

June examination memorandum

Marks: 300

Time: 3 hours

Question 1 Income Statement, Balance Sheet and Notes (36 minutes, 60 marks)

1.1 INCOME STATEMENT

Sales	3 600 000
Cost of sales	✓✓✓(✓) (2 000 000)
Gross profit	✓(✓) 1 600 000
Operating income	✓(✓) (40 000)
Gross income	(✓) 1 560 000
Operating expenses	✓✓ (720 000)
Operating profit	840 000
Interest income (on fixed deposit)	40 000
Net profit before interest expense	880 000
Interest expense	✓(✓) (440 000)
Net profit before taxation	✓(✓) 440 000
Income tax	✓✓(✓) (132 000)
Net profit after tax	✓✓ 308 000

1.2 Notes to the Financial Statements

1.2.1

Retained income	
Balance at the beginning of the year	✓(✓) 702 000
Net profit after tax	✓(✓) 308 000
Total dividends	✓✓ (210 000)
Paid	120 000
Recommended	✓(✓) 90 000
Balance at the end of the year	✓(✓) 800 000

1.2.2

Trade and other payables	
Trade creditors	380 800
Income received in advance	24 000
Accrued expenses	18 000
SARS (income tax) (R3 200✓ + R132 000✓ – R112 400✓)	(✓) 22 800
Shareholders for dividends	(✓) 90 000
	535 600

Balance Sheet as at 28 February 20.9

ASSETS	
Non-current assets	✓(✓) 6 250 160
Fixed assets (balancing amount)	✓(✓) 6 050 160
Fixed deposit	✓(✓) 200 000
Current assets	✓(✓) 1 285 440
Trade inventories	620 000
Trade and other receivables	480 000
Cash and cash equivalents	✓(✓) 185 440
TOTAL ASSETS	✓(✓) 7 535 600

EQUITY AND LIABILITIES	
Capital and reserves	✓(✓) 5 000 000
Ordinary share capital (R1 200 000✓ + R3 000 000✓✓✓)	(✓) 4 200 000
Retained income	✓(✓) 800 000
Non-current liabilities (R7 000 000 – R5 000 000)	2 000 000
Current liabilities	✓(✓) 535 600
TOTAL EQUITY AND LIABILITIES	✓(✓)77 535 600

Question 2 Cash Flow and ratios

(39 minutes, 65 marks)

2.1

Cash flow from investing activities	✓(✓) (322 000)
Purchase of tangible assets (R656 000✓ – (R66 000✓ + R84 000✓ + R872 000✓)	(✓) (366 000)
Proceeds from sale of tangible assets	✓✓ 84 000
Increase in financial assets (R100 000✓ – R60 000✓)	✓ (40 000)

2.2 $1\ 200✓ \times R2✓ = R2\ 400✓$

2.3 Liquidity is the ability to pay short-term debts using short-term assets.✓✓
Solvency is the ability to meet obligations on time or to pay long-term debts.✓✓

2.4.1 Percentage net profit before tax on turnover

$$= \frac{210\ 000✓}{608\ 820✓} \times 100✓ = 34,5\% (✓)$$

Percentage operating expenses on turnover

$$= \frac{186\ 130✓}{608\ 820✓} \times 100✓ = 30,6\% (✓)$$

2.4.2 The percentage net profit before tax on turnover increased from 25,78% in 20.7 to 34,5% in 20.8.✓✓

The percentage operating expenses on turnover decreased from 38,39% in 20.7 to 30,6% in 20.8.✓✓

This implies that the company has better cost control.✓✓

2.5.1 Average debtors = $\frac{R64\ 150 + R52\ 650}{2} = R58\ 400$

$$\frac{R58\ 400✓✓}{R426\ 820✓} \times \frac{365✓}{1} = 50\ \text{days} (✓)$$

2.5.2 Charge overdue debtors' accounts with interest

Give discounts for early payments.

Sent out account statements.

Sent out SMS's

Any $2 \times 2 = 4$ ✓✓✓✓

2.5.3 The current ratio increased from 0,84 : 1 in 20.7 to 1,11 : 1 in 20.8.

The acid test ratio increased from 0,47 : 1 in 20.7 to 0,38 : 1 in 20.8.

Stock holdings period increased from 115 days in 20.7 to 150 days in 20.8.

Debtors collection period decreased from 55 days in 20.7 to 50 days in 20.8.

The creditors payment period increased from 72 days in 20.7 to 97 days in 20.8.

Any $2 \times 2 = 4$ ✓✓✓✓

It will be easier for the company to pay their short-term debt in 20.8 than it was in 20.7. Although the liquidity is better, it is still not good and needs improvement.✓✓

2.6.1 $250\ 000✓ : 600\ 000✓✓ = 0,42 : 1 (✓)$

2.6.2 Do not take another loan. If you look at the interest rate cover and liquidity, the business risk is high which implies that the finance risk is low. ✓✓
Rather opt for shareholder funding by means of a shares issue. ✓✓

2.7.1 $\frac{600\,000 \checkmark \checkmark}{300\,000 \checkmark} \times \frac{100 \checkmark}{1} = 200 \text{ cents } (\checkmark)$

2.7.2 It is good to sell ✓✓, the market value is more than the net asset value ✓✓

Question 3 Corporate governance and auditing

(12 minutes, 20 marks)

3.1 International Financial Reporting Standards ✓

3.2.1 Balance Sheet ✓✓

3.2.2 Income Statement ✓✓

3.3 Accept any one valid reason below. ✓✓

Protecting the shareholders/separation of ownership from control.

Public funds are used.

To ensure that it is a fair reflection of financial statements.

To ensure that Directors are not misrepresenting the figures.

To be accountable to stakeholders, e.g. shareholders, SARS

To discourage fraud.

3.4 Any one of the other stakeholders ✓ Reason ✓✓

- Prospective investors (financial institutions) to make investments.
- Lenders to see whether the company is solvent and security for their loans.
- Suppliers to see if amounts owed can be paid.
- SARS to calculate the tax accurately.
- Competitors to compare results.
- Trade unions for wage negotiations/job security.
- Board of Directors to assess performance.
- Government for statistical information.
- Registrar of Companies to comply with legislation.

3.5 Any one valid explanation ✓✓✓

- Auditors give reasonable assurance because they do not check everything in the books of the company (sampling test only)
- Cost factor / time-consuming if everything checked.

3.6 Any one valid explanation indicates less time spent on the external audit ✓✓✓

- Internal auditors will reduce mistakes made by employees.
- External auditors will spend less time auditing the books.
- Admin should be in place, e.g. documents filed correctly

3.7 Any two valid reasons ($2 \times 2 = 4$)

- Disciplinary procedure against member who is negligent
- Compliance with Code of Ethics/ credibility
- Compliance with GAAP and IFRS
- Professional development/training/updated circulars
- Ensure high competence levels
- Control qualifications
- Market the profession
- Investigate complaints against members

Question 4 Inventory valuation

(29 minutes, 48 marks)

4.1 First-in, first-out OR The oldest soccer balls are the ones that are sold first. ✓✓

4.2 $\frac{R430\,500 \checkmark}{2\,100 \text{ balls} \checkmark} = R205 \text{ each } \checkmark$

4.3 Total balls available ($750 + 2\,480 - 1\,100$) = 2 130 balls ✓✓
Number sold = 2 100 balls ✓✓

4.3.1 Number stolen = 30 balls ✓

4.3.2 Debit TRADING INVENTORY DEFICIT / loss due to the theft ✓ R3 300 ✓

Credit TRADING INVENTORY ✓ R3 300

4.4 480 balls at R160 R 76 800 ✓✓✓

620 balls at R120 R 74 400 ✓✓✓

Total R151 200 ✓

4.5 Opening inventory R 82 500 ✓

Purchases 340 800 ✓

Stolen (3 300) ✓

Closing inventory (151 200) ✓

Cost of sales 268 800 ✓

Gross profit for the year

Sales R430 500 (✓)

4.5.1 Cost of sales (268 800) (✓)

4.5.2 Gross profit 161 700 (✓)

4.6.1 On average, 175 balls are sold per month. Inventory will last 6,3 months.

OR

Cost of sales for the year is R268 800 (R22 400 per month) – final inventory is R151 200. Inventory could last 6.8 months. *Any* $1 \times 3 = 3$

4.6.2 Advice

Purchase inventory in smaller quantities but more frequently.

Only order when they reach their minimum inventory level (re-order level)

They are holding too much inventory. *Any* $2 \times 2 = 4$

4.7.1 Employees who think they were unfairly dismissed, can go to the CCMA for restitution. ✓✓✓

4.7.2 Yes. ✓ The owner was supposed to follow a disciplinary procedure as guided by South African labour legislation. ✓✓✓

4.7.3 Hold a disciplinary hearing. Peter has the right to have any internal person to represent him, e.g. shop steward or any employee. Depending on the company's policy about theft, Peter could either be dismissed at the hearing or receive a final written warning. Theft is a serious matter and the punishment should reflect the seriousness of the offence. *Any* $1 \times 3 = 3$

4.7.4 There are professional bodies to help him to set up a code of conduct. Once the code of conduct is ready to be implemented, it must be communicated to each employee. *Any* $1 \times 3 = 3$

Question 5 VAT

(30 minutes, 50 marks)

5.1 (A) $\frac{14}{100} \times 300 = 42$ (✓)

(B) $\frac{114}{14} \times 1\,400 = 11\,400$ (✓)

(C) $\frac{14}{100} \times 1\,400 = 10\,000$ (✓)

(D) $\frac{14}{100} \times 250 = 35$ (✓)

5.2

Dr					VAT INPUT					Cr				
2.11					2.11									
Apr	1	Balance	b/d	✓ 22 380	Apr	30	Creditors control ✓	CPJ	✓ 84					
	30	Bank ✓	CPJ	✓ 4 480			Creditors control ✓	CAJ	✓ 588					
		Creditors control ✓	CJ	✓ 4 200			VAT control ✓	GJ	(✓) 30 388					
				31 060									31 060	

VAT OUTPUT

2.11 Apr	30	Debtors control✓ Debtors control✓ Debtors control✓ VAT control✓	CRJ DAJ GJ GJ	✓ 42 ✓ 140 ✓ 35 (✓) 32 883	2.11 Apr	1 30	Balance Bank✓ Debtors control✓	b/d CRJ DJ	✓ 28 340 ✓ 3 360 ✓ 1 400
				33 100					33 100

VAT CONTROL

2.11 Apr	30	VAT input✓ Balance	GJ c/d	(✓) 30 388 (✓) 2 495 32 883	2.11 Apr	30	VAT output✓	GJ	(✓) 32 883
									32 883
					2.11 May	1	Balance	b/d	(✓) 2 495

5.3 Amount payable✓ to SARS = R2 495✓
Trade and other payables✓✓

Question 6 Bank reconciliation

(28 minutes, 46 marks)

6.1

Bank Reconciliation Statement on 31 May 20.8	Debit R	Credit R
Credit balance✓ according to Bank Statement		(✓) 833
Credit outstanding deposit		✓✓ 1 620
Debit outstanding cheques: B 89712	✓✓ 270	
B 89830	✓✓ 826	
B 89834	✓✓ 3 400	
Credit cheque incorrectly debited		✓✓ 150
Credit balance✓ according to BANK account		(✓) 1 893
(R33 720✓ + R2 700✓ – R38 415✓ + R750✓ – R165✓ – R120✓ – R65✓ – R298✓)		
	4 496	4 496

6.2.1 Comparisons are made to documents received from outside organisations, or to figures in other aspects of the books. If differences can be explained, then errors, omissions or fraud is minimised.✓✓✓

6.2.2 The cheque is stale✓, cancel in CRJ✓✓ OR Dr BANK; Cr DONATIONS

6.2.3 Put in the Bank Reconciliation Statement again as an outstanding cheque.✓✓

6.2.4 Reverse the cheque✓ Dr BANK✓ and Cr CREDITORS CONTROL✓

6.2.5.1 Any valid explanation ($1 \times 3 = 3$) ✓✓✓

Suggested answer:

Cashier is deliberately under-stating the deposits each month. She is possibly taking a large amount of money for personal use and replaces this each month with new funds received near the end of the month. This is known as "Rolling of Cash".

6.2.5.2 Any three valid measures (any $3 \times 2 = 6$) ✓✓✓✓✓✓

Suggested answer:

Internal auditor must check the cashier's process of depositing cash.

Deposits must be made on a daily basis.

Seperation of duties. The cashier should not be receipting, completing deposit slips and banking the cash because this allows opportunity for her to roll cash.

6.2.5.3 Any two valid steps (*any* $2 \times 2 = 4$) ✓✓✓✓

Suggested answer:

Management must be informed immediately.

Disciplinary action should follow. The cashier is entitled to a fair hearing and may have legal representation while the company has a duty to detect and act when fraud is suspected.

If the outcome of the disciplinary hearing is guilty, the company may decide to lay a criminal charge at the police station if the amount is less than R30 000. If the amount exceeds R30 000, the company is obliged by South African legislation to lay a criminal charge.

If found guilty, she could face dismissal or depending on the company policy, receive a final warning.

Question 7 Debtors age analysis

(7 minutes, 11 marks)

- 7.1 Debtors age analysis provides information per debtor per outstanding period. It will provide a total for each outstanding period.
This information is important to owner because he/she must know whether debtors are adhering to the credit terms.
Debtors age analysis is a tool to quickly manage the outstanding debt of the business.
- 7.2 Debt of debtors with amounts outstanding older than 90 days is substantial due to a large amount outstanding from debtor Abrahams (90 days outstanding is larger than current debt).
Regardless of the large amount owed by Abrahams, credit is still granted to this debtor.
Debtor Fouche has a negative balance on 30 days which could be an indication of poor administration.
Debtor Venter continues making monthly purchases (though smaller than Abrahams) despite having debt older than 90 days. The company allows his actions.