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WORKSHEET 3:

**COMPANIES: FINANCIAL STATEMENTS,
AUDIT REPORT AND INTERPRETATION**

You are presented with information from the accounting records of Carnac Ltd, a public company registered on the JSE. The financial year ends on 28/29 February each year.

REQUIRED:

- 1.1 Complete the Income Statement by filling in the missing amounts. (12)
- 1.2 Prepare the following notes to the Balance Sheet:
 - 1.2.1 Ordinary Share Capital (8)
 - 1.2.2 Retained income (8)
- 1.3 Complete the **EQUITIES and LIABILITIES** section of the **Balance Sheet**. Where notes are not required, show all workings in brackets. (18)
- 1.4 Refer to **Information D** on Fixed Assets:
 - 1.4.1 Prepare the Asset Disposal account for the equipment sold. (9)
 - 1.4.2 Calculate the missing amounts indicated by (a) – (e) on the note provided. (18)
- 1.5 Calculate the following amounts for the Cash Flow Statement on 28 February 2019.
 - 1.5.1 Income tax paid (4)
 - 1.5.2 Dividends paid (3)
 - 1.5.3 Net change in cash and cash equivalents (indicate inflow or outflow). (5)
- 1.6 Prepare the CASH EFFECTS OF FINANCING ACTIVITIES section of the Cash Flow Statement on 28 February 2019. (7)
- 1.7 Calculate the following financial indicators:
 - 1.7.1 Current ratio (3)
 - 1.7.2 Stock turnover rate (5)
 - 1.7.3 Return on average capital employed. (7)
 - 1.7.4 Debt/equity ratio (3)
- 1.8 Comment on the liquidity position of the business. Quote THREE financial indicators (with figures) to support your comment. (8)
- 1.9 Certain shareholders were concerned that the company did not make any attempt to reduce the loan. What are your views? Quote TWO financial indicators (with figures) in your explanation. (6)
- 1.10 A shareholder was of the opinion that the directors paid too much to the estate of the insolvent shareholder to buy back his shares. Comment on the price paid. Make reference to TWO financial indicators (with figures) in your answer. (4)
- 1.11 K. Mickey, a shareholder, is not satisfied with the dividends he earned this year. Explain to her why she should not feel that way. Quote relevant figures in your explanation. (4)
- 1.12 A recent newspaper article stated that local businesses on the east coast was disposing waste into the nearby river and vacant land causing pollution and damage to the wildlife. This company is situated on the east coast. As an existing shareholder, how would you address this problem? Provide TWO points. (4)
- 1.13 It has come to your attention that a fellow director has informed his friend to buy shares in the company because a new contract has allegedly been signed with an international company which will result in greater profits within the next six months. What are your views about this director? State TWO points. (4)

2. Refer to **Information G**: The audit report.
- 2.1 Why is this report addressed to the shareholders? (2)
- 2.2 Provide a suitable reason why the Companies Act require the books of a company to be audited by an external auditor. (2)
- 2.3 What type of report did this company receive? Explain. (4)
- 2.4 Why does this report specify that the financial statements “fairly presents” the financial position of the company? (2)

INFORMATION:

A. Extract of the Income Statement on 28 February 2019

Turnover	6 600 000
Other operating income	392 000
Net profit after income tax	1 274 400

- B. The following percentages apply to figures not provided on the Income Statement:

• Gross profit on turnover	40%
• Operating Expenses on turnover	17%
• Income tax rate	28%

- C. The **loan statement** from Shark Bank is as follows:

Balance on 1 March 2018	1 200 000
Repayments during the financial year (including interest)	260 000
Interest capitalised	?
Balance on 28 February 2019	?

12% of the outstanding loan balance is expected to be repaid in the next financial year.

- D. The **net profit** for the financial year takes into account the following:

- Rent income received for March 2019. Note that the tenant leased the premises from 1 October 2018. A total amount of R39 360 was received from the tenant. This included a 5% increase which was effective from the 1 January 2019.
- An amount of R25 560 for rates was paid for the period 1 January 2018 to 31 December 2018. Rates is a fixed monthly premium which remained unchanged for the current financial year.

C. Share Capital and Dividends

- Authorised Share Capital: 1 500 000 ordinary shares.
- 60% of the authorised shares were in issue on 1 March 2018.
- On 1 November 2018, 300 000 additional shares were issued at R6,80 per share.
- On 1 December 2018, the company bought back 150 000 shares from the estate of a shareholder who was declared bankrupt. A payment of R1,60 above the average share price was paid for these shares.
- On 1 September 2018, an interim dividend of 65 cents per share was paid.
- On 28 February 2019, a final dividend was declared. Note that dividends are payable to the number of shares in issue at that time.

D. Fixed Assets

The fixed asset register lists only two categories of fixed assets as per note below:

Equipment is depreciated at 15% p.a. on carrying value.

Additions and alterations to the existing buildings were made during the current financial year.

On 30 June 2018, old equipment, cost R250 000 was sold at carrying value. The accumulated depreciation on these assets were R184 000 on 1 March 2018.

On 1 September 2018, new equipment for R950 000 was purchased for cash.

Fixed Asset Note:

	BUILDINGS	EQUIPMENT
Cost (1 March 2018)	2 564 000	3 800 000
Accumulated Depreciation (1 March 2018)	-	(1 164 000)
Carrying value (1 March 2018)	2 564 000	(b)
Movements:		
Additions	(a)	950 000
Disposals	0	(c)
Depreciation	-	(d)
Carrying value (28 February 2019)	3 812 750	
Cost (28 February 2019)	3 812 750	(e)
Accumulated Depreciation (28 February 2019)	-	

E. Information extracted from the Balance Sheet on 28 February:

	2019	2018
Fixed assets (carrying value)	?	5 200 000
Fixed deposit: Bull Bank	220 000	316 000
Total current assets	769 000	974 600
Inventories	425 600	456 600
Trade and other receivables	319 000	337 000
SARS: Income tax	19 400 (Dr)	8 000 (Dr)
Cash and cash equivalents	5 000	173 000
Shareholders' equity	?	4 776 600
Ordinary share capital	?	4 680 000
Retained income	178 500	96 600
Loan: Shark Bank	?	1 200 000
Total current liabilities	726 500	514 000
Sundry creditors	163 420	351 000
Income received in advance	?	-
Prepaid expenses	?	1 000
Shareholders for dividends	?	162 000
Bank overdraft	55 000	-

F. Financial indicators for the financial year ended 28 February:

	2019	2018
Current ratio	?	1,9 : 1
Acid-test ratio	0,5 : 1	1 : 1
Debtors Collection period	45 days	37 days
Creditors payment period	76 days	65 days
Debt/equity ratio	?	0,3 : 1
Return on average capital employed	?	26%
Return on shareholders' equity	23,5%	21%
Earnings per share	132 cents	122 cents
Dividends per share	100 cents	118 cents
Net asset value per share	577 cents	531 cents
Market price of shares (JSE)	678 cents	680 cents
Current interest rate on loans	12%	12%

G. Audit report**Audit report – To the shareholders:**

In our opinion, the financial statements fairly present, in all material respects, the financial position of the company at 28 February 2019 and the results of their operations and cash flows for the year then ended, in accordance with International Financial Reporting Standards and in the manner required by the Companies Act in South Africa.

DST and Associates

Chartered Accountants (SA)