 3:** Any valid problem identified ✓ Quoting of relevant figure. ✓
*Possible responses:*
The driver has been fraudulent – fees collected are R75 000 short (R487 500 – R412 500).
Any valid solution related to the problem identified above.✓
*Possible responses:*
- Conduct an internal audit of fees collected.
- Conduct a disciplinary enquiry against the driver.

Use the following rubric to assess this Task:

| Criteria | Level 1 | Level 2 | Level 3 | Level 4 |
|---|---|---|---|---|
| Identification of problem relating to each delivery vehicle. | No idea of any problem explained. | One problem for one delivery vehicle correctly identified and explained. | One problem for each of two delivery vehicle correctly identified and explained. | One problem for each delivery vehicle correctly identified and explained. |
| Identification of problem relating to each taxi. | No idea of any problem explained. | One problem for one taxi correctly identified and explained. | One problem for each of two taxis correctly identified and explained. | One problem for each taxi correctly identified and explained. |
| Provision of valid evidence. | No valid evidence provided. | Figures provided to support one problem identified. | Figures provided to support each of two problems identified. | Figures provided to support each of three problems identified. |
| Suggestion of valid solution. | No valid suggestion provided. | Valid solutions provided to one problem identified. | Valid solutions provided to each of the two problems identified. | Valid solutions provided to each of the three problems identified. |

## TASK 15.13 JK Ltd: Asset disposal, Fixed asset note, Internal control

**15.13.1** **GENERAL LEDGER OF JK LTD**
**NOMINAL ACCOUNTS SECTION**

**Dr** **Asset disposal** **N** **Cr**

| 20.0 | | | | | 20.0 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Vehicles | GJ | **110 000** | Aug | 31 | Acc dep on vehicles | GJ | 77 000 |
| | | | | | | | Loss on sale of asset | GJ | 28 000 |
| | | | | | | | Creditors control | GJ | 5 000 |
| | | | | **110 000** | | | | | **110 000** |

**15.13.2 NOTE TO THE FINANCIAL STATEMENTS ON 28 FEBRUARY 20.1**
**FIXED/TANGIBLE ASSETS**

| | **Vehicles** |
|---|---|
| Carrying value at beginning of year | 320 000 |
| Cost | **480 000** |
| Accumulated depreciation | (160 000) |
| **Movements** | 8 000 |
| Additions at cost | 140 000 |
| Disposals at carrying value | **(33 000)** |
| Depreciation (11 000 + 14 000 + 74 000) | (99 000) |
| Carrying value at end of year | **328 000** |
| Cost | **510 000** |
| Accumulated depreciation | 182 000 |

| **15.13.3** | **The management is very concerned about the loss on the sale of the vehicle. Do you think they have reason to be concerned? Why? Suggest 3 measures they should consider introducing in the future to prevent further losses.** |
|---|---|

Yes.
A loss on the sale means a loss of profits and also a possible loss of control.
Suggestions:
Get a maintenance plan.
Use a Log book to control private use.
Install a tracker.

## TASK 15.14 Van Rooyen Ltd: Asset disposal, Fixed asset note and Internal control

**15.14.1** **GENERAL LEDGER OF VAN ROOYEN LTD**
**NOMINAL ACCOUNTS SECTION**

**Dr** **Asset disposal** **N** **Cr**

| 20.1 | | | | | 20.1 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Sept | 30 | Vehicles | GJ | 96 000 | Sept | 30 | Acc dep on vehicles | GJ | 58 900 |
| | | Profit on sale of asset | GJ | 2 900 | | | Debtors control | GJ | 40 000 |
| | | | | **98 900** | | | | | **98 900** |

**15.14.2 NOTE TO THE FINANCIAL STATEMENTS ON 28 FEBRUARY 20.2**

| FIXED/TANGIBLE ASSETS | Land & buildings | Vehicles | Equipment |
|---|---|---|---|
| Carrying value at beginning of year | 2 200 000 | **472 500** | 560 000 |
| Cost | 2 200 000 | **960 000** | **880 000** |
| Accumulated depreciation | 0 | (487 500) | **(320 000)** |
| **Movements** | 200 000 | 108 900 | (33 500) |
| Additions at cost | 200 000 | **240 000** | **150 000** |
| Disposals at carrying value | **0** | (37 100) | **0** |
| Depreciation | 0 | **(94 000)** | *(183 500) |
| Carrying value at end of year | 2 400 000 | 581 400 | 526 500 |
| Cost | **2 400 000** | **1 104 000** | 1 030 000 |
| Accumulated depreciation | - | **(522 600)** | (503 500) |

*176 000 + 7 500

| 15.14.3 | (a) Explain why the internal auditor referred to the Fixed Asset Register in conducting this internal audit. |
|---|---|

The fixed asset register gives individual details of the different assets owned by the company.
This is how he determined that there should have been 24 chairs in stock.

**(b) Explain the bookkeeper's reference to the concept of materiality. Do you agree with his attitude? Why? Explain the possible consequences of the bookkeeper's attitude.**

The concept of materiality refers to the fact that it is insignificant in the context of the business to worry about 6 chairs that are missing.
Yes or no.
While the value might be small this could be an indication of much larger problems in the business.

**(c) Discuss three possible solutions that the internal auditor could consider introducing to prevent situations like this from occurring in the future.**

- Constant checks must be done on the physical stock.
- There must be division of duties in that more than one person must be involved in the counting and keeping records.
- Strict records must be kept of any breakages.

## TASK 15.15 Red Square: Fixed asset note and Internal control

**15.15.1 NOTE TO THE FINANCIAL STATEMENTS ON 28 FEBRUARY 20.8**

| FIXED/TANGIBLE ASSETS | Land & buildings | Vehicles |
|---|---|---|
| Carrying value at beginning of year | **1 260 000** | 235 000 |
| Cost | **1 260 0000** | **360 000** |
| Accumulated depreciation | **0** | **(125 000)** |
| **Movements** | 190 000 | 107 800 |
| Additions at cost | 190 000 | 204 000 |
| Disposals at carrying value | **0** | (31 200) |
| Depreciation | 0 | (65 000) |
| Carrying value at end of year | **1 450 000** | 342 800 |
| Cost | **1 450 000** | 484 000 |
| Accumulated depreciation | 0 | (141 200) |

| 15.15.2 | (a) **Which GAAP principle is used when assets are depreciated? Explain the purpose of the principle.** |
|---|---|
| Prudence – be realistic as assets lose value over time. | |
| | (b) **The owner, Mary has suggested to the bookkeeper that in future vehicles must be depreciated by 50% on cost, in order to get the greatest tax benefit. Explain to her whether this is feasible or not as well as the consequences of this decision.** |
| No – SARS stipulates the maximum depreciation to be written off.<br>Writing off higher amounts would be fraud as this would result in lower profits and therefore less tax.<br>This can result in penalties, fines, jail sentences. | |
| | (c) **Mary budgeted R50 000 for motor expenses in the year ended 31 May 20.8 that included maintenance and licences. She was very concerned when the Income Statement was produced to notice that the actual costs were R95 000. Discuss 2 possible reasons for this difference and suggest to her 2 measures that she could use in future to prevent these great differences.** |
| **Reasons:**<br>Higher fuel costs.<br>Vehicle did more mileage than budgeted.<br>Fraud – private use.<br>Any other feasible answer.<br>**Suggestions:**<br>Re-look at budget in view of latest price increases in fuel.<br>Set up internal controls to monitor private use.<br>Any other feasible answer. | |

## TASK 15.16 True or False

Indicate whether the following statements are True or False. If false, give a reason.

| No. | Answer |
|---|---|
| **1.** | False, they are called members. |
| **2.** | False, they are called shareholders. |
| **3.** | True. |
| **4.** | True. |
| **5.** | True. |
| **6.** | False, he/she must be qualified. |
| **7.** | False, not compulsory. |
| **8.** | False, maximum number is 10. |
| **9.** | True. |
| **10.** | False, has continuity because it is a legal person. |

## TASK 15.17 Hillcrest CC: Ledger accounts

**GENERAL LEDGER OF VAN HILLCREST CC**
**BALANCE SHEET ACCOUNTS SECTION**

**15.17.1 Dr — Members' contribution — B — Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.8 | | | | | 20.7 | | | | |
| Feb | 28 | Balance | c/d | 450 000 | Mar | 1 | Balance | b/d | 300 000 |
| | | | | | Apr | 1 | Bank | CRJ | 50 000 |
| | | | | | | | Vehicle | GJ | 100 000 |
| | | | | **450 000** | | | | | **450 000** |
| | | | | | 20.8 | | | | |
| | | | | | Mar | 1 | Balance | b/d | 450 000 |

**15.17.2 — Retained income — B**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.8 | | | | | 20.7 | | | | |
| Feb | 28 | Balance | c/d | 154 000 | Mar | 1 | Balance | b/d | 30 000 |
| | | | | | 20.8 | | | | |
| | | | | | Feb | 28 | Appropriation | GJ | 124 000 |
| | | | | **154 000** | | | | | **154 000** |
| | | | | | Mar | 1 | Balance | b/d | 154 000 |

**15.17.3 — SARS (Income tax) — B**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.7 | | | | |
| Apr | 1 | Bank | CPJ | 5 000 | Mar | 1 | Balance | b/d | 5 000 |
| Aug | 31 | Bank | CPJ | 80 000 | 20.8 | | | | |
| 20.8 | | | | | Feb | 28 | Income tax | GJ | 114 000 |
| Feb | 28 | Bank | CPJ | 51 000 | | | Balance | c/d | 17 000 |
| | | | | **136 000** | | | | | **136 000** |
| Mar | 1 | Balance | b/d | 17 000 | | | | | |

**15.17.4 Dr** **Distribution payable to members** **B** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.7 | | | | |
| Apr | 20 | Bank | CPJ | 25 000 | Mar | 1 | Balance | b/d | 25 000 |
| 20.8 | | | | | 20.8 | | | | |
| Feb | 28 | Balance | c/d | 70 000 | Feb | 28 | Distribution to members | GJ | 70 000 |
| | | | | **100 000** | | | | | **100 000** |
| | | | | | Mar | 1 | Balance | b/d | 70 000 |

**NOMINAL ACCOUNTS SECTION**

**15.17.5** **Income tax** **N**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.8 | | | | | 20.8 | | | | |
| Feb | 28 | SARS (Income tax) | GJ | 114 000 | Feb | 28 | Appropriation | GJ | 114 000 |

**15.17.6** **Distribution to members** **N**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.8 | | | | |
| Sept | 15 | Bank | CPJ | 72 000 | Feb | 28 | Appropriation | GJ | 142 000 |
| 20.8 | | | | | | | | | |
| Feb | 28 | Distribution payable to members | GJ | 70 000 | | | | | |
| | | | | **142 000** | | | | | **142 000** |

**FINAL ACCOUNTS SECTION**

**15.17.7** **Appropriation** **F3**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.8 | | | | | 20.8 | | | | |
| Feb | 28 | Income tax | GJ | 114 000 | Feb | 28 | Profit and loss | GJ | 380 000 |
| | | Distribution to members | GJ | 142 000 | | | | | |
| | | Retained income | GJ | 124 000 | | | | | |
| | | | | **380 000** | | | | | **380 000** |

## TASK 15.18 Gavwood CC: Ledger accounts

**GENERAL LEDGER OF GAVWOOD CC**
**BALANCE SHEET ACCOUNTS SECTION**

**15.18.1 Dr** **Members' contribution** **B** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.8 | | | | | 20.7 | | | | |
| Feb | 28 | Balance | c/d | 415 000 | Mar | 1 | Balance | b/d | 265 000 |
| | | | | | 20.8 | | | | |
| | | | | | Jan | 4 | Vehicle | GJ | 150 000 |
| | | | | **415 000** | | | | | **415 000** |
| | | | | | 20.8 | | | | |
| | | | | | Mar | 1 | Balance | b/d | 415 000 |

**15.18.2 Dr** **Retained income** **B** **Cr**

| 20.8 | | | | | 20.7 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Balance | c/d | 250 000 | Mar | 1 | Balance | b/d | 17 450 |
| | | | | | 20.8 | | | | |
| | | | | | Feb | 28 | Appropriation | GJ | 232 550 |
| | | | | **250 000** | | | | | **250 000** |
| | | | | | Mar | 1 | Balance | b/d | 250 000 |

**15.18.3** **SARS (Income tax)** **B**

| 20.7 | | | | | 20.7 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Apr | 27 | Bank | CPJ | 10 072 | Mar | 1 | Balance | b/d | 10 072 |
| Aug | 31 | Bank | CPJ | 85 000 | 20.8 | | | | |
| 20.8 | | | | | Feb | 28 | Income tax | GJ | 160 000 |
| Feb | 20 | Bank | CPJ | 100 000 | | | Balance | c/d | 25 000 |
| | | | | **195 072** | | | | | **195 072** |
| Mar | 1 | Balance | b/d | 25 000 | | | | | |

**15.18.4** **Distribution payable to members** **B**

| 20.7 | | | | | 20.7 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Apr | 15 | Bank | CPJ | 45 000 | Mar | 1 | Balance | b/d | 45 000 |
| 20.8 | | | | | 20.8 | | | | |
| Feb | 28 | Balance | c/d | 211 450 | Feb | 28 | Distribution to members | GJ | 211 450 |
| | | | | **256 450** | | | | | **256 450** |
| | | | | | Mar | 1 | Balance | b/d | 211 450 |

**15.18.5** **Loan from Gav** **B**

| 20.7 | | | | | 20.7 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| May | 1 | Bank | CPJ | 3 000 | Mar | 1 | Balance | b/d | 24 000 |
| 20.8 | | | | | | | | | |
| Feb | 28 | Balance | c/d | 21 000 | | | | | |
| | | | | **24 000** | | | | | **24 000** |
| | | | | | Mar | 1 | Balance | b/d | 21 000 |

**FINAL ACCOUNTS SECTION**

**15.18.6** **Appropriation** **F3**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Income tax | GJ | 160 000 | Feb | 28 | Profit and loss | GJ | *640 000 |
| | | Distribution to members | GJ | 247 450 | | | | | |
| | | Retained income | GJ | 232 550 | | | | | |
| | | | | **640 000** | | | | | **640 000** |

*$\frac{160\ 000}{25}$ x 100 = R640 000

# TASK 15.19 Bushy CC: Ledger accounts & Ethics

| 15.19.1 | (a) What is the main advantage of a CC in comparison to a partnership? |
|---|---|
| CC enjoys limited liability.<br>Separate legal personality.<br>Etc. | |
| | **(b) What makes up the Members' Equity in a CC?** |
| Members contribution<br>Retained income | |
| | **(c) Bushy CC requires extra finance for expansion purposes. The members are prepared to invest in the business but are not sure whether to record this investment as part of their capital or a loan to the CC. Advise them by discussing at least 2 points they need to consider in their decision.** |
| Loan or contribution.<br>Loan earns interest.<br>Loan gets repaid first.<br>Contribution is a commitment.<br>Etc. | |

**15.19.2**

**GENERAL LEDGER OF BUSHY CC**
**BALANCE SHEET ACCOUNTS SECTION**

**(a) Dr** **SARS (Income tax)** **B** **Cr**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.7 | | | | | 20.8 | | | | |
| Mar | 1 | Balance | b/d | 14 000 | Feb | 28 | Income tax | GJ | 131 600 |
| Aug | 28 | Bank | CPJ | 41 000 | | | | | |
| 20.8 | | | | | | | | | |
| Feb | 21 | Bank | CPJ | 60 000 | | | | | |
| | 28 | Balance | c/d | 16 600 | | | | | |
| | | | | **131 600** | | | | | **131 600** |
| | | | | | Mar | 1 | Balance | b/d | 16 600 |

**FINAL ACCOUNTS SECTION**

**(b)** **Appropriation** **F3**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.8 | | | | | 20.8 | | | | |
| Feb | 28 | Income tax | GJ | 131 600 | Feb | 28 | Profit and loss | GJ | 420 000 |
| | | Distribution to members* | GJ | 141 000 | | | | | |
| | | Retained income | GJ | 147 400 | | | | | |
| | | | | **420 000** | | | | | **420 000** |

*(21 000 + 120 000)

| 15.19.3 | **Write a report in which you discuss whether Bush has reason to be concerned and discuss at least 3 possible actions he could take.** |
|---|---|

**Concerns:**
He has reason for concern as this is unethical and it defrauding SARS both in terms of VAT and Income tax. As a member of a CC, Bush will also be implicated in any legal action that is taken against them.

**Advice:**
- Needs to tell Hay that this is not acceptable.
- Change the agreement between the members.
- Take legal advice on how to handle the matter.

Etc.

## TASK 15.20 XY Traders CC: Problem solving

**Evaluation of information:**

- Very low current ratio (0.6 : 1) and acid-test ratio (0.2 : 1).
- Low cash balance – does not cover immediate debts.
- High debt / equity ratio (13 : 1) – high risk – interest and loan repayments will be problematic.

**Possible strategies:**

- Increase equity through admission of a new member.
- Reduce loan as much as possible with the inflow of capital as above.

## TASK 15.21 Vanity Fashions Ltd: Ethics & professional bodies

| | |
|---|---|
| **15.21.1** | **The audit opinion is in respect of "pages 30 to 58" of the annual report of Vanity Fashions Ltd.** |
| | • **List the main documents that would be covered by the audit report.** |
| Income Statement<br>Balance Sheet & notes<br>Cash Flow Statement<br>Directors report | |
| | • **Why is it necessary for the auditors to stipulate the page numbers?** |
| The directors sometimes use the annual report to communicate extra information on the company and its prospects for the future.<br>The auditors cannot give an opinion on anything which might be uncertain. Alternative valid answers to be accepted. | |
| **15.21.2** | **A number of people are interested in the financial statements and auditor's report.** |
| | • **To which group of people are the auditors addressing their report, and why?** |
| Shareholders, because they appoint the auditors at the AGM. | |
| | • **Who else will be interested in reading the auditor's report? Provide three examples.** |
| Creditors<br>Lenders<br>Employees<br>SARS | |
| | • **Which group of people are responsible for preparing the financial statements?** |
| Directors, mainly the financial director. | |
| **15.21.4** | **Why does the auditor's report refer to the following:** |
| | • **International Financial Reporting Standards.** |
| This is required by the auditing standards.<br>The IFRS set the standard for the way in which financial statements are prepared.<br>Readers need to be able to compare financial statements of different companies, even those in different countries. | |
| | • **The Companies Act?** |
| This is the law which governs companies in SA.<br>If the company does not comply with this law, those responsible will be guilty of a crime. | |
| **15.21.5** | **In performing their audit, the auditors will assess the quality of the internal control processes. Why is this necessary, and what would they be hoping to observe in this regard?** |
| As they are conducting their audit on a test basis, they need to know that they systems in the company are reliable.<br>If they are not, the extent of the test will have to be enlarged, which will involve delays and extra cost in the form of audit fees.<br>The auditors will hope to see good division of duties, proper authorisation and documentation of transactions, and accurate recording. | |

| 15.21.6 | **If the auditors do not "plan and perform" their audit properly there could be severe consequences for them. Explain what these might be, with reference to the role that the professional bodies would play.** |
|---|---|

As auditors all have the CA (SA) qualification, they are all bound by the code of professional conduct of the SA Institute of Chartered Accountants.
This body has its disciplinary procedures in place, which could involve de-registering a member as a CA (SA).
The Independent Regulatory Board of Auditors (IRBA) is another body which would be involved in misconduct relating to an audit.
This body also has its disciplinary procedures in place, which could involve de-registering a member as an auditor.
Any negligent auditor could also find himself/herself subjected to criminal procedures through a court of law, depending on the nature of the offence.

## TASK 15.22 Dodgy Ltd.: Auditing & ethical situations

| 15.22.1 | **A 5-year old vehicle has been sold to one of the directors at the book value, which is R1.00. A similar vehicle of this age is being sold by second-hand car dealers for R50 000. The business has had to buy a new vehicle for R350 000 to replace the old one.** |
|---|---|

**Action:**
Table at a directors meeting.
If the board agrees, sell it to the director at the market value, or if it is sold at R1.00 then the difference must be treated as the directors remuneration, which is taxable in his hands.

**Reason:**
Transparency – the sale at R1,00 is effectively another reward to the director.
The directors are appointed by the shareholders and this is a way of hiding extra remuneration.
A formal decision must be made to sell the vehicle, as the cost of replacing is very high.

| 15.22.2 | **The cost price of certain articles has decreased over the past six months. Dodgy Ltd has not changed the selling prices displayed on the shelves.** |
|---|---|

**Action:**
Advise the board of directors to reduce prices when cost prices drop. Inform customers of this policy as well.

**Reason:**
This will create goodwill for the business.
The customer should come first, as they are the lifeblood of the business.
Also it makes good business sense because competitors might reduce their prices, and customers will be lost.

| 15.22.3 | **In observing a cashier at a till, you notice that the cashier is entering only every second item bought by a certain customer. The cashier is, nevertheless, placing every item in the customer's packets.** |
|---|---|

**Action:**
Accumulate definite evidence on the action of the cashier. Hold a disciplinary hearing.
If the cashier is found guilty, he/she must be dismissed, with the possibility of legal action.
Reassess the manner in which cashiers are employed and trained, and reassess the internal control procedures in the firm.

**Reason:**
This is theft or fraud – the customer is probably a friend or family member of the cashier.
This is also a breach of internal control measures – if it is happening with one cashier, it might be happening with others, causing considerable loss to the company.
The value of the stock stolen will show up as a trading stock deficit when the stock count is done.
Place security personnel at the doors to check the document to the goods taken out by the customer.

| 15.22.4 | **Trading stock (cost price R60 000, selling price R90 000 excluding VAT), was sold to a special customer for cash. Instead of charging the customer R90 000 plus VAT, a junior director invoiced him for R65 000 plus VAT. You also find out that the customer has paid the difference of R25 000 privately to the director in cash.** |
|---|---|

**Action:**
Accumulate sufficient evidence against the director and report it to the managing director, or the independent auditors.
The director must repay the difference of R25 000 plus VAT of R3 500.
The director should be dismissed, with the possibility of legal action against him.
The directors must also decide how to deal with this customer in future.

**Reason:**
This is VAT fraud as well as fraud by a director.
The customer should be paying VAT of R12 600 but he has been charged R9 100.
The director should be dismissed – transparency and accountability are important, and as directors are controlling funds of the shareholders their integrity should be above reproach.

| 15.22.5 | **Every time you inspect the bank reconciliations prepared by the bookkeeper at the end of each month, you notice that there is always a large outstanding deposit each month of at least R10 000, even though the money appears to have been receipted several days before the month end.** |
|---|---|

**Action:**
Accumulate evidence – this should not be difficult if a surprise cash count is done at the month end.
If the cash is short again, the employee must be placed before a disciplinary hearing to face possible dismissal and/or legal action to repay any cash stolen. In future, the new employee must be told to take leave – his/her replacement will encounter a problem if this type of fraud persists.

**Reason:**
This is a type of fraud known as rolling of cash.
A bookkeeper takes a large sum of cash and substitutes the next months' takings to replace it.

| 15.22.6 | **The profits expected are looking low at the year-end of 30 June 20.2. Goods were sold at a profit of R60 000 on 2 July 20.2. The managing director decides to change the date of this invoice to 30 June 20.2.** |
|---|---|

**Action:**
Force the directors to reflect this invoice in the next financial year.
If there is no positive response, report it to the external independent auditors as this will have an effect on the profit reported in the Income Statement.

**Reason:**
This is a violation of the Matching Principle. It is distorting the profit of two consecutive years.
The Income Statement will not reflect what actually occurred during the year if the date is changed.

| 15.22.7 | **The board of directors of Dodgy Ltd has entered into a very large building contract with Dubious Construction Ltd to build a large warehouse for R2m. You hear a rumour that the wife of one of the directors is a major shareholder in Dubious Construction Ltd.** |
|---|---|

**Action:**
Table this at a directors meeting. The contract should be cancelled and opened to other suppliers.
The director in question could face legal action and jail.

**Reason:**
Transparency and conflict of interest. Directors have a duty to disclose such interests.
They are safeguarding shareholders' funds and cannot personally profit from this, even if it is indirect.

## TASK 15.23 Article: Ethics

**Suggested marking grid:**

| | 0 marks | 1-2 marks | 3-4 marks | 5-6 marks |
|---|---|---|---|---|
| **Positive point #1** | No valid positive point mentioned. | One valid positive point satisfactorily explained. | One valid positive point well explained with evidence from the question. | One valid positive point convincingly and completely explained with evidence from the question. |
| **Positive point #2** | No 2nd valid positive point mentioned. | 2nd valid positive point satisfactorily explained. | 2nd valid positive point well explained with evidence from the question. | 2nd valid positive point convincingly and completely explained with evidence from the question. |
| **Negative points #1** | No valid negative point mentioned. | One valid negative point satisfactorily explained. | One valid negative point well explained with evidence from the question. | One valid negative point convincingly and completely explained with evidence from the question. |
| **Negative points #2** | No 2nd negative point mentioned. | 2nd valid negative point satisfactorily explained. | 2nd valid negative point well explained with evidence from the question. | 2nd valid negative point convincingly and completely explained with evidence from the question. |
| | | | | **24** |

| **15.23.1** | **Assume that you are a shareholder in this company, and that you are about to attend the AGM.** |
|---|---|
| | **(a) What would please you about this company, i.e. what would motivate you to remain a shareholder? Explain two points.** |
| The CEO is willing to accept a 40% pay-cut.<br>This is a business with a fine tradition based on Ford family values.<br>The share price has not dropped recently.<br>The company is trying to economise as best possible – even cutting the number of directorship posts. | |
| | **(b) What would not please you about this company, i.e. what would motivate you to sell your shares as soon as possible? Explain two points.** |
| The CEO is possibly being paid too much already.<br>The profits have dropped significantly – quote figures from question.<br>The share price fell significantly last year.<br>The company is cutting back by reducing its operations and employees.<br>There are two types of shares which entrench voting with a certain group of people.<br>There is disagreement amongst the shareholders – proposals last year were outvoted (only 25% support). | |

| 15.23.2 | **Briefly explain what is meant by the 'King Code' and explain whether, in your opinion, the King Code will encourage South African business executives to take decisions similar to that of Bill Ford.** |
|---|---|

The King Code is a report commissioned by the SA government from judge Mervyn King.
This report recommended standards for conduct for directors of companies and emphasised the need for responsible corporate activities having due regard for the society in which companies operate.
The seven primary characteristics of good governance are discipline (a commitment to governance), transparency, independence (not being susceptible to undue influence), accountability, responsible management, fairness in dealing with stakeholders, social issues (in relating to the outside world, the environment, the wider community).

**Opinion on South Africa:**
Possible responses, e.g. the focus on the King Code will cause SA directors to work towards these principles.
The principle of Accountability should influence directors to make the best decisions in the interests of the company, and to be held accountable for the performance of their companies.
They cannot expect to earn high directors fees if their companies are not performing to the satisfaction of the owners.

## TASK 15.24 Tick-Tock: Inventory valuation, Internal control

| **15.24.1** | **Explain why do you think that Tick-Tock chose the FIFO method as the most appropriate method in this case.** |
|---|---|
| Clock radios can be distinguished from each other.<br>The stock is valued at the most recent prices which is more realistic. | |
| **15.24.2** | **Calculate the value of the closing stock on 31 December 20.0 using the FIFO method of valuation.** |
| 90 x R82 = R7 380<br>30 x R75 = R2 250<br>7 380 + 2 250 = **R9 630** | |
| **15.24.3** | **Calculate the Cost of sales for the year ended 31 December 20.0.** |
| 1 420 + 49 530 – 4 200 – 9 630 = **R37 120** | |
| **15.24.4** | **Calculate the Gross profit of the year ended 31 December 20.0.** |
| 49 590 – 37 120 = **R12 470** | |
| **15.24.5** | **Calculate how many clock radios have gone missing.** |
| 20 + 640 – 120 – 522 = **18** | |

## TASK 15.25 Bravo Music: Inventory valuation; Internal control

| **15.25.1** | **Value the stock on hand at the end of the year according to the Weighted average method.** |
|---|---|
| Weighted average:<br>(175 000 + 1 150 000) ÷ (2 500 + 15 000)<br>1 325 000 ÷ 17 500<br>= R75.71<br><br>Stock value = 3 020 units x R75.71 = **R228 644**<br>(or R288 657 or similar figure – depends on rounding off – this will affect other parts of the question). | |
| **15.25.2** | **Calculate the number of CD's that have apparently been shop-lifted and value them at the Weighted average.** |
| 2 500 + 15 000 – 14 400 – 3 020 = 80 units<br>Value at weighted average:<br>80 x R75.71 = **R6 057** | |

**15.25.3**

**GENERAL LEDGER OF BRAVO MUSIC**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **TRADING STOCK** **B** **Cr**

| 20.8 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Mar | 1 | Balance | b/d | 175 000 | Feb | 28 | Loss due to theft | | 6 057 |
| 20.9 | | | | | | | Cost of sales | | 1 090 299 |
| Feb | 28 | Creditors control | | 1 150 000 | | | Balance | c/d | 228 644 |
| | | | | **1 325 000** | | | | | **1 325 000** |
| Mar | 1 | Balance | b/d | 228 644 | | | | | |

| 15.25.4 | **Calculate the gross profit and the mark-up % achieved for the year.** |
|---|---|

Gross profit = 1 800 000 – R1 090 299 = R709 701
Mark-up %:

$$\frac{709\,701}{1\,090\,299} \times \frac{100}{1} = \mathbf{\underline{65\%}}$$

| 15.25.5 | **Consider the pricing policy of Bravo Music. Would a change in policy improve their profits? Explain briefly.** |
|---|---|

Yes / No – with proper supporting opinion, e.g.:
Overall impression.
There has been a decline from 75% to 65%.
The fact that they keep their prices constant could be a problem.
They should consider increasing and decreasing selling prices in line with the purchase prices.
Educate the public about the reasons for the fluctuations, e.g. exchange rates.
An opposing viewpoint could be that this would turn customers away.
Depends on the price-sensitivity of the customers, especially as there is another viable competitor in the area.

| 15.25.6 | **In your opinion, does Bravo Traders keep sufficient stock on hand to satisfy its customers? Calculate a financial indicator using figures from the question to support your opinion.** |
|---|---|

**Various indicators possible** – to compare to the 3 020 CD's on hand, e.g.:
14 400 units sold p.a. = 1 200 per month - this will last 2.5 months

$$\text{Turnover rate of stock} = \frac{1\,090\,299}{\frac{1}{2}(175\,000 + 228\,644)} = \mathbf{\underline{5.4 \text{ times}}}$$

$$\text{Period of stock on hand} = \frac{228\,644}{1\,090\,299} \times \frac{365}{1} = \mathbf{\underline{76 \text{ days}}}$$

**Conclusion:**
Yes / No, depending on opinion.

| 15.25.7 | **If Bravo Music had chosen to use the FIFO method of valuing stock, what effect would this have had on their gross profit? To support your answer, provide a calculation using information from the question.** |
|---|---|

Stock on hand would be 3 020 units x R80 = R241 600
Difference in stock valuation = R241 600 – R228 644 = R12 956
Gross profit would increase by R12 956 under FIFO method.

| 15.25.8 | **Provide three points of practical advice to Bravo Music on how to improve control over their stock.** |
|---|---|

Any three valid points, e.g. consider the possibility of theft of CD's by employees – assess internal control measures in this regard.
Security measures at the door to be improved, e.g. alarm at door with tags on CD's.
Consider till points – possible collusion or error by employees when CD's are sold.
Consider purchase procedures – proper authorisation and checking of CD's received.

## TASK 15.26 Fashionable Accessories: Inventory valuation; Internal control

| | |
|---|---|
| **15.26.1** | **Name one other method that the business could have used instead of the Weighted average method in validating their stock.** |
| FIFO or LIFO | |
| **15.26.2** | **Give one reason why Mary chose the Weighted average method to validate her stock.** |
| Stock prices did not vary that much.<br>Simpler to calculate.<br>Differences over a period of time are ironed out.<br>Any other feasible reasons. | |
| **15.26.3** | **Calculate the value of the closing stock of cashmeres for July using the Weighted Average method. Round off to the nearest Rand.** |
| (R48 000 + R71 300) ÷ (240 + 310)<br>119 300 ÷ 550 = R217 (R216.91)<br>302 x R217 = **R65 534** | |
| **15.26.4** | **Calculate the Cost of sales, Gross profit and mark-up % achieved on Cashmeres for the month of July.** |
| Cost of sales: 205 x R217 = R44 485<br>Gross profit: R98 400 – R44 485 = R53 915<br>Mark-up %: $^{53\,915}/_{44\,485}$ x $^{100}/_{1}$ = **121%** | |
| **15.26.5** | **Mary is very pleased that the turnover is so high and believes that the business is doing very well. However, her accountant has said that while some results are very positive he feels the business is not doing as well as it should and that there are many areas that need to be better controlled to ensure that the business achieves its profitability budget. Explain to Mary what you think the accountant means in his statement by addressing the following:** |
| | • **The difference in opinion regarding Mary stating the turnover is so high while the accountant claims the business is not as profitable as it could be.** |
| Mary is referring to turnover which is only the sales.<br>The accountant is referring to the profit made by the business.<br>He has therefore considered the sales but taken into account the costs of buying the goods as well.<br>As the costs have increased the gross profit is less. | |
| | • **Comment on the statement "some results are very positive". Discuss at least 3 positive aspects of the stock records.** |
| Scarves have a surplus of 7, while 43 cashmeres are missing.<br>Scarves have a lower mark-up but sales are good.<br>Stocks of scarves are much lower.<br>Any other feasible explanation. | |
| | • **What areas "need to be better controlled" – discuss at least 2 areas.** |
| Stock holding of cashmeres is too high – must only order when necessary.<br>Scarves have a surplus of 7 – this is equally a problem as it indicates a lack of control.<br>Control measures need to be introduced to prevent stock losses.<br>Need to advertise more to ensure higher sales. | |

# TASK 15.27 Kloof Stores: Periodic inventory system – Ledger, Calculations, Internal control

**15.27.1** **GENERAL LEDGER OF KLOOF STORES**
**FINAL ACCOUNTS SECTION**

**Dr** **TRADING ACCOUNT** **F1** **Cr**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb | 28 | Opening stock | | 46 000 | Feb | 28 | Sales[3] | | 397 600 |
| | | Purchases[1] | | 219 340 | | | Closing stock | | 56 700 |
| | | Carriage on purchases[2] | | 13 460 | | | | | |
| | | Custom duties | | 1 500 | | | | | |
| | | Profit & loss a/c | | 174 000 | | | | | |
| | | | | **454 300** | | | | | **454 300** |

[1] 100 240 + 120 650 – 2 300 + 500 – 1 200 + 1 450
[2] 12 450 + 420 + 590
[3] 250 000 + 150 000 - 2 400

| **15.27.2** | **Determine the percentage mark-up achieved by Kloof Stores.** |
|---|---|
| Cost of sale = 397 600 – 174 000 = R223 600<br>Mark-up % = $^{174\,000}/_{223\,600}$ x 100 = **77.8%** | |

| **15.27.3** | **Comment on this percentage mark-up. The mark-up achieved in the previous year was 70%. Give reasons why the achieved and desired mark-up may differ.** |
|---|---|
| The mark-up achieved improved by nearly 8% in the current period.<br>The owner should be pleased with this. In 2006 the business almost succeeded in obtaining their target mark-up of 80%.<br>This indicates that fewer trade discounts were possibly granted and better stock control was exercised. | |
| **15.27.4** | **There are differences between the periodic and perpetual inventory systems:** |
| | • **Briefly explain a significant difference.** |
| Perpetual: Cost of sales recorded as goods are sold.<br>Periodic: Stock counted at end of period to determine cost of sales. | |
| | • **Briefly explain how a business would decide which system to adopt.** |
| Depends on type of articles sold, and funds available for set-up of system; perpetual system requires extra outlay and probably extra investment in equipment (e.g. bar-code readers). | |
| | • **If you were appointed as the internal auditor, how would you check that the internal control is acceptable under each system?** |
| Perpetual: Count goods, value them and compare actual to balance on Trading stock account.<br>Periodic: Work out GP, calculate mark-up % and assess if this is what was expected. | |

## TASK 15.28 Sundance Traders: Bank Reconciliation

| | |
|---|---|
| **15.28.1** | **The new bookkeeper, Ima Phoole, appears to be confused on certain issues. She has a three year contract, so firing her is not an option. You need to develop her understanding on these matters. What would you say to her in each case?** |
| | **(a) She says it is impossible for the January bank statement to reflect an overdraft if the bank account in the ledger reflects a favourable balance.** |
| There are differences between our books and the bank's books.<br>These could swing the balance from favourable to unfavourable (and vice-versa).<br>E.g.: A large outstanding deposit could cause this to happen. | |
| | **(b) She says she does not want to do bank reconciliations because these are an irritation and are not necessary.** |
| Vital for internal control.<br>Check to an external document. | |
| | **(c) She says she will not process any more credit card transactions for customers because the bank charges are too high in this regard.** |
| Most businesses accept credit cards.<br>Unless we do this, we will lose sales and customers.<br>Also convenient for customers & therefore we should offer this facility. | |
| **15.28.2** | **Refer to the Bank Reconciliation information in information (1) provided below when answering these questions. What should be done in each of the following cases when completing the bank reconciliation for February 20.7? Provide a reason for your action in each case.** |
| | **(a) Cheque no. 1203 does not appear on the bank statement for February.** |
| Cancel it in the CRJ.<br>It is stale. | |
| | **(b) Cheque no. 1876 does not appear on the bank statement for February.** |
| No action, except to enter on this month's statement.<br>Due date has not arrived.<br>A post-dated cheque issued is treated as outstanding cheque. | |
| | **(c) Cheque no. 1879 does not appear on the bank statement for February.** |
| No action, except to enter on this month's statement.<br>Payee has not yet deposited the cheque.<br>Can be presented at the bank any time within the next 6 months. | |
| **15.28.3** | **Calculate the following on 28 February 20.7:** |
| | **(a) The figure that would be reflected as bank charges in the books for February.** |
| 202 + 400 + 745 = **R1 347** | |
| | **(b) The correct total for the February CRJ.** |
| 325 700 + 2 000 + 80 000 = **R407 700** | |
| | **(c) The correct total for the February CPJ.** |
| 384 400 + 1 400 + 1 347* + 610 + 880 + 900 = **R389 537**<br>*202 + 400 + 745 | |
| | **(d) The correct balance on the Bank account in the ledger (you may draft the Bank account to do this).** |
| 4 000 + 407 700 – 389 537 = **R22 163** | |

**15.28.4 Bank Reconciliation Statement on 28 February 20.7**

| | | |
|---|---|---|
| Balance per bank statement | 39 183 | Cr |
| Outstanding deposit | 12 000 | Cr |
| Outstanding cheques: | | |
| No. 1876 (dated 15 April 2007) | (19 500) | Dr |
| No. 1879 | (7 200) | Dr |
| No. 1905 | (2 320) | Dr |
| Balance per bank account | **R22 163** | Dr |

| **15.28.5** | **If you are required to prepare a Balance Sheet on 28 February 20.7:** |
|---|---|
| | • **Where would you reflect the Bank account?** |
| Under Cash & cash equivalents – as a current asset. | |
| | • **What amount would you reflect as 'Cash at bank'?** |
| 22 163 + 19 500 = **R41 663** | |

## TASK 15.29 Ekubo Ltd: Reconciliation – Bank, Creditors, Debtors, Auditing

| **15.29.1** | **List the errors that Ivor has appeared to have made, and in each case explain what should be done to correct these.** |
|---|---|

- Post-dated cheque (PDC) received dated 31 March should not be recorded yet – cancel R15 000 in CPJ.
- Cheque no. 1034 is stale – cancel R2 400 in CRJ.
- Cheque no. 2341 is incorrect in the CPJ – enter correction of R360 through CRJ.
- Direct transfer of R12 000 must be entered in CPJ not CRJ – correct error by entering R24 000 on CPJ.
- Interest on overdraft is valid – the actual balance at the bank is unfavourable due to large outstanding deposit – enter R510 in CPJ.
- The insurance premium is clearly a bank error this must be reflected on the Bank Reconciliation Statement as a credit.

| **15.29.2** | **Calculate the following:** |
|---|---|
| | • **The correct bank balance that should appear in the ledger.** |

| | | |
|---|---|---|
| Balance per bank statement | (17 400) | Dr |
| Outstanding deposit | 29 000 | Cr |
| Outstanding cheques: | | |
| No. 2346 | (1 300) | Dr |
| No. 2348 | (850) | Dr |
| No. 2350 | (1 020) | Dr |
| Correction of bank error | 770 | Cr |
| Balance per bank account | **R9 200** | Dr |

***OR:*** 45 950 + 360 – 15 000 + 2 400 – 24 000 – 510 = R9 200

| | • **The bank balance that will appear in the Balance Sheet on 28 February 20.2.** |
|---|---|
| 9 200 + 850 = **R10 050** | |

| **15.29.3** | **List the corrections that Ivor must make in the books of Ekubo Ltd.** |
|---|---|

- Cheque for R4 200 must be corrected in the GJ – credit Xpert Manufacturers and debit XS Suppliers.
- Correct invoice for R1 090 in GJ – debit Xpert Manufacturers / Creditors Control, and credit Trading stock with R810.
- Correct error – cancel the R110 credit and then enter another R110 debit – this decreases the balance of Xpert Manufacturers by R220.

**15.29.4 Calculate the correct amount owed to Xpert Manufacturers on 28 February 20.2.**

From Reconciliation Statement: 18 550 – 9 120 – 480 + 10 500 – 3 300 – 350 = **R15 800**
OR Balance per ledger: 12 630 + 4 200 – 810 – 220 = **R15 800**

**15.29.5 Calculate the correct amount owed by Jackson CC on 28 February 20.2.**

37 580 – 7 200 – 10 000 – 300 – 2 800 + 240 + 518 – 360 = **R17 678**

**15.29.6 Explain the difference of R 4 382 between the balance on the Debtors Control account and the Debtors Listing on 28 February 20.2.**

Debtors control: 304 700 – 7 200 – 300 + 24 – 6 600 = R290 840
Listing: 309 082 – 7 200 – 300 – 2800 + 240 + 518 – 6 600 – 360 – 1 740 = R290 840
The difference is caused by:

| | |
|---|---|
| Credit note 45 = 1 400 x 2 | (2 800) |
| VAT omitted from DL account | 518 |
| Adding error on DL account | (360) |
| Credit balance treated as debit | (1 740) |
| **DIFFERENCE** | **R4 382** |

**15.29.7 Judging from this debtor's account, is Ekubo Ltd controlling its debtors well? Explain three points, quoting evidence from the question.**

No, they are not controlling their debtors well.
Any three valid points, e.g.:
Debtors not signing invoices as proof of collection of goods.
Errors in processing receipts – the R10 000 was not picked up for two months – there is now another debtors in arrears.
They are still selling goods to Jackson CC even though their account is overdue for 2 months.

**15.29.8 You have been appointed as the external independent auditor of Ekubo Ltd.**

**(a) Briefly describe the nature of your job responsibilities.**

To report to the shareholders and to express an opinion on the fair presentation of the financial statements.

**(b) Briefly explain how you would verify that the figures for Bank, Debtors and Creditors are properly reflected in the financial statements.**

Tests to be done on transactions to check internal control processes and division of duties – documents, authorisation of purchase procedures.
Verify to external documents, e.g. bank statements & creditors statements.
Contact selected debtors to check that they agree on balances, etc.

## TASK 15.30 Emma Furnishers: Debtors control and Age analysis

**15.30.1 How can the preparation of a Debtors Collection Schedule and Debtors Age Analysis assist Emma and Jenna in controlling debtors?**

**Debtors Collection Schedule:**
- Project anticipated receipts from debtors.
- Ensure that debtors keep to terms of their accounts, i.e. 30 days.
- Act if the debtors do not comply with credit terms.
- Compare anticipated budget with actual budgets.

**Debtors Age Analysis:**
- Effective method of credit control.
- Action can be taken against debtors who do not comply by charging interest/legal action.
- Bad debts can be minimised.
- Make decisions based on Age Analysis of the debtor/s.

| | |
|---|---|
| **15.30.2** | **Refer to Information 2 below.**<br>**Calculate the expected monthly collection of credit sales for March 20.1 for inclusion in the Debtors Collection Schedule. Total sales for the year ended 28 February 20.2 is expected to increase to R960 000. The rest of the credit terms and expected payments will remain the same as given in Information No. 2 below.** |

**DEBTORS COLLECTION SCHEDULE:**

| Month | Credit sales | March 20.1 | April 20.1 | May 20.1 |
|---|---|---|---|---|
| March 20.1 | 960 000 ÷ 12 x 75% = R60 000 | R17 640 | R30 000 | R9 000 |

| | |
|---|---|
| **15.30.3** | **The balance on the Debtors control account was R42 500 on 1 March 20.0, the beginning of the financial year and R83 500 on 28 February 20.1, the end of the financial year.** |
| | • **Calculate the Debtors average collection period (in days) for the past financial year ended 28 February 20.1.** |

$$\frac{\text{Average debtors}}{\text{Credit sales}} \times \frac{365}{1}$$

$$\frac{63\,000}{630\,000} \times \frac{365}{1} = \mathbf{\underline{36.5 \text{ days}}}$$

| | |
|---|---|
| | • **Explain whether Emma should be satisfied with this.** |

Yes / No.
Valid reason depending on calculation. Needs to compare to credit terms of 30 days.

| | |
|---|---|
| | • **Provide a reason for your opinion.** |

Debtors are not complying with the 30 day credit term.
He expected that some debtors would pay within the 60 days.
The collection period is therefore not good.

| | |
|---|---|
| **15.30.4** | **Emma feels that the control of debtors has not been satisfactory since Jenna was employed. Emma wants you to report to her on what appears to have gone wrong. Refer to the Debtors Age Analysis (Information 3) and the Debtors control account (Information 4) provided below.**<br><br>**Explain FOUR points that you would include in your report. You must quote specific information from the Age Analysis of debtors (TWO points) and from the Debtors control account (TWO points) to support your answer.** |

**Debtors Age Analysis:**

- M. MacKenzie's debt exceeds 60 days – R13 000 outstanding for 60+ days.
- M. MacKenzie and A. Mkhize's balances are higher than the credit limits of R15 000.

**Debtors control account:**

- Dishonoured cheques amounts to 17.2% of payments received from debtors. Received R61 000 – dishonoured cheques R10 500 (R9 700 + R800). This is not acceptable.
- R2 000 bad debts written off. They sold too much on credit to unreliable debtors – customers are not screened properly.
- Debtor's allowances are 5.7% of sales. Too much stock is returned by debtors, (R3 000).

## TASK 15.31 MacCallum Stores: Debtors control and Age analysis

**15.31.1 Calculate the correct Debtors control balance of the Pinetown branch.**

| | |
|---|---|
| Balance | R23 940 |
| 3.1 | (800) |
| 3.2 | (420) |
| 3.3 | 1 320 |
| 3.4 | (360) |
| 3.6 | (180) |
| **TOTAL** | **23 500** |

**15.31.2 Calculate the correct Debtors List of the Pinetown branch.**

| DEBTOR | WORKINGS | FINAL BALANCE |
|---|---|---|
| E. Singels | 5 200 - 240 - 180 | 4 780 |
| I. Page | 6 600 + 1 320 - 360 | 7 560 |
| I. Pieterse | 12 400 - 620 - 620 | 11 160 |
| **TOTAL** | | **23 500** |

**15.31.3 The owner is concerned that the bookkeeper is not controlling the debtors in the Kloof branch effectively.**

**(a) Do you agree with him? Why? Use information to substantiate your answer.**

Yes.
Smith and Lake's accounts are overdue.
Smith's account is more than the credit limit.

**(b) What advice would you give regarding the three debtors of the Kloof Branch?**

J. Henry must be rewarded or congratulated on the effective running of his account.
Smith's account must be frozen until the overdue amount has been settled and it is brought back within the credit limits.
Lake's account must be followed up and even given to a debt-collector as it is overdue.

**(c) The bookkeeper is of the opinion that drawing up an Age Analysis is a waste of time. She says that there is a Debtors control and a Debtor's ledger and completing an Age Analysis is not only time consuming but is duplicating her work. Do you agree with her? Why? Explain fully.**

No.
The age analysis looks at each individual debtor and can pick up problems.
You can identify which are your good customers and which are the problem debtors.
Corrective action can be taken against those debtors that are a problem.

## TASK 15.32 Debbie Stores: Creditors Reconciliation

**DEBBIE STORES**
**CREDITORS RECONCILIATION STATEMENT ON 31 MAY 20.8**

| | |
|---|---|
| Balance as per statement | 11 710 |
| Discount | (550) |
| Incorrect invoice | (1 000) |
| Correction of error on debit note | (5 200) |
| Outstanding invoice | 1 200 |
| Outstanding cheque | (5 800) |
| Correct balance | **360** |

**CREDITORS LEDGER**

| | |
|---|---|
| Balance as per account | 1 200 |
| Trade discount | (840) |
| Correct balance | **360** |

## TASK 15.33 Wood Stores: Age analysis

**15.33.1 Briefly explain how the completion of an Age Analysis can assist the business in terms of their internal control measures. Discuss at least two benefits.**

- Can identify those debtors that are over their credit terms so that they can be followed up on.
- Can identify those debtors that manage their accounts effectively.

**15.33.2 A friend of yours has just received a statement on which appears an Age Analysis. This looks very similar to the one given in your answer book that you will have to complete. She does not understand what is meant by the terms, current, 30 days, etc. Explain to her what these terms meant and how she must read the Age Analysis.**

Current – shows the amounts owing for this month.
60 days – amounts owing from 30 days – is amount owing from last month and two months ago (these amounts are now overdue).
90 days – amounts owing from three months ago (these amounts are now overdue).

**15.33.3 Complete the Age Analysis of G. Smith on 31 March 20.9.**

**AGE ANALYSIS ON 31 MARCH 20.9**

| 90 days Dec | 60 days Jan | 30 days Feb | Current March |
|---|---|---|---|
| 4 800 | 12 000 | 16 600 | 2 300 |
| (2 400) | (1 200) | | 6 800 |
| (120) | (1 320) | | |
| (2 280) | (180) | | |
| | (4 000) | | |
| | (200) | | |
| | (1 890) | | |
| **0** | **3 210** | **16 600** | **9 100** |

**15.33.4 Is G. Smith meeting their credit terms? Why? Explain briefly by quoting figures.**

No.
The R3 210 is overdue (60 days). (If the terms are 30 days then the current and 30 days amounts are okay but anything beyond this becomes overdue.)

| 15.33.5 | **Explain to the owner three different measures they could introduce in order to control any debtors whose accounts are not meeting their credit terms.** |
|---|---|

- Charge interest on the overdue amounts.
- Offer discounts or higher discounts for amounts paid in the credit terms.
- Close accounts of debtors whose accounts are overdue.
- Send out reminders to the debtors, telephone, email, etc.

Any other feasible measure.

## TASK 15.34 ABC Traders: Problem solving – Debtors

**ABC Traders has a cash flow problem. What advice will you offer to resolve the problem?**

**Evaluation of information:**

- Debtors are paying slowly. Less than half the credit sales for a month are settled in the subsequent month. The Debtors control balance is increasing each month. This will cause a cash flow problem as suppliers will have to be paid promptly.
- Debtors allowances are high in relation to sales (e.g. $^{5\ 120}/_{23100}$ x 100 = 22%). This could indicate a problem with stock quality, but probably indicates that agents are not being discerning in who they sell to.

**Possible strategies:**

- Better internal control over debtors – monthly statements, credit checks, incentives for early payment, legal action.
- Address problem of stock quality with suppliers. Ask debtors for feedback.
- Change the commission strategy. Do not pay commission to agents unless the debtors' accounts are settled.

## TASK 15.35 VAT: Theory, Interpretation, Calculations

**15.35.1 What is meant by 'Value Added Tax' and at what rate is VAT is calculated?**

Tax calculated on goods sold.
14%.

**15.35.2 The accountant of Bestbuy Traders, a registered VAT vendor, made a mistake on the VAT 201 return. When completing the form he recorded Input VAT as R8 000 instead of R5 000.**

**(a) How does the error affect the amount payable to SARS?**

VAT has been underpaid by R3 000.

**(b) What action can the accountant take with regard to the error?**

He must approach SARS to correct the error – SARS will allow him an opportunity to correct the error if it is a genuine error.

**15.35.3 The approximate turnover of Themba's Construction Company for the past three years is R800 000 per annum. He has not yet registered as a VAT vendor.**

**(a) Should he register as a VAT vendor? Give a reason for your answer.**

Yes – as his turnover exceeds R1 000 000 he must register as a vendor.

**(b) How would Themba benefit from being a registered VAT vendor?**

He would be able to claim deductions in respect of input VAT.
VAT Output would be recovered from customers.

**(c) Explain whether Themba would be liable for tax penalties.**

Yes – ignorance of the law is no excuse.

**15.35.4 Helen Frana owns HF Clothing. The business is registered for VAT under Category B (the invoice basis) on a one-month period. The business also only deals with other VAT-vendors. No goods, expenses or services were exempt from VAT or zero-rated. You are provided with information for the month of June 20.7:**

| Transaction | Document | Journal | Amount including VAT | Value Added Tax | Amount excluding VAT |
|---|---|---|---|---|---|
| Stock bought for cash | Cheque | **CPJ** | 39 900 | 4 900 | **35 000** |
| Equipment bought for cash | Cheque | CPJ | **159 600** | 19 600 | 140 000 |
| Expenses paid by cheque | Cheque | CPJ | **17 100** | **2 100** | 15 000 |
| **Goods sold for cash** | Cash slip | **CRJ** | 136 800 | **16 800** | 120 000 |
| Fee income received | **Receipt** | CRJ | 91 200 | 11 200 | 80 000 |
| Stock bought on credit | **Invoice** | **CJ** | 45 714 | 5 614 | 40 100 |
| **Stock returned to creditors** | **Debit note** | CAJ | **684** | 84 | **600** |
| **Goods sold on credit** | **Invoice** | DJ | 86 640 | **10 640** | **76 000** |
| Goods returned by debtors | **Credit note** | **DAJ** | 2 622 | 322 | 2 300 |
| Bad debts | **JV** | **GJ** | 1 368 | 168 | 1 200 |

**(a) Fill in the missing details and figures in the table provided above.**

See above.

| | |
|---|---|
| | **(b) Calculate the amount payable for VAT for June 20.7 (you may prepare a VAT control account if you wish to do so).** |

| Input | Output |
|---|---|
| 4 900 | 16 800 |
| 19 600 | 11 200 |
| 2 100 | 84 |
| 5 614 | 10 640 |
| 322 | |
| 168 | |
| **32 704** | **38 724** |
| **VAT PAYABLE = R6 020** | |

| | |
|---|---|
| **15.35.5** | **You purchase goods from Shifty Furnishers. The owner John Shifty has offered you a special price of R570 including VAT instead of R684 provided you pay cash and do not require a document.** |
| | **(a) What concerns would you have regarding VAT?** |

John Shifty will be keeping R70 VAT for himself.
Without a document a SARS auditor will not be able to trace the transaction.

**(b) Would you accept the offer? Explain briefly.**

Yes / No with reason.
Do not accept unethical or illegal response.

## TASK 15.36 Wood Ltd: Theory, VAT Input & Output, Ledger

| | |
|---|---|
| **15.36.1** | **Briefly explain what is meant by VAT Input and VAT Output.** |

VAT Output is collected from customers on goods sold and services rendered.
VAT Input is paid to suppliers on goods and services bought – this is deducted from the VAT Output to calculate the amount to be paid over to SARS.

| | |
|---|---|
| **15.36.2** | **What is the present VAT rate in South Africa? How can this VAT rate change?** |

14%
The Minister of Finance has the power to change the rate.

| | |
|---|---|
| **15.36.3** | **Are all goods in South Africa charged at the same rate? Explain.** |

No.
Zero-rated and VAT exempted items do not have VAT added to them.

**15.36.4**

Totals in the Creditors Journal for August 20.9 Folio: CJ6

| Creditors control | Trading stock | Equipment | Stationery | VAT |
|---|---|---|---|---|
| R353 400 | R200 000 | R100 000 | R10 000 | ***(a) R43 400*** |

Totals in the Creditors Allowances Journal for August 20.9 Folio: **CAJ6**

| Creditors control | Trading stock | Equipment | Stationery | VAT |
|---|---|---|---|---|
| ***(c) R22 344*** | R14 000 | R5 000 | R600 | ***(b) R2 744*** |

Totals in the Debtors Journal for August 20.9 Folio: **DJ6**

| Debtors control | Sales | VAT | Cost of sales |
|---|---|---|---|
| ***(f) R437 760*** | ***(d) R384 000*** | ***(e) 53 760*** | R240 000 |

Totals in the Debtors Allowances Journal for August 20.9 Folio: **DAJ6**

| Debtors control | Sales | VAT | Cost of sales |
|---|---|---|---|
| ***(h) R4 560*** | ***(g) R4 000*** | 560 | ***(i) R2 500*** |

Totals in the Petty Cash Journal for August 20.9 Folio: **PCJ6**

| Petty cash | Delivery expenses | Stationery | VAT |
|---|---|---|---|
| R5 472 | R4 000 | ***(j) R800*** | R672 |

Totals in the Cash Receipts Journal for August 20.9 Folio: **CRJ6**

| Bank | Sales | Fee income | VAT | Cost of sales | Debtors control (Receipts) | Discount allowed |
|---|---|---|---|---|---|---|
| ***(k) R165 460*** | R54 000 | R35 000 | R12 460 | R33 750 | R64 000 | R2 800 |

Totals in the Cash Payments Journal for August 20.9 Folio: **CPJ6**

| Bank | Trading stock | Salaries | Consuma-ble stores | VAT | Creditors control (Pay-ments) | Discount received | Sundry accounts |
|---|---|---|---|---|---|---|---|
| ***(m) R264 960*** | R60 000 | R72 000 | R4 000 | ***(l) R8 960*** | R110 000 | R4 218 | R10 000 |

Entries in the General Journal for August 20.9 Folio: **GJ8**

10.1 The VAT on the discount allowed amounted to ***(n) R344***.

**15.36.5** **GENERAL LEDGER OF WOOD LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**Dr** **VAT Input** **B** **Cr**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 1 | Balance | b/d | 21 200 | Aug | 31 | Creditors control | CAJ | 2 744 |
| | 31 | Creditors control | CJ | 43 400 | | | Discount received | GJ | 518 |
| | | Petty cash | PCJ | 672 | | | VAT Control | GJ | 70 970 |
| | | Bank | CPJ | 8 960 | | | | | |
| | | | | **74 232** | | | | | **74 232** |

**VAT Output** **B**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Debtors control | DAJ | 560 | Aug | 1 | Balance | b/d | 22 400 |
| | | Discount allowed | GJ | 344 | | 31 | Debtors control | DJ | 53 760 |
| | | Bad debts | GJ | 540 | | | Bank | CRJ | 12 460 |
| | | VAT Control | GJ | 88 296 | | | Drawings | GJ | 1 120 |
| | | | | **89 740** | | | | | **89 740** |

**VAT Control** **B**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | VAT Input | GJ | 70 970 | Aug | 31 | VAT Output | GJ | 88 296 |
| | | Balance | c/d | 17 326 | | | | | |
| | | | | **88 296** | | | | | **88 296** |
| | | | | | Sept | 1 | Balance | b/d | 17 326 |

**OR ALTERNATIVE – IF POSTED DIRECTLY TO THE VAT CONTROL ACCOUNT.**

**Dr** **VAT CONTROL** **B** **Cr**

| 20.9 | | | | | 20.9 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Aug | 31 | Creditors control | CJ | 43 400 | Aug | 1 | Balance (22 400 – 21 200 | b/d | 1 200 |
| | | Debtors control | DAJ | 560 | | 31 | Creditors control | CAJ | 2 744 |
| | | Petty cash | PCJ | 672 | | | Debtors control | DJ | 53 760 |
| | | Bank | CPJ | 8 960 | | | Bank | CRJ | 12 460 |
| | | Discount allowed | GJ | 344 | | | Discount received | GJ | 518 |
| | | Bad debts | GJ | 540 | | | Drawings | GJ | 1 120 |
| | | Balance | c/d | 17 326 | | | | | |
| | | | | **71 802** | | | | | **71 802** |
| | | | | | Sep | 1 | Balance | b/d | 17 326 |

## TASK 15.37 Memele: VAT calculations

**Calculate the VAT owing to SARS / or the VAT owing by SARS for the 2 months ended 31 August 20.9, using the information given below.**

| No. | Working | Amount |
|---|---|---|
| 1. | 486 900 – 120 000 x $^{14}/_{100}$ | 51 366.00 |
| 2. | 156 000 x $^{14}/_{114}$ | (19 157.89) |
| 3. | 45 600 x $^{14}/_{100}$ | (6 384.00) |
| 4. | (24 500 – 4 500) x $^{14}/_{100}$ | (2 800.00) |
| 5. | 5 000 x $^{14}/_{114}$ | (614.04) |
| 6. | 14 000 x $^{14}/_{114}$ | 1 719.30 |
| 7. | 1 800 x $^{14}/_{114}$ | 221.05 |
| 8. | 800 x $^{14}/_{100}$ | (98.25) |
| | **TOTAL AMOUNT OWING TO SARS** | **R24 252.17** |

## TASK 15.38 JJ Jerseys: Production Cost Statement, Calculations, Interpretation

**Note:**
This is an extensive question covering most aspects of financial statements of a manufacturing business. This could comprise a valid test in a class situation. You should expect to answer only selected aspects of this type of question in a formal examination.

### 15.38.1 PRODUCTION COST STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 20.7

| | Note | |
|---|---|---|
| ✓Prime cost | | ☑1 875 900 |
| ✓Direct materials cost | 1 | ☑1 112 900 |
| ✓Direct labour cost [835 000✓ – 36 000✓ – 36 000✓] | | ✓763 000 |
| ✓Factory overhead cost | 2 | ☑611 000 |
| ✓Total cost of production | | ☑2 486 900 |
| ✓Work-in-process at beginning of year | | ✓81 000 |
| | | 2 567 900 |
| ✓Work-in-process at end of year | | ✓(62 000) |
| **Total cost of production of finished goods** | | **☑2 505 900** |
| | | **(18)** |

**NOTES:**

**1. Direct Materials Cost**

| | |
|---|---|
| Raw materials on hand at beginning of year | ✓72 000 |
| Purchases [850 000 + 56 000] | ☑✓906 000 |
| Carriage on purchases | ✓53 000 |
| Customs duty [127 500 + 8 400] | ☑✓135 900 |
| | 1 166 900 |
| Raw materials on hand at end of year | ✓(54 000) |
| **Direct materials cost** | **☑1 112 900** |
| | **(8)** |

**2. Factory Overheads Cost**

| | |
|---|---|
| Indirect materials [7 000✓ + 43 000✓ – 3 800✓] | ✓46 200 |
| Rent [320 000 x 80%] | ☑✓256 000 |
| Water & electricity | ✓21 000 |
| Wages | ✓36 000 |
| Salary of factory foreman | ✓142 000 |
| Insurance [(3 600 + 42 000 – 7 000) x 80%] | ☑✓30 880 |
| Sundry expenses [17 400 x 80%] | ☑✓13 920 |
| Depreciation [650 000 x 10%] | ☑✓65 000 |
| **Factory overheads cost** | **☑611 000** |
| | **(16)** |

**15.38.2 (a) Administration Cost**

| | |
|---|---|
| Rent [320 000 x 5%] | ✓16 000 |
| Water & electricity [7 000 ÷ 2] | ☑✓3 500 |
| Salaries of two office administrative assistants | ✓130 000 |
| Insurance [(3 600 + 42 000 – 7 000) x 5%] | ☑✓1 930 |
| Stationery and printing | ✓11 000 |
| Telephone costs [32 000 ÷ 2] | ☑✓16 000 |
| Interest on loan [360 000✓ – 75 600✓ – 322 000✓] | ✓37 600 |
| Sundry expenses [17 400 x 5%] | ☑✓870 |
| Wages: Office cleaner | ✓36 000 |
| Depreciation [140 000 x 10%] | ☑✓14 000 |
| **Administration Cost** | **☑266 900** |

**(19)**

**(b) Selling & Distribution Cost**

| | |
|---|---|
| Rent [320 000 x 15%] | ☑✓48 000 |
| Water & electricity [7 000 ÷ 2] | ☑✓3 500 |
| Salaries of three salespersons | ✓150 000 |
| Commission paid to salespersons [100 000 + 305 264] | ☑✓405 264 |
| Insurance [(3 600 + 42 000 – 7 000) x 15%] | ☑✓5 790 |
| Advertising paid [55 000 + 3 500] | ☑✓58 500 |
| Motor vehicle expenses | ✓74 000 |
| Telephone costs [32 000 ÷ 2] | ☑✓16 000 |
| Sundry expenses [17 400 x 15%] | ☑✓2 610 |
| Bad debts | ✓15 000 |
| Depreciation [510 000✓ – 460 000✓ – 3*✓] | ✓49 997 |
| **Selling & distribution cost** | **☑828 661** |

**Fully depreciated – value each car at R1.00*

**(22)**

**15.38.3 Calculate:**

**(a) Unit cost of production** **(2)**

2 505 900 ÷ 16 000 = **R156.62** ✓✓

**(b) Cost of sales for the year** **(2)**

165 000 + 2 505 900 – 138 000 = **R2 532 900** ✓✓

**(c) Sales for the year** **(2)**

2 532 900 x 160% = **R4 052 640** ✓✓

**(d) Gross profit for the year** **(2)**

2 532 900 x 60% = **R1 519 740** ✓✓

**(e) Net profit for the year** **(2)**

1 519 740 – 266 900 – 828 661= **R424 179** ✓✓

**(f) Net profit as a % of sales** **(2)**

$\frac{424\,179}{4\,052\,640} \times \frac{100}{1}$ = **10.5%** ✓✓

**(g) % return on average equity** **(2)**

$\frac{424\,179}{1\,500\,000} \times \frac{100}{1}$ = **28.3%** ✓✓

| 15.38.4 | **What is your opinion on the results of the business? Should John be satisfied, and do you agree that he should withdraw all the net profit each year?** | **(3)** |
|---|---|---|

Yes / No with supporting argument.
28.3% return is good – exceeds returns on alternative investments and it exceeds his returns in the recent past.
The business appears to be sustainable, especially as soccer is a popular sport, and his jerseys appear to be good quality using the best imported fabric.
Net profit margin is very low at 10.5% of sales – if sales drop significantly, fixed costs will be a problem.
He is entitled to withdraw all the profit, but he should consider repaying the loan out of profits as quickly as possible, or he could consider buying the property instead of renting it to reduce fixed costs.

**✓✓✓ Excellent answer = 3 marks; Good = 2; Poor = 1; Incorrect = 0**

**TOTAL MARKS = 100**

## TASK 15.39⌘ Freda's Fashions: Production Cost Statement, Calculations, Income Statement

**15.39.1 PRODUCTION COST STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 20.7**

| | Note | |
|---|---|---|
| Prime cost | | 1 113 600 |
| Direct materials cost | 1 | 930 000 |
| Direct labour cost | 2 | 183 600 |
| Factory overhead cost | 3 | 219 800 |
| Total cost of production | | 1 333 400 |
| Work-in-process at beginning of year | | 57 500 |
| | | 1 390 900 |
| Work-in-process at end of year | | (102 900) |
| **Total cost of production of finished goods** | | **1 288 000** |

**NOTES:**

**1. Direct Materials Cost**

| | |
|---|---|
| Direct materials on hand at beginning of year | 80 000 |
| Purchases of direct materials (120 000 x 7.00) | 840 000 |
| Customs duty | 252 000 |
| Shipping costs | 46 000 |
| | 1 218 000 |
| Direct materials on hand at end of year | (288 000) |
| **Direct materials cost** | **930 000** |

**2. Direct Labour Cost**

| | |
|---|---|
| Basic direct wages (4 x 160 x 9 x 30) | 172 800 |
| Overtime (4 x 5 x 12 x 45) | 10 800 |
| **Direct labour cost** | **183 600** |

**3. Factory Overheads Cost**

| | |
|---|---|
| Indirect materials (4 800 + 17 600 – 3 200) | 19 200 |
| Indirect labour – foreman | 110 000 |
| Indirect labour – cleaner [(3 640 x 12) x $^{5}/_{7}$] | 31 200 |
| Electricity & water (27 000 x $^{150}/_{250}$) | 16 200 |
| Rent (66 000 + 6 000) x $^{150}/_{250}$) | 43 200 |
| **Factory overheads cost** | **219 800** |

**15.39.2 Calculation of Cost of sales**

| | |
|---|---|
| Opening stock of finished goods | 92 000 |
| Cost of production of finished goods | 1 288 000 |
| Less: Loss due to theft | (7 500) |
| Less: Closing stock of finished goods | (127 500) |
| **Cost of sales** | **1 245 000** |

**Calculation of Sales**

| | |
|---|---|
| 1 245 000 x $^{160}/_{100}$ | |
| OR 1 245 000 x $^{12\,000}/_{7\,500}$ | **1 992 000** |
| | |

**15.39.3 INCOME STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 20.7**

| | |
|---|---|
| Sales | 1 992 000 |
| Cost of sales | (1 245 000) |
| **Gross profit** | 747 000 |
| **Operating costs** | (277 000) |
| Administration cost | 133 000 |
| Selling & distribution cost | 144 000 |
| **Operating profit** | 470 000 |
| Interest income | 3 000 |
| **Operating profit before Interest expense** | 473 000 |
| Interest expense (140 000 – 126 000 – 33 000) | (19 000) |
| **Net profit** | **454 000** |

## TASK 15.40 CS Soccer Balls: Cost calculations, Interpretation

**15.40.1 Fill in the missing details in the statements above denoted by the letters (a) to (l).**

| No. | Answer |
|---|---|
| **(a)** | Factory overhead cost |
| **(b)** | Cost of production of finished goods |
| **(c)** | Cost of sales |
| **(d)** | Selling & distribution cost |
| **(e)** | R364 250 |
| **(f)** | R310 200 |
| **(g)** | R1 222 000 |
| **(h)** | R875 610 |
| **(i)** | R346 390 |
| **(j)** | R323 360 |
| **(k)** | R158 860 |
| **(l)** | R23 030 |

**15.40.2 Calculate the following:**

**(a) Total fixed costs**

201 160 + 158 860 = **R360 020**

**(b) Fixed costs per unit**

360 020 ÷ 4 700 = **R76.60**

**(c) Variable costs per unit**

66.00 + 35.00 + 77.50 = **R178.50**

| 15.40.3 | **Break-even and economies of scale:** |
|---|---|
| | **(a) Calculate the break-even point for the year ended 28 February 20.7.** |
| 360 020<br>(260.00 – 178.50)<br>360 020<br>81.50<br>**4 417** or **4 418 units** | |
| | **(b) Should Cyril be satisfied with the level of his production of soccer balls in the 20.7 financial year? Explain briefly, quoting appropriate figures.** |
| No.<br>Current production is only 283 units higher than the break-even point **(**BEP). | |
| | **(c) Briefly explain what is meant by 'economies of scale' with specific reference to fixed costs. Provide an example from the question to illustrate this point.** |
| As more units are produced, the fixed cost per unit will decline.<br>Administration costs remained constant (approximately R159 000), yet unit costs dropped from R37.82 to R33.80. | |
| **15.40.4** | **Cyril was aiming at a net profit of R200 000 in 20.7. How many soccer balls should he have produced to meet this objective?** |
| (360 020 + 200 000) ÷ 81.50<br>560 020 ÷ 81.50<br>**6 871 units**<br>or **6 872 units** | |
| **15.40.5** | **You feel that Cyril cannot reach his target net profit of R200 000 next year without economising on certain costs.** |
| | **(a) Identify which costs have not been well controlled in 20.7. Quote appropriate figures/indicators to support your answers. In each case provide a possible solution to reverse the negative trend.** |
| Direct labour cost:<br>R52 to R66 (increase); Monitor workers for greater efficiency, etc.<br><br>Selling & distribution cost:<br>R18.40 to R35.00 (increase); Source cheaper packaging, etc. | |
| | **(b) Identify which costs have been well controlled in 20.7. Quote appropriate figures/indicators to support your answers. In each case, provide a possible reason why the positive trend has occurred.** |
| Direct materials cost:<br>R80.00 to R77.50 (decrease); Greater efficiency / Reduced prices.<br><br>Factory overhead cost:<br>R224 700 to R201 160 (decrease); Steps to reduce wastage, etc.<br><br>**Note**: Do not accept Administration cost – total has increased. | |

# TASK 15.41 Thabo's Tent Manufacturers: Calculations, Analysis and interpretation

**15.41.1 THABO'S TENT MANUFACTURERS**
**PRODUCTION COST STATEMENT**

| | 20.4 | | 20.3 | |
|---|---|---|---|---|
| | **Total** | **Per unit** | **Total** | **Per unit** |
| ***Number of units produced and sold*** | ***2 100 tents*** | | ***3 000 tents*** | |
| Direct material cost | R966 000 | ***(a)*** 460 | R1 230 000 | 410 |
| Direct labour cost | 430 500 | ***(b)*** 205 | 660 000 | 220 |
| Prime cost | 1 396 500 | ***(c)*** 665 | 1 890 000 | 630 |
| Factory overhead cost | ***(d)*** 840 000 | 400 | 810 000 | 270 |
| Total cost of production | **2 236 500** | ***(e)*** **1 065** | **2 700 000** | **900** |

**INCOME STATEMENT**

| | 20.4 | | 20.3 | |
|---|---|---|---|---|
| | **Total** | **Per unit** | **Total** | **Per unit** |
| ***Number of units produced and sold*** | ***2 100 tents*** | | ***3 000 tents*** | |
| Sales | ***(f)*** 3 129 000 | 1 490 | 4 050 000 | 1 350 |
| Cost of sales | (2 236 500) | ***(g)*** 1 065 | (2 700 000) | (900) |
| Gross profit | ***(h)*** 892 500 | ***(i)*** 425 | 1 350 000 | 450 |
| Administration cost (Fixed cost) | (132 300) | ***(j)*** (63) | (150 000) | (50) |
| Selling & distribution cost (Variable cost) | ***(k)*** (172 200) | (82) | (240 000) | (80) |
| Operating profit | 588 000 | 280 | 960 000 | 320 |
| Interest expense (12% p.a.) (Fixed cost) | (63 000) | (30) | (63 000) | (21) |
| Net profit (loss) | **525 000** | ***(l)*** **250** | **897 000** | **299** |

**15.41.2 Calculate the Variable costs per unit and Fixed costs per unit for 20.4.**

**Variable costs per unit:**
460 + 205 + 82 = **R747**
**Fixed costs per unit:**
400 + 63 + 30 = **R493**

**15.41.3 Calculate the break-even point for this business. What does this indicate about the long-term sustainability of the business?**

**Calculation**:
Total fixed costs = 840 000 + 132 300 + 63 000 = R1 035 300
Contribution per unit = 1 490 – 747 = R743
Break even point = 1 035 300 ÷ 743 = **1 393 units**
**Indicates**:
Production will have to drop significantly (by 707 units, i.e. 34%) before losses are made.
The business appears to be sustainable.
The decline in sales from 3 000 to 2 100 in 20.4 is a concern (sales dropped 30% in 20.4) – this must not be repeated.

**15.41.4 Calculate and comment on the mark-up% of the business. Should Thabo adjust his prices in the future to increase profits?**

Mark-up % = $^{425}/_{1\,065}$ x 100 = 40%
This is a decline from the previous year (20.3 was 50%).
Nevertheless his prices have increased by 10% (higher than inflation).
Customers will not tolerate this as evidenced by lower sales volume.
Do not increase prices.

| 15.41.5 | Comment on the following trends in the following indicators, offering one probable or possible reasons for the change from 20.3 to 20.4: |
|---|---|

**Raw materials cost per unit:**
Trend: R410 to R460 (increase); Reason: Increase price / wastage.
**Direct labour costs per unit:**
Trend: R220 to R205 (decrease); Reason: Greater efficiency / Economising on workers / Fewer holidays.
**Factory overhead costs per unit:**
Trend: R270 to R400 (increase); Reason: No economies of scale – production declined / Inflation would account for 6% increase at the most.
**Administration cost per unit:**
Trend: R50 to R63 (increase); Reason: No economies of scale – production and sales declined.
**Selling & distribution cost per unit:**
Trend: R80 to R82 (increase); Reason: Inflationary increase in remuneration to salespersons / Increase in fuel price / More advertising.
**Interest / finance cost per unit:**
Trend: R21 to R30 (increase); Reason: No economies of scale – production and sales declined.

| 15.41.6 | What would be your response to Thabo? Explain the major reason/s for your opinion. |
|---|---|

- Fabric: Do not sacrifice quality. His product will soon get a poor reputation.
- Workers: This strategy will affect quality of the tents. The goodwill of the business will be negatively affected. In any case, the direct labour cost per unit declined, so the workers appear not to be the problem.
- Long-term: Sales will decline even further. Should he decide to sell his business in future, the decline in goodwill will negatively affect the price he can get from a prospective new owner.

| 15.41.7 | List three other points that Thabo should consider to improve his profits next year. |
|---|---|

- Repay the loan – save on interest (R30 per unit).
- Assess why sales have declined – if there is a new competitor, consider another area to market the tents.
- Try to decrease wastage of raw materials.
- Investigate factory overheads – increase in unit cost indicates a potential problem.

## TASK 15.42 Analysis and interpretation, Problem solving, Debtors Collection Schedule, Calculations

**PART A: High Class Jackets**

**15.42.1 Provide advice to Jenny on what options are open to her. If you were in Jenny's position, what option would you follow? Explain with reasons, quoting information from the question.**

| Criteria | Examples of expected responses | Level 1<br>1 mark | Level 2<br>2 marks | Level 3<br>3 marks | Weight | Marks |
|---|---|---|---|---|---|---|
| Evaluation of sales revenue and net profit | Sales have dropped 20% due to increased competition (from R750 000 to R600 000). Net profit has dropped by 57% (from R151 500 to R64 800). | Poor explanation, little evidence quoted. | Good explanation with evidence quoted. | Excellent explanation with evidence quoted. | X1 | 3 |
| Evaluation of costs | Direct labour cost has increased by R20 per unit (18%). Direct materials cost has not been the problem. Fixed costs are proving to be a problem as these do not decrease with reduction in volume – now up to R124 per unit (was R98). Factory overhead costs have not increased in total, but per unit they have increased due to low production. Administration costs have increased by R3 per unit (37.5%), partly due to reduced volume of production. | Poor explanation, little evidence quoted. | Good explanation with evidence quoted. | Excellent explanation with evidence quoted. | X1 | 3 |
| Evaluation of the fabric used | She is using a good quality fabric. Although the cost has not increased it is obviously higher than that used by the competitor. There is an ethical consideration here. Ultimately reducing the quality of the jackets will lead to loss of goodwill. | Poor opinion. Ethics overlooked. | Good opinion. Ethics mentioned. | Excellent insight. Ethical dilemma identified. | X1 | 3 |
| Factors to consider in deciding on the course of action | **Marketing**: There is misinformation about the product of the competitor. Jenny could counter this with tactful advertising.<br>Pricing: If she reduces her selling price this could lead to more sales and production which could will reduce unit costs. Needs to do market research.<br>**Ethics**: Consider the reliability of existing supplier and poor quality of the other supplier. Maybe the competitor's strategy is not sustainable. Consider the tradition of the business, should be maintained or should she reduce quality too?<br>**Labour costs**: Discuss problem with employees, increased efficiency could lead to improved labour costs which could allow her to decrease selling price to be more competitive, develop a three-year plan to rectify the problem, consider new markets, etc.<br>**Other options**: Ultimately Jenny has other options – she could consider taking the other job and appointing a manager for High Class Jackets, but this might compromise quality. | Poor understanding of options open to the owner. Little insight and creativity evident in responses. | Good understanding of options open to the owner. Good insight and creativity evident in responses. | Excellent understanding of options open to the owner. Excellent insight and creativity evident in responses. | X2 | 6 |
| | | | | | | **Total: 15 marks** |

**PART B: Waterside Stores**

**15.42.2 DEBTORS COLLECTION SCHEDULE FOR MARCH TO MAY 20.6**

| Month / 20.6 | Credit Sales | March | April | May |
|---|---|---|---|---|
| January | R28 800 | ✓**5 760** | **Nil** | **Nil** |
| February | R31 200 | ✓**15 600** | **6 240** | **Nil** |
| March | R31 200 | ✓**9 126** | **15 600** | **6 240** |
| April | R33 600 | **Nil** | **9 828** | ✓**16 800** |
| May | R33 600 | **Nil** | **Nil** | ✓**9 828** |
| **TOTALS** | | ✓**30 486** | ✓**31 668** | ✓**32 868** |

**(8)**

| | | |
|---|---|---|
| **15.42.3** | **Taking all relevant information into account, calculate the interest on the loan to be paid during May 20.6.** | **(1)** |
| 70 000 – 20 000 = R50 000<br>50 000 x $^{18}/_{100}$ x $^{1}/_{12}$ = **R750** ✓ | | |
| **15.42.4** | **The issue price of the additional shares is expected to be R2.50 each. How many shares are expected to be issued in April 20.6?** | **(1)** |
| 100 000 ÷ 2.50 = **40 000 shares** ✓ | | |
| **15.42.5** | **Calculate the total purchases for March 20.6.** | **(1)** |
| 30 000 + 30 000 = **R60 000** ✓ | | |
| **15.42.6** | **The May 20.6 credit purchases are R40 000. Calculate how much of this R40 000 will be payable to creditors in June and August 20.6.** | **(2)** |
| June 20.6:<br>40 000 x 40% = **R16 000** ✓<br>August 20.6:<br>R40 000 x 20% = **R8 000** ✓ | | |
| **15.42.7** | **In your opinion is the average debtors collection policy and average creditors payment policy satisfactory? Motivate your answer.** | **(2)** |
| YES.✓<br>Collection good: 80% of debtors are expected to pay by the end of the month following the transaction (30 days).✓<br>No debts are expected to go bad.<br>Creditors – only 40% are paid in 30 days. | | |
| **15.42.8** | **Employees will be receiving a salary increase in May 20.6. What % increase has been budgeted for by Waterside Stores? (Assume no additional workers will be hired during the budget period.) Should the employees be satisfied with this increase? Explain.** | **(2)** |
| 13 440 – 12 000 x 100 = **12% increase** ✓<br>12 000 1<br>Yes – Higher than current inflation rate and will increase employees' buying power.✓ | | |
| **15.42.9** | **Calculate the cash surplus / deficit expected in April 20.6. State whether a surplus or deficit is expected.** | **(2)** |
| X – 25 764 = R54 354<br>Therefore X = 54 354 + 25 764 = **R80 118 (surplus)** ✓✓ | | |

| | | |
|---|---|---|
| **15.42.10** | **If the return on total capital employed is 30%, was it a good decision to borrow money? Motivate your answer.** | **(3)** |
| YES – Good decision to borrow money. Positive gearing and low risk. ✓<br>70 000 : 300 000 = 0.2 : 1 ✓<br>ROTCE (30%) is higher than the Interest rate on loans (18%). ✓ | | |
| **15.42.11** | **Calculate the final dividend per share declared for the year ended 28 February 20.6. The directors will be paying this dividend during March 20.6.** | **(2)** |
| R20 000 ÷ 100 000 shares = **20 cents per share** ✓✓ | | |
| **15.42.12** | **Do you think the shareholders will be happy with these dividends? The interim dividend paid was 10c per share and the total dividend for the financial year ending 28 February 20.5 was 19c per share.** | **(3)** |
| Yes OR No (with suitable reason). ✓<br>Dividend for current year ended 28:2:20.6 is 30 cents per share. ✓<br>Last year it was only 19c per share. ✓<br>OR – The business should retain more of the profit. | | |
| **15.42.13** | **Refer to the budget. Will Waterside Stores need to apply to the bank to increase their overdraft facility over the next 3 months? Motivate your answer.** | **(2)** |
| No.<br>Obviously they already have an overdraft facility of R80 000 as shown by the Bank overdraft carried over from the end of February. ✓<br>Overdraft is expected to be much less in March and thereafter they expect a positive bank balance over the following 2 months. ✓ | | |

**15.42.14**

| No. | Account DR | Account CR | Amount | A | O | L | |
|---|---|---|---|---|---|---|---|
| (a) | Bank ✓ | Ordinary share capital | R100 000 | + | + | 0 | ✓ |
| (b) | Loan ✓ | Bank | R20 000 | - | 0 | - | ✓ |
| (c) | Creditors ✓ | Bank | R28 000 | - | 0 | - | ✓ |

**(6)**

**Total: 35**

**PART A = 15 marks**
**PART B = 35 marks**
**TOTAL = 50 marks**

## TASK 15.43 Palesa Hair Stylist: Projected Income Statement

| | |
|---|---|
| **15.43.1** | **Refer to the Projected Income Statement to identify / calculate the following:** |
| | **(a) The monthly salary paid to each hair stylist.** |
| 25 500 ÷ 3 = **R8 500**<br>OR<br>34 000 ÷ 4 = **R8 500** | |
| | **(b) The % increase in wages that the cleaner will receive during the projected period.** |
| $^{272}/_{3\ 400}$ x 100 = **8%** | |
| | **(c) The % interest rate on the fixed deposit.** |
| $^{3\ 315}/_{468\ 000}$ x 12 x 100 = **8.5%** | |
| | **(d) The rental per square metre, and the number of additional square metres she will rent from 1 May 20.1.** |
| 24 600 ÷ 60 = R410<br>30 750 ÷ 410 = 75 sq metres<br>OR<br>60 x 30 750 ÷ 24 600 = 75 sq metres<br>Increase = 75 – 60 = **15 sq metres** | |
| **15.43.2** | **As the internal auditor you compare the following projected figures to the actual figures at the end of April. Provide four comments (1 per figure) that you would include in your internal auditor's report in respect of scenarios A, B, C and D below.** |
| **A Telephone**<br>The telephone costs have exceeded projections by R1 950.<br>These have not been well controlled and measures must be implemented to rectify this.<br><br>**B Water & electricity**<br>The water & electricity costs are R1 100 under the projections.<br>These have been well controlled especially considering the increase in electricity tariffs (and the increase in the number of customers).<br><br>**C Fee income & Consumable stores**<br>There was a good increase in fee income (+14%) which indicates that the business is popular with its customers.<br>The consumables stores (e.g. shampoos, conditioners) increased slightly (+5%) but not in the same proportion as the fees received.<br><br>**D Sales of hair products, Cost of sales, Gross profit**<br>There was a good increase in sales (+R24 500 / +28%) which was caused by the decrease in the mark-up % (from 75% to 60%).<br>The increased sales volume on the lower mark-up resulted in an increase in the gross profit (+R4 500 / +12%).<br>It appears that this was a good strategy. | |
| **15.43.3** | **Palesa is considering changes to the Fixed assets owned by the business.** |
| | **(a) Calculate the cost of the new vehicle which she plans to purchase on 30 April 20.1.** |
| 7 100 ÷ 0.2 x 12 = **R426 000** | |

**(b)** **GENERAL LEDGER OF PALESA HAIR STYLIST**
**NOMINAL ACCOUNTS SECTION**

**Dr** **Asset disposal** **N** **Cr**

| 20.1 | | | | | 20.1 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| July | 1 | Equipment | GJ | 164 000 | July | 1 | Acc dep on equipment | GJ | 153 750 |
| | | Profit on disposal of | | | | | (147 600 + 6 150) | | |
| | | asset | GJ | 12 750 | | | Creditors control | GJ | 23 000 |
| | | | | **184 950** | | | | | **184 950** |

**(c) What effect will the purchase of the new equipment have on the expected profits of the business each month? Provide calculations to support your answer.**

**Interest on loan:** 15% x 379 000 = R4 737.50 p.m. – negative effect.
**Depreciation:** 15% x 402 000 ÷ 12 less R2 050 = R2 975 p.m. – negative effect.
**Maintenance:** R3 500 p.m. – positive effect.

**(d) Palesa is thinking of purchasing the business premises rather than renting them. Explain one major advantage and one major disadvantage of this option.**

**Advantage:**
Saving on rent.
Earn capital gains on property values.
**Disadvantage:**
Repairs and maintenance to be paid.
She will need a bond to finance this option (high repayments).

**(e) Has Palesa acted responsibly in the decisions she has taken/planned regarding the Fixed assets? Explain, quoting specific information from the question. (See Additional information 5 above.)**

It was responsible of her to replace the old equipment.
The new equipment will attract customers, will make working conditions better and will involve less maintenance.
With regard to the vehicles, it was irresponsible of her to purchase an expensive new car, especially as the customers travel to the business.
Also, this meant that the fixed deposit was used to finance the expensive car.
This money could have been used to finance the equipment without high interest charges.

**15.43.4** **Palesa is not sure if she had made the right decision to give up her previous job many years ago and to invest R800 000 in this business. Refer to the projected monthly profit for this period. Based on these projections, what is your opinion on the decision which Palesa took? Explain.**

Her projections show that she expects to earn an average of R66 549 p.m. from this business, approximately R798 564 p.a.
She is losing out on interest on her savings – approximately R68 000 p.a. or R5 667 p.m. (based on interest rate 8.5% p.a.)
She is befitting by more than R700 000 p.a. which means she has probably made the right decision.

## TASK 15.44 Clearwater Pool Cleaning Services: Analysis and Interpretation, Problem solving

Evaluation of information:

- Fee income is expected to increase significantly from R600 000 to R840 000, i.e. 40%.
- Managers' salaries budgeted to increase by 40% as well.
- Bookkeeper not being given an increase.
- Pool cleaners get only 5% increase – each cleaner earning only R18 900 p.a. each.
- Ben will take drawings of R250 000 – an increase of R160 000.
- Reasonably high bank balances at year end.
- The above indicates a lack of appreciation of the work done by the pool cleaners and the bookkeeper – the increase in clients will mean extra work for them too.

Possible strategies:

- Try to equalise wage/salary % increases, but be aware that the pool cleaners work off a small base – their real increases will be small in comparison to the others – adjust for this too.
- Meet with each employee – express appreciation.
- Employees must also appreciate that they have jobs – however they are also contributing to the success of the business.

Use the following rubric to assess the learner's report:

| Criteria | Level 1 | Level 2 | Level 3 | Level 4 |
|---|---|---|---|---|
| **Discussion of budget.** | Learner lacks insight into a budget. | Aspects of the budget discussed. | A good discussion on budgets. | Excellent discussion showing insight. |
| **Suggestions.** | Fails to make meaningful suggestions. | Aspects of the suggestions acceptable. | Good, practical suggestions made. | Excellent suggestions showing insight. |

# MODULE 16
# EXAMINATION PAPERS

## GRADE 12 ACCOUNTING
## MID-YEAR EXAMINATION PAPER
**MARKS: 300 MINUTES: 180**

## QUESTION 1

### COMPANY CONCEPTS & LEDGER ACCOUNTS (40 marks; 24 minutes)

**1.1**

| No. | Answer |
|---|---|
| **1.1.1** | Shareholders ✓ |
| **1.1.2** | Directors ✓ |
| **1.1.3** | Memorandum ✓ of Incorporation ✓ |
| **1.1.4** | Independent ✓ |
| **1.1.5** | Unqualified ✓ **(6)** |

**1.2** **GENERAL LEDGER OF DULAZI LTD**
**BALANCE SHEET ACCOUNTS SECTION**

**1.2.1** **Dr** **ORDINARY SHARE CAPITAL** **B1** **Cr**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.3 | | | | |
| June | 30 | Bank✓ | CPJ | ✓✓324 000 | July | 1 | Balance | b/d | ✓2 500 000 |
| | | Balance | c/d | ☑3 456 000 | | | Bank✓ | CRJ | ✓1 280 000 |
| | | | | **3 780 000** | | | | | **3 780 000** |
| | | | | | 20.4 | | | | |
| | | | | | July | 1 | Balance | b/d | ☑3 456 000 |
| | | | | | | | | | **(8)** |

**1.2.2** **RETAINED INCOME** **B2**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.4 | | | | | 20.3 | | | | |
| June | 30 | Bank✓ | CPJ | ✓✓96 000 | July | 1 | Balance | b/d | ✓950 000 |
| | | Balance | c/d | ☑1 484 000 | 20.4 | | | | |
| | | | | | June | 30 | Appropriation✓ | GJ | ☑630 000 |
| | | | | **1 580 000** | | | | | **1 580 000** |
| | | | | | July | 1 | Balance | b/d | ☑1 484 000 |
| | | | | | | | | | **(8)** |

**1.2.3** **SARS – INCOME TAX** **B4**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 20.3 | | | | | 20.3 | | | | |
| July | 20 | Bank✓ | CPJ | ✓17 000 | July | 1 | Balance | b/d | ✓17 000 |
| 20.4 | | | | | 20.4 | | | | |
| Dec | 31 | Bank | CPJ | ✓270 000 | June | 30 | Income tax✓ | GJ | ✓510 000 |
| June | 30 | Bank | CPJ | ✓250 000 | | | Balance | c/d | ☑10 000 |
| | | | | **537 000** | | | | | **537 000** |
| July | 1 | Balance | b/d | ☑10 000 | | | | | |
| | | | | | | | | | **(9)** |

**FINAL ACCOUNTS SECTION**

**1.2.4 Dr** **APPROPRIATION ACCOUNT** **F3** **Cr**

| 20.4 | | | | | 20.4 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| June | 30 | Income tax✓ | GJ | ✓510 000 | June | 30 | Profit and loss✓ | GJ | ✓1 700 000 |
| | | Dividends on ordinary shares✓ | GJ | ✓✓560 000 | | | | | |
| | | Retained income✓ | GJ | ☑630 000 | | | | | |
| | | | | **1 700 000** | | | | | **1 700 000** |
| | | | | | | | | | **(9)** |

## QUESTION 2

## COMPANY CONCEPTS & BALANCE SHEET (115 marks; 69 minutes)

**2.1 (5)**

| Column X | Column Y |
|---|---|
| 2.1.1 | B ✓ |
| 2.1.2 | E ✓ |
| 2.1.3 | A ✓ |
| 2.1.4 | C ✓ |
| 2.1.5 | D ✓ |

**2.2 Calculate the correct net profit for the year. (27)**

| **Preliminary calculation of net profit before tax** | **1 140 000** | |
|---|---|---|
| Profit of sale of vehicle (180 000 – 132 000 – 55 000) | + 7 000 | ✓✓ |
| Depreciation | -151 920 | ☑☑ |
| Gross profit lost on goods returned | -4 000 | ✓✓ |
| Loss on stock stolen | -10 000 | ✓✓ |
| Salary & benefits not recorded (30 000 + 6 600) | -36 600 | ✓☑ |
| Insurance prepaid | +12 200 | ✓☑ |
| Interest not recorded | -83 000 | ✓✓ |
| Trading stock deficit | -38 000 | ✓☑ |
| Packing materials on hand | +7 500 | ✓✓ |
| Provision for bad debts adjustment | +3 200 | ✓✓ |
| Rent received in advance | -15 600 | ✓☑ |
| Audit fees owed | -180 000 | ✓✓ |
| Income tax not recorded | -224 000 | ✓✓ |
| **Correct net profit after tax** | **523 580** | ☑ |

**Workings: Sale of Vehicle**

Cost = R180 000

Depreciation for current year = 20% x R180 000 x $^{10}/_{12}$ = 30 000

Accumulated depreciation at date of sale = R102 000 + R30 000 = R132 000

Book value at date of sale = R48 000; Selling price = R55 000; Loss = R7 000

**2.2.3 PITCO LIMITED**
**BALANCE SHEET / STATEMENT OF FINANCIAL POSITION ON 28 FEBRUARY 20.4**

| **ASSETS** | **Note** | |
|---|---|---|
| **Non-current assets** | | ☑4 550 080 |
| **Fixed/Tangible assets** | 1 | **4 010 080** |
| Financial assets: | | |
| ✓Fixed deposits (750 000 ✓– 210 000✓) | | ✓540 000 |
| **Current assets** | | ☑2 024 600 |
| ✓ Inventories (1 440 000✓ – 50 000 ✓– 38 000✓ + 7 500✓) | | ☑1 359 500 |
| ✓Trade & other receivables (306 000✓ – 14 000✓ – 15 000✓ + 40 000✓ +12 200✓ + 242 200✓ – 224 000✓ + 55 000✓✓ + 3 200✓) | | ☑405 600 |
| ✓Cash & cash equivalents (45 500✓ + 4 000✓ + 210 000✓) | | ☑259 500 |
| **Total assets** | | **☑6 574 680** |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | | ☑4 899 180 |
| ✓Ordinary share capital | 2 | ☑3 750 000 |
| ✓Retained income | | ☑1 149 180 |
| **Non-current liabilities** | | ☑623 000 |
| ✓Loan from Kloof Lenders (606 000✓ + 83 000✓ – 66 000✓) | | 623 000 |
| **Current liabilities** | | ☑1 052 500 |
| ✓ Trade & other payables (255 500✓+ 14 800✓ – 11 000✓ + 36 600✓ + 15 600✓ + 180 000✓) | | ☑491 500 |
| ✓ Shareholders for dividends | | ✓✓495 000 |
| ✓ Current portion of loan # | | ✓✓66 000 |
| **Total equity and liabilities** | | **☑6 574 680** |

# Maybe shown in Note for Trade & other payables **(56)**

**NOTES TO THE FINANCIAL STATEMENTS AT 28 FEBRUARY 20.4**

| **3. FIXED/TANGIBLE ASSETS** | **Land & buildings** | **Vehicles** | **Equipment** | **Total** |
|---|---|---|---|---|
| Carrying value at beginning of year | ✓3 550 000 | ✓340 000 | ✓30 000 | 3 920 000 |
| Cost | 3 550 000 | **640 000** | **570 000** | 4 760 000 |
| Accumulated depreciation | - | **(300 000)** | **(540 000)** | (840 000) |
| **Movements** | 290 000 | (170 000) | (29 920) | 90 080 |
| Additions at cost | ✓290 000 | - | - | 290 000 |
| Disposals at carrying value | - | ☑✓(48 000) | - | (48 000) |
| Depreciation | - | ✓☑(122 000) | ✓☑(29 920) | (151 920) |
| Carrying value at end of year | ✓3 840 000 | ☑170 000 | ✓✓80 | 4 010 080 |
| Cost | 3 840 000 | ✓✓460 000 | ✓570 000 | 4 870 000 |
| Accumulated depreciation* | - | ☑✓(290 000) | ☑✓(569 920) | (859 920) |

*Vehicles: 300 000 + 122 000 – 132 000 **(21)**

| **7. ORDINARY SHARE CAPITAL** | |
|---|---|
| **AUTHORISED** | |
| **1 000 000 ordinary shares** | |
| **ISSUED** | |
| 800 000 ✓shares in issue at beginning of year | ✓3 200 000 |
| 100 000 ✓shares issued at R5.50 each during the year | ✓550 000 |
| 900 000 ✓shares in issue at end of year | ✓3 750 000 |

**(6)**

## QUESTION 3

## CASH FLOW & CALCULATION OF INDICATORS (50 marks; 30 minutes)

**3.1 BANDEX LTD**
**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 20.6**

| | |
|---|---|
| **Cash flows from operating activities** | ☑602 400 |
| Cash generation from operations | **1 481 440** |
| Interest paid | ✓(86 160) |
| Dividends paid (216 000✓ + 131 880✓) | ✓(347 880) |
| Tax paid (84 000✓ + 346 000✓ + 15 000✓) | ✓(445 000) |
| **Cash flows from investing activities** | ☑(864 000) |
| Purchase of non-current assets (1 266 000✓ + ***721 000*** – 37 000✓ – 174 000✓ = 1 776 000✓) | ✓(721 000) |
| Proceeds from disposal of non-current assets | ✓✓37 000 |
| Financial assets (investment) | ✓✓(180 000) |
| **Cash flows from financing activities** | ☑462 000 |
| Proceeds from issue of share capital | ✓✓630 000 |
| Repurchase of shares (72 000✓ + 18 000✓) | ✓(90 000) |
| Payment of capital portion of long-term borrowings (480 000✓ – 402 000✓) | ✓(78 000) |
| **Net change in cash equivalents** | ☑200 400 |
| Cash and cash equivalents – beginning of year | ✓44 400 |
| Cash and cash equivalents – end of year | ✓**244 800** |
| | **(31)** |

**Workings:**

**Purchase of Non-current assets:**

| | |
|---|---|
| Book value at beginning | 1 266 000 |
| Additions | **721 000** |
| Disposals | [37 000] |
| Depreciation | [174 000] |
| Book value at end | 1 776 000 |

**Loan:**

| | |
|---|---|
| Start | 480 000 |
| **Interest** | **86 160** |
| Repaid (12 x 13 680) | [164 160] |
| End | 402 000 |

**3.2**

| | | |
|---|---|---|
| **3.2.1** | **Earnings per share** | **(4)** |
| R1 240 080✓- 346 000✓ ÷ 324 000✓ shares x 100 = **<u>276 cents</u>** ☑ *operation, one part correct* | | |
| **3.2.2** | **% Return on equity** | **(4)** |
| R894 080 ☑ *see above* ÷ R1 534 100✓✓ x 100 = **<u>58.3%</u>** ☑ *operation, one part correct* | | |
| **3.2.3** | **Net asset value per share** | **(4)** |
| R1 996 800✓ ÷ 474 000 ✓✓ *see above* shares x 100 = **<u>421.3 cents</u>** ☑ *operation, one part correct*<br>**Note to Teacher:** The new shares issued on the last day of the financial year should be taken into account for calculating the NAV. However, as the new shares did not have any effect on the operations of the company they should not affect the calculations of EPS or DPS. | | |
| **3.2.4** | **Debt/equity ratio** | **(3)** |
| R402 000✓ : R1 996 800✓ = **<u>0.2 : 1</u>** ☑ *operation, one part correct* | | |
| **3.2.5** | **Acid-test ratio** | **(4)** |
| R322 800✓✓ : 541 200✓ = **<u>0.6 : 1</u>** ☑ *operation, one part correct* | | |

## QUESTION 4

## INTERPRETATION OF FINANCIAL INFORMATION (55 marks; 33 minutes)

| | | |
|---|---|---|
| **4.1** | **Comment on the change in the mark-up policy of the company. Has this improved the results of company? Explain.** | **(5)** |

No.✓
The gross profit has in fact decreased by R44 000✓.
Although the company uses a mark-up of 75%✓ they have been offering trade discounts which have reduced their mark up to 70% in 20.7 and 55% in 20.8✓.
Although this has led to an increase in sales, they have been making smaller gross profit on each sale.✓

| | | |
|---|---|---|
| **4.2** | **Have the directors controlled the operating expenses well? Explain.** | **(4)** |

Yes.✓
The operating expenses on sales have decreased from 40% to 32%✓✓ despite the fact that sales have increased.
This has led to the operating profit on sales increasing from 21% to 24%.✓

| | | |
|---|---|---|
| **4.3** | **Comment on the liquidity of the company. Explain four points.** | **(10)** |

The liquidity situation is more efficient in 20.8 than in 20.7.✓
Current ratio was too high at 4 : 1. It is now more reasonable at 1.9 : 1.✓✓
Acid-test ratio was too high at 2.2 : 1. It is now more reasonable at 0.8 : 1.✓✓
They were holding too much stock for 202 days.
It is now more reasonable for a clothing shop at 91 days.
Stock turnover rate has improved from 1.8 to 4 times. ✓✓✓
Debtors are still taking too long to pay, although this has improved from 90 days to 70 days.
They should bring this down to less than 30 days.✓✓

| | | |
|---|---|---|
| **4.4** | **As a shareholder of the company, would you be satisfied with the return, earnings and dividends over the past two years? Explain.** | **(8)** |

The return on shareholders equity has increased from 20% to 22% and is fair compared to alternative investments. ✓✓
Earnings per share have increased from 106 cents to 120 cents. ✓✓
The dividends were increased from 12 cents to 72 cents per share. ✓✓
In 20.7 the company paid out 11% ($^{12}/_{106}$ x $^{100}/_{1}$) of its earnings and retained 89%.✓
In 20.8 a higher 60% ($^{72}/_{120}$ x $^{100}/_{1}$) of earnings were paid to shareholders and 40% was retained in the business. ✓

| | | |
|---|---|---|
| **4.5** | **The directors are considering the expansion of the operations of the business. In order to do this, they are considering taking out a large long-term loan at an interest rate of 12% or issuing more ordinary shares. Which of these two methods of financing do you advise for this company? Explain.** | **(6)** |

Take out loans.✓
Return on capital employed is 32% which is higher than the interest rate of 12%.✓✓
Positive gearing. Returns to shareholders will be geared up by use of loans.✓
The debt/equity ratio has increased from 0.2 : 1 to 0.6 : 1 but the company is still in a low-risk situation.✓
Issuing more shares will simply lead to lower dividends per share and lower earnings per share. ✓

| | | |
|---|---|---|
| **4.6** | **In your opinion, should the shareholders be satisfied with the market price of their shares in this company? Explain. What should the directors do about this?** | **(7)** |

No.✓
The market price has dropped from 590 cents to 490 cents. ✓✓
This is now lower than the net asset value of 550 cents.✓
The directors must investigate the reasons for the poor public demand for the share.✓
They must rectify any poor business decisions / They should also publicise the good plans for the future in the press and in their published financial statements.
Possibly involve themselves in projects that will benefit the local community or the environment. ✓✓

| | | |
|---|---|---|
| **4.7** | **The Chief Executive Officer (CEO) and his family currently own 48% of the issued shares. How many extra shares will they have to buy to gain control of the company, and how much will these extra shares cost them on the JSE?** | **(5)** |

They own 48% of 1 000 000 shares = 480 000 shares✓
The need to own at least 50% = 500 001 shares / 500 100 / 510 000 shares✓
They need another 20 001 / 20 100 / 30 000 shares.✓
Multiply chosen figure by R4.90.☑☑

| | | |
|---|---|---|
| **4.8** | **The CEO feels that the company should issue all the unissued shares rather than increase the loans to finance the expansion. He and his family have offered to buy all the remaining shares at 400 cents per share, provided these shares are not offered to the general public. What is your opinion on this proposal? Explain.** | **(5)** |

This is not ethical.✓
This is a public company and shares should be offered to the general public according to transparent procedures.✓✓
The shareholders will lose out if the CEO benefits himself and his family with a low share price.✓
R4.00 is below the market price ✓of the share, and will cause the share price to drop further.

| | | |
|---|---|---|
| **4.9** | **One of the shareholders asks the company to repurchase his 80 000 shares from him. What questions should the directors consider before decide whether to agree to this or not? Explain.** | **(5)** |

What price will he accept for the shares?✓
If it is significantly above the market value and the average issue price, then the other shareholders will be disadvantaged because the retained income will drop.✓✓
Does the company have sufficient cash to pay for these shares without negatively affecting the liquidity and solvency?✓✓
Any other valid response.

## QUESTION 5

## BANK RECONCILIATION, DEBTORS' AGE ANALYSIS, CONTROL & AUDITS (40 marks; 25 minutes)

| | | |
|---|---|---|
| **5.1** | **Explain the role of the internal auditor in a business.** | **(3)** |

Checks the internal controls in the business. ✓
Ensures that all procedures are followed, that all documents are filed to support the transactions.✓
Liaises with the independent auditor who will rely on the controls that the internal auditor oversees. ✓

| | | |
|---|---|---|
| **5.2** | **Explain why it is important for the business to prepare each of the above records each month, i.e. the Bank Reconciliation Statement and the Debtors' Age Analysis.** | **(4)** |

They are both important parts of the internal control processes.✓
Bank Reconciliation enables a business to see that all the cash is properly accounted for, and enables the business' books to be checked against an external document from the bank.✓✓
The age analysis allows the business to identify debtors who are not paying according to normal credit terms.✓

| | | |
|---|---|---|
| **5.3** | **Does the bank have a favourable or unfavourable balance at the bank? Explain.** | **(2)** |

Favourable.✓
Credit balance indicates that the business is a one of the bank's creditors (the bank owes the creditor). ✓

| | | |
|---|---|---|
| **5.4** | **Identify two errors in the Bank Reconciliation Statement. Quote figures to support your answer. Explain how the figures should have been treated.** | **(6)** |

Cheque no. 546 for R2 000 is stale.✓✓
It should be cancelled by an entry in the CRJ.✓
The bank charges of R20 should not be in the reconciliation.✓✓
It should be entered in the CPJ.✓

| | | |
|---|---|---|
| **5.5** | **Identify a major problem reflected by the Bank Reconciliation Statement. Explain why you regard this as a problem and how you would handle this amount. Explain how you will prevent this problem in future.** | **(6)** |

The outstanding deposit of R33 000 is almost one month late.
This indicates possible fraud through rolling of cash.
An employee might have stolen the cash instead of depositing it and then tried to cover it by replacing it with cash received at a later date. ✓✓
If the money cannot be recovered from the culprit, the amount must be written off as a loss (rule of prudence). ✓✓
In future, deposits must be made on the day received, or at least on the morning of the next business day.
There should be division of duties to ensure that the person receiving the money is not the same person why deposits the money. ✓✓

| | | |
|---|---|---|
| **5.6** | **An employee wants to borrow R10 000 from the business for urgent private affairs. Would you agree to his request? List and explain three points that you would mention to him.** | **(7)** |

No OR Yes, with conditions. ✓
Any three valid points. ✓✓ ✓✓ ✓✓
The business needs its own money to pay for all its expenses.
The business cannot set precedents – if this is done for one employee it will have to be done for all.
He could possibly ask for an advance on his salary if he is earning more than this amount (depends on the rules of the business).
Maybe he is not managing his money properly, he might need debt counselling.

| | | |
|---|---|---|
| **5.7** | **A new customer wants to buy on credit from this business. Explain the process you should follow before allowing the customer to buy on credit. Discuss four processes.** | **(4)** |

Ask for his ID document, make a copy.✓
Ask for proof of residence.✓
Ask for credit references and check up on these.✓
Determine an appropriate credit limit for him.✓

| | | |
|---|---|---|
| **5.8** | **Refer to the age analysis above. Identify TWO different problems shown by the age analysis and quote evidence to support your answer. In each case explain what should be done to correct the problem.** | **(8)** |

Some debtors have exceeded their credit limits. ✓✓
Any two reasons with figures: ✓✓
Venter has exceeded his limit by R1 800.
Pillay has exceeded his limit by R3 000.
Some debtors are paying too slowly. ✓✓
Any two reasons with figures. ✓✓
Only 50% paying within 30 days.
Venter has R4 000 outstanding for more than 30 days and R2 400 for more than 60 days.
Jones has R1 000 outstanding for more than 60 days.
Pillay has R3 300 outstanding for more than 30 days.

## GRADE 12 ACCOUNTING
## YEAR-END EXAMINATION PAPER
## MARKS: 300 MINUTES: 180

## QUESTION 1

### PROJECTED INCOME STATEMENT (45 marks; 30 minutes)

| | | |
|---|---|---|
| **1.1** | **Calculate the mark-up % that Caitlyn uses for her business.** | **(4)** |
| $^{240\ 000}$ ✓✓ / $_{300\ 000}$ ✓✓x 100 = **80%** | | |
| Or use figures from any of the other columns. | | |
| **1.2** | **Refer to the actual figures for September for Interest income and Depreciation. In each case, provide a probable reason why the actual figure is different from the budget for September.** | **(4)** |
| **Probable reason for Interest income:** | | |
| The investment was decreased. ✓✓ | | |
| **Probable reason for Depreciation:** | | |
| More fixed/tangible assets were bought. ✓✓ | | |
| **1.3** | **Caitlyn is always worried about the internal control over three expenses in particular: Stationery, Telephone and Motor vehicle expenses (especially as the petrol price increased unexpectedly by 25% at the beginning of August).** | **(7)** |
| | **Comment on whether or not these expenses have been well controlled. Quote figures to support your answer.** | |
| **Comment on Stationery:** | | |
| Well controlled in August, but R3 000 over-budget in September. This is possibly due to wastage / theft. ✓✓ | | |
| **Comment on Telephone:** | | |
| Abuse is apparent. R2 000 over budget in August and R4 000 over budget in September. Not well controlled. ✓✓ | | |
| **Comment on Motor vehicle expenses:** | | |
| Well controlled. The variance is only 10% ($^{1\ 200}/_{12\ 000}$) whilst the price of petrol increased by 25%. ✓✓✓ | | |
| **1.4** | **Caitlyn is concerned that she has to keep contributing more capital each month so that the business can settle its debts. Explain why the Projected Income Statement will not help her in identifying the reasons for this problem.** | **(3)** |
| Cash problems will be identified in the Cash Budget. | | |
| The Projected Income Statement reflects profit. | | |
| Certain income items might not have been collected, while payments for debts are not reflected in the projected Income Statement. ✓✓✓ | | |
| **1.5** | **Caitlyn has also borrowed money to set up this business. She is not sure if she can afford the loan repayments which start in October.** | |
| | • **Calculate the amount of the loan.** | **(4)** |
| 37 500✓÷ 0.15✓ x 12✓ = **R3m** ✓ | | |
| | • **What advice would you give her regarding accessing funds in order to repay the loan? Provide two points.** | **(4)** |
| - Liquidate the investment as the interest is only 6%.✓✓ | | |
| - Admit a partner/member.✓✓ | | |
| - Sell off unused property. | | |
| Any other valid point. | | |

| | | |
|---|---|---|
| **1.6** | **Caitlyn is concerned about the support she is getting from her customers. She is concerned about losing 'goodwill'.** | |
| | • **Quote figures from the question which indicates that she appears to be losing customers.** | **(2)** |

August actual sales R396 000 budgeted R540 000. ✓✓
OR Sept actual sales R360 000 budgeted R594 000.
OR Sept actual sales R360 000 are less than August R396 000.

| | | |
|---|---|---|
| | • **Identify three points, with appropriate figures from the projected Income Statement, which indicate that she has made mistakes in dealing with her customers.** | **(6)** |

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

| | | |
|---|---|---|
| **1.7** | **The shop assistants earn equal wages. Two of the six shop assistants resigned at the beginning of September. They have not been replaced.** | |
| | • **Calculate the monthly salary earned by each shop assistant in August.** | **(3)** |

R24 000 ✓÷ 6 ✓= **R4 000**✓

| | | |
|---|---|---|
| | • **Calculate the % salary increase that Caitlyn granted the shop assistants in September.** | **(4)** |

R16 800 ÷ 4 = R4 200 ✓
Increase = R4 200 – R4 000 ☑ = R200
% increase = $^{200}/_{4\,000}$ x 100 = **5%** ✓☑

| | | |
|---|---|---|
| | • **Provide two reasons why they would not be happy with this increase. Quote evidence from the question to support your answer.** | **(4)** |

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

## QUESTION 2

**MANUFACTURING** **(50 marks; 30 minutes)**

| **2.1** | **Calculate the Direct Labour cost for the month.** | **(7)** |
|---|---|---|
| ✓ 15 employees x ✓ 14 days x 9 hours x ✓ R36 | = R68 040 | |
| ✓ 15 employees x ✓ 45 hours x ✓ R72 | = R48 600 | |
| TOTAL | = ✓ **R116 640** | |

**2.2 BASIL TABLES MANUFACTURERS**
**PRODUCTION COST STATEMENT FOR JULY 20.8** **(12)**

| | |
|---|---|
| Direct material cost (40 000 ✓+ 180 000✓ – 65 000✓) | ✓☑ 155 000 |
| Direct labour cost | ☑ 116 640 |
| Prime cost | ☑ 271 640 |
| Factory overhead cost | ☑ 85 160 |
| Total cost of production | ☑ 356 800 |
| Work-in-process on 1 July 20.8 | ✓ 55 000 |
| | 411 800 |
| Work-in-process on 31 July 20.8 | ✓ (40 000) |
| Cost of production of finished goods (410 tables) | ☑ **371 800** |

**Note 1: Factory overhead cost** **(14)**

| | |
|---|---|
| Indirect materials [75% x (6 000 + 20 000)] | ✓☑ 19 500 |
| Wages of factory cleaner | ✓ 2 600 |
| Salary of factory foreman (15 000 + 1 500) | ✓☑ 16 500 |
| Depreciation | ✓ 7 400 |
| Factory maintenance (8 000 + 3 500) | ✓☑ 11 500 |
| Electricity & water | ✓ 4 140 |
| Factory rent ($^{630}/_{900}$ x R30 000) | ✓☑ 21 000 |
| Insurance ($^{630}/_{900}$ x R43 200 ÷ 12) | ✓☑ 2 520 |
| | ☑ **85 160** |

| **2.3** | **Calculate the unit cost of the production of finished goods for July 20.8.** | **(3)** |
|---|---|---|
| R371 800☑ ÷ 410 tables✓ = R906.83✓ | | |
| **2.4** | **Basil feels that the power cuts have had a significantly negative effect on his business. Provide two points from the question which indicate that he is correct. Quote figures / calculations from the question to support your answer.** | **(6)** |
| - Production is 40 units short. Loss of gross profit = 40 x R500 = R20 000. ✓✓✓<br>- The overtime wages paid cause a difference in Direct Labour cost of ½ x R48 600 = R24 300, i.e. R59.27 per table. ✓✓✓<br>- They were exceeding their BEP by 130 tables. During July, the margin reduced to 90 tables. | | |
| **2.5** | **Basil is concerned about the control over certain costs. Direct materials account for more than 40% of the cost of one table, while direct labour accounts for more than 30%. Basil wants your advice.** | |
| | • **Provide two suggestions on how to improve efficiency in the use of direct materials.** | **(4)** |
| - Identify the exact amount of direct material required for each table.✓✓<br>- Proper documentation for stocks drawn from the store-room.✓✓<br>- Assess the degree of wastage (off-cuts). | | |

| | | |
|---|---|---|
| | • **Provide two suggestions on how to improve the efficiency of the direct labourers.** | **(4)** |

- Time & work study – inspect and calculate how long it takes for one table to be made.✓✓
- Proper training of direct workers.✓✓
- Assess procedure for clocking in & out.
- Monitor tea breaks, lunch breaks, sick leave, etc.
- Reduce overtime – buy a generator to restrict work to normal time.

## QUESTION 3

## INTERPRETATION OF FINANCIAL INFORMATION (60 marks; 36 minutes)

**3.1** **Column 1 reflects the items that Rooplal Ltd has included in their published annual report. Match the first column with its description in the second column.** **(6)**

| COLUMN 1 | COLUMN 2 |
|---|---|
| **1.** | E ✓ |
| **2.** | F ✓ |
| **3.** | B ✓ |
| **4.** | C ✓ |
| **5.** | D ✓ |
| **6.** | B ✓ |

**3.2 NOTE FOR RETAINED INCOME ON 30 JUNE 20.8** **(8)**

| | | |
|---|---|---|
| **Retained income at beginning of year** | **708 000** | |
| Add: Net income after tax | 388 000 | ✓ |
| Less: Shares repurchased (32 000 x R1.10) | (35 200) | ✓✓✓ |
| Less: Dividends (960 000 shares x 73 cents) | (700 800) | ✓✓✓ |
| Retained income at end of year | 360 000 | ☑ |

**3.3** **Refer to Information 1-4 at the end of this question. Calculate the following financial indicators for 20.8:**

▪ **Acid-test ratio** **(3)**

290 000 ✓ : 482 000 ✓ = **0.6 : 1** ☑

▪ **Stock turnover rate** **(3)**

2 880 000 ✓ ÷ 411 500 ✓ = **7 times p.a.** ☑

▪ **Net asset value per share** **(4)**

$^{3\ 758\ 400}$✓/$_{928\ 000}$ ✓✓ x 100 cents = **405 cents** ☑

▪ **% Return on average shareholders' equity** **(4)**

$^{388\ 000}$✓/$_{3\ 729\ 200}$ ✓✓ x 100 = **10.4%** ☑

▪ **Earnings per share** **(3)**

$^{388\ 000}$✓/$_{960\ 000}$✓ x 100 cents = **40.4 cents** ☑

| 3.4 | **Comment on the control of working capital and the liquidity situation of the company. Quote the relevant financial indicators (actual ratios or percentages) to support your answer.** | **(9)** |
|---|---|---|

General comment ✓✓✓✓
*Excellent = 4 marks; Good = 3; Satisfactory = 2; Poor = 1; No/invalid comment = 0*

Although the current ratio and acid-test ratio are quite low, they should be able to settle their current debts as they have relied on low liquidity ratios in the past.
There are also financial assets and fixed assets that they can borrow against if they run short of cash to settle current debts.
They should be concerned about the debtors paying slowly.
As a result they have had to pay their creditors more slowly too, which could negatively affect their reputation.

Quoting of indicators:
Current ratio 1.6 : 1 → 1.5 : 1 ✓
Acid-test ratio 0.7 : 1 → 0.6 : 1 ✓
Stock turnover rate 9 times p.a. → 7 times p.a. ✓
Debtors collection period 28 → 40 days ✓
Creditors payment period 60 → 87 days✓

| 3.5 | **Comment on the returns, earnings and dividends of the company. Quote three relevant financial indicators (actual ratios or percentages) to support your opinion.** | **(10)** |
|---|---|---|

Decline in % return: 19.3% → 10.4%. ✓✓
% Return might now be lower than that on alternative investments. ✓✓
Decline in EPS: 60.5c → 40.4c. ✓✓
Increase in DPS: 25c → 73c. ✓✓
They are using retained income to pay dividends which exceed earnings.
(high pay-out rate = $^{73}/_{40.4}$ x 100 = 181%). ✓✓

| 3.6 | **The directors are concerned that the market price has declined and is now below the net asset value per share. Explain three important factors that could have negatively influenced the market price in the 20.8 financial year.** | **(6)** |
|---|---|---|

Any two ✓✓ ✓✓ ✓✓
- They issued the new shares at a low price of 350 cents (this should have been higher than NAV).
- They bought back the 32 000 at a high price of 480 cents which exceeds the average issue price and exceeds the NAV and market price.
- The company paid excessive dividends which has affected retained income and hence the NAV (NAV would have influenced the market price).
- The decline in the % ROSHE could have affected the confidence of the public in the company and could have led to a decline in the demand for the shares.

| 3.7 | **Rather than issue more shares, the directors think it will be preferable to take out additional loans next year. Quote two relevant financial indicators (actual ratios or percentages) to support their opinion.** | **(4)** |
|---|---|---|

Two financial indicators. ✓✓ ✓✓
- Return on capital employed for 2008 = 44.3%
- Current interest rate = 12%
- Debt : Equity ratio decreased from 0.2 : 1 to 0.1 : 1

## QUESTION 4

## FIXED ASSETS & CASH FLOW (75 marks; 45 minutes)

| 4.1 | **Explain what is meant by each of these concepts and give a practical example of each in connection with Fixed assets.** | |
|---|---|---|
| | • **Historical cost** | **(2)** |
| Unless otherwise stated, the value of fixed assets is recorded at historical cost, e.g. Land & buildings might be bought at a historical cost of R2m; if the current market price increases to R3m, the value of the land & buildings remains at R2m in the books. ✓✓ | | |
| | • **Faithful representation** | **(2)** |
| Financial results must be complete, free from error and they must be neutral, e.g. if vehicles are no longer worth their historical cost they must be depreciated by an appropriate rate not to benefit any party. ✓✓ | | |
| **4.2** | **You are the internal auditor of Benzo Ltd. Explain four important and separate checks you would carry out to assess whether the system of internal control over fixed assets is acceptable or not.** | **(8)** |

- Ensure that the fixed assets are correctly recorded in the Fixed Asset Register.✓✓
- The physical count of fixed assets must agree with the Fixed Asset Register.✓✓
- All purchases and sale of fixed assets must be supported by appropriate documents (e.g. invoice) and it must be authorised by a senior person.✓✓
- Make sure that the physical security of the goods is good, i.e. computer are correctly stored and the vehicles are parked in garages.✓✓

Any other valid reason.

**4.3** **(8)**

**GENERAL LEDGER**
**NOMINAL ACCOUNTS SECTION**

**Dr** **Asset Disposal** **N** **Cr**

| 20.8 | | | | | 20.8 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Dec | 31 | Vehicle✓ | GJ | ✓✓234 000 | Dec | 31 | Acc dep on vehicle✓ | GJ | ✓✓104 400 |
| | | | | | | | Bank✓ | CRJ | ✓ 129 600 |
| | | | | **234 000** | | | | | **234 000** |

**4.4**

**NOTE 1: FIXED ASSETS** **(11)**

| | **Land and buildings** | **Vehicles** | **Equipment** |
|---|---|---|---|
| Carrying value at beginning of year | ✓ 2 556 000 | ✓ 594 000 | 783 000 |
| Cost | ✓ 2 556 000 | 1 620 000 | 1 107 000 |
| Accumulated depreciation | 0 | (1 026 000) | ✓ (324 000) |
| **Movements** | 414 000 | 306 000 | 378 000 |
| Additions at cost | 414 000 | ✓✓ 550 800 | 540 000 |
| Disposals at carrying value | 0 | (129 600) | 0 |
| Depreciation | 0 | (115 200) | ✓✓ (162 000) |
| Carrying value at end of year | **2 970 000** | **900 000** | ✓ **1 161 000** |
| Cost | 2 970 000 | 1 936 800 | ✓ 1 647 000 |
| Accumulated depreciation | 0 | ✓ (1 036 800) | (486 000) |

**4.5 BENZO LIMITED** **(35)**

**CASH FLOW STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 20.9**

| | | | |
|---|---|---|---|
| **CASH FLOW FROM OPERATING ACTIVITIES** | | 973 000 | ☑ |
| Cash generated from operations | | **2 097 000** | |
| ✓Interest paid | | (259 200) | ✓✓ |
| ✓Taxation paid (43 200 + 462 000 + 13 000) | | (518 200) | ✓✓✓ |
| ✓Dividends paid (145 800 + 226 800) | | (372 600) | ✓✓✓ |
| **CASH FLOW FROM INVESTING ACTIVITIES** | | (1 785 200) | ☑ |
| ✓Purchase of fixed assets | | (1 504 800) | ✓✓ |
| ✓Increase in fixed deposits | | (410 000) | ✓✓ |
| ✓Proceeds from the sale of fixed assets | | 129 600 | ✓ |
| **CASH FLOW FROM FINANCING ACTIVITIES** | | 528 900 | ☑ |
| ✓Proceeds from the issue of shares | | 1 275 000 | ✓✓ |
| ✓Repurchase of shares (182 700 + 22 500) | | (205 200) | ✓✓✓ |
| ✓Repayment of loan (799 200 – 259 200) | | (540 000) | ✓✓ |
| **NET CHANGE IN CASH AND CASH EQUIVALENTS** | | (282 200) | ☑ |
| Cash and cash equivalents at beginning of the year | | 977 200 | ✓ |
| Cash and cash equivalents at end of the year | | **695 000** | ✓ |

**4.6** **The Cash Flow Statement indicates certain important Investing and Financing decisions that have been made by the directors. List three of the most significant of these decisions. In each case provide a possible reason why the directors took that decision.** **(9)**

| **Decisions** | **Reason** |
|---|---|
| Acquired additional fixed assets.✓ | Existing tangible assets may be obsolete; fixed assets are needed to attract customers and generate more profit in future.✓✓ |
| Issue of additional shares.✓ | To repay part of the loan and/or pay for the purchasing of tangible assets; to improve the gearing and financial risk.✓✓ |
| Repayment of loan.✓ | To reduce interest costs; to improve gearing and reduce risk.✓✓ |

Other decisions, e.g. repurchase shares, increase fixed deposit are not as significant as the three listed above.

## QUESTION 5

## RECONCILIATIONS (35 marks; 20 minutes)

### 5.1 Bank Reconciliation

| | | |
|---|---|---|
| **5.1.1** | **Why is it important for a business to prepare a monthly Bank Reconciliation Statement? Provide two points.** | **(2)** |

- For internal control purposes.✓
- To identify the correct bank balance / update records.✓
- Deposits made and cheques issued not only affect the business but also the bank concerned.
- The business keeps a record of all cash transactions.
- The bank also keeps a record of its transactions with the business.
- The books of the business and that of the bank should agree and the bank balance should be the same in both books.
- Comparisons between the books of the business and that of the bank must be made on a monthly basis by preparing a bank reconciliation statement.
- Errors and dishonesty can be detected on a monthly basis.

| | | |
|---|---|---|
| **5.1.2** | **One of the cheques not presented to the bank has been treated incorrectly. Which cheque is it and explain your choice. Indicate the correct course of action to be taken.** | **(4)** |

Cheque no 1654 ✓ for R6 000 is stale.✓ (older than six months)
**Correct course of action:**
It must be cancelled in the Cash Receipts Journal (CRJ).✓ ✓

| | | |
|---|---|---|
| **5.1.3** | **Calculate the correct balance for the bank account in the ledger of Geoffrey Traders (take into account your response in 5.1.2 above).** | **(4)** |

(R29 460)✓ + R12 390✓ - R 10 500✓ = (R27 570)✓

| | | |
|---|---|---|
| **5.1.4** | **Explain how cheque no. 2235 should be treated when preparing the financial statements as at 31 August 20.6, and explain the reason for this treatment.** | **(4)** |

Decrease bank overdraft and increase creditors by R2 500.✓✓
**Reason:**
The funds have not been lost by the business.
The amount is still owed to creditors. ✓✓

| | | |
|---|---|---|
| **5.1.5** | **Explain why a post-dated cheque received by Geoffrey Traders on 20 August 20.6 but dated 20 September 20.6 does not appear in the Bank Reconciliation Statement.** | **(2)** |

- Post-dated cheques (PDC's) received are recorded in the PDC Register.✓✓
- PDC's are deposited on the day they are due.
- PDC's have no effect until the due date.
- Rule of Prudence – do not record until certain.

| | | |
|---|---|---|
| **5.1.6** | **(a) Why should the internal auditor be seriously concerned about the difference of R10 000.** | **(2)** |

This is a major error, or possibly fraud. ✓✓

| | | |
|---|---|---|
| | **(b) Briefly explain how the internal auditor could have discovered the 'problem' with cheque no. 2725.** | **(2)** |

- Smith Traders complained that their account had not been paid.
- The internal auditor checked the cheque.
- Any other acceptable suggestion.

| | (c) What should the internal auditor do about this? Provide two points. | (2) |
|---|---|---|

- Check from the receipts to the deposit slip to identify if cash collected was all deposited.✓
- Check if there is an error on the deposit slip.✓
- Investigate if the cash has been stolen – question the cashier / bookkeeper.
- Establish proper internal control procedures – division of duties – so that one person serves as a check on another to avoid this problem in future.
- Screen the employees (for trustworthiness).
- Owner can do the banking himself.

**5.2 Creditors' Reconciliation**

| 5.2.1 | Why should these two figures agree? | (2) |
|---|---|---|

- Figures in General Ledger should correspond with figures in Creditors' Ledger.✓✓
- This is the internal control procedure – one process is a check on the other.

| 5.2.2 | Calculate the amended balance of the Creditors' control account and Creditors' list. Use the format provided to show your workings. | (11) |
|---|---|---|

| Transaction | Creditors' Control | Creditors' List |
|---|---|---|
| Provisional balance/total | **55 670** | **39 240** |
| Transaction (a) | | ✓✓+ 480 |
| Transaction (b) | ✓✓+ 1 960 | ✓✓+ 1 960 |
| Transaction (c) | | ✓✓- 450 |
| Transaction (d) | ✓✓- 16 400 | |
| ☑ | **41 230** | **41 230** |

## QUESTION 6

## INVENTORY VALUATION (35 marks; 20 minutes)

| 6.1 | Explain the meaning of the term 'FIFO'. | (2) |
|---|---|---|

First-in first-out. ✓✓
OR
The oldest rugby balls are the ones that are sold first.

| 6.2 | The selling price of rugby balls was kept constant throughout the year. Calculate the selling price per rugby ball. | (3) |
|---|---|---|

R430 500✓ ÷ 2 100✓ balls = **R205 each**✓

| 6.3 | The owner, John Watson, is aware that some rugby balls were stolen from the storeroom in April 20.8. No entry has been made. | |
|---|---|---|
| | • Calculate the number of balls that are missing. | (5) |

Total balls available = 750 ✓ + 2 480 ✓ – 1 100 ✓ = 2 130 balls
Number sold = 2 100 balls ✓
Number stolen = **30** balls ✓

| | • What entry would you make in the books to record this? | (2) |
|---|---|---|

✓ Debit Trading stock deficit / Loss due to theft R3 300
✓ Credit Trading stock R3 300

| 6.4 | **Value the stock on hand at the year-end according to the FIFO method.** | **(7)** |
|---|---|---|

| | |
|---|---|
| ✓ 480 balls at R160 ✓ | ✓76 800 |
| ✓ 620 balls at R120✓ | ✓74 400 |
| TOTAL | ✓**151 200** |

| 6.5 | **Calculate following:** | |
|---|---|---|
| | • **Cost of sales** | **(5)** |

| | | |
|---|---|---|
| Opening stock | ✓ | 82 500 |
| Purchases | ✓ | 340 800 |
| Stolen | ☑ | (3 300) |
| Closing stock | ☑ | (151 200) |
| Cost of sales | ☑ | **268 800** |

| | • **Gross profit for the year.** | **(3)** |
|---|---|---|

| | | |
|---|---|---|
| Sales | ✓ | 430 500 |
| Cost of sales | ☑ | 268 800 |
| Gross profit | ☑ | **161 700** |

| 6.6 | **John is not sure when to place his next order of rugby balls.** | |
|---|---|---|
| | • **How long can he expect the closing stock to last? Provide figures or a calculation to support your answer.** | **(4)** |

On average, 175 balls are sold per month✓✓ – stock will last 6.3 months.✓✓
OR
Cost of sales for the year is R268 800 (R22 400) – final stock is R151 200 – stock could last 6.8 months.

| | • **What advice will you offer John about his purchases of stock? Provide two points.** | **(4)** |
|---|---|---|

- Purchase in smaller quantities more often.✓✓
- Only order when they reach their minimum stock level (re-order level).✓✓
- They are holding too much stock.