Question 1:

Discuss which of the proposals complies with the provisions of the Companies Act 71 of 2008. Your discussion must be limited to the class and type of shares that will be issued in the formation of the company.

[2 marks]

Suggested solution:

Proposal 2 - the Companies Act 71 of 2008 stipulates that companies can only have share of no par value, thus the proposal made by the son to issue par value shares is not permitted.

[2 marks]

Question 2:

Discuss whether the interpretation and advice given by Mr. Rajah Singh that the shareholders will be entitled to a refund of the cash paid by them for the no par value shares, as they have no value to be disclosed in the financial statements, is true and correct in terms of the provisions of the Companies Act (Act 71 of 2008).

[5 marks]

Suggested solution:

The interpretation of Mr. Rajah Singh is incorrect (1) because he lacks the understanding of the concept of par and no par value shares (1). Par value shares has a fixed/nominal value attached to the shares while no par value has no nominal value (1). The type of shares affects the share capital value that should be reported in the financial statements, viz. (i) par value shares will have a value equal to the number of shares multiplied by its nominal and any amount paid by the investors in excess of the nominal value is represented by the share premium (1), and (ii) no par value shares will have a value equal to the amount received from the investors in exchange for the shares (1). Irrespective of the type of shares, the share capital must have a value based on the amount invested by the shareholders (1) – represent the capital invested by the shareholders. If the cash raised from an issue of shares is returned to the shareholders, then it will represent a return of the capital invested or the cancellation of the shares issued (similar to a share buy-back) (1). Furthermore, a company with no share capital cannot exist legally (1).

[5 marks]

Question 3:

Record the journal entries to implement Proposal 1 above (narrations is required).

[6 marks]

Suggested solution:

		Debit	Credit
Bank	*(1)*	*75,000*	
Share capital –no par value	*(1)*		*75,000*
[Issue of shares to the members of the CC]	*(1)*		
Bank	*(1.5)*	*20,000*	
Share capital – no par value	*(1.5)*		*20,000*
[Issue of shares to the Trust for employees]	*(1)*		

[6 marks]

Question 4:

Disclose the information relating to share capital in the financial statements of Lekkerbek Foods for the reporting period ended 29 February 2016 in compliance with the accounting standards and Companies Act.

[6 marks]

Suggested solution:

Statement of financial position as at 28 February 2016		(0.5)
Equity		
Share capital – no par value	(2)	95,000
Notes to the financial statements – 28 February 2016	(0.5)	
7. Share capital		
Authorised: xxxxx ordinary share of no par value	(1)	
Issued: 60,000 ordinary shares of no par value	(1)	95,000
The unissued shares are under the control of the directors.	(1)	

[6 marks]

Question 5:

Discuss whether the recommendation of the Professional Accountants with respect to utilising shareholders' loan accounts for the purchase of shares in the company complies with the Companies Act.

[3 marks]

Suggested solution:

Section 45 (1) of the Companies Act 71 of 2008 prohibits (1) the company from providing financial assistance to shareholders/directors to purchase equity instruments in the company. However, financial assistance can be provided if the terms and conditions of the loan is fair and reasonable to the company (1) and special resolution has been passed (1). In addition, the board must be satisfied that after providing the financial assistance the company would satisfy the solvency and liquidity tests (1) (financial assistance will not negatively affect the business).

[3 marks]

Question 6:

Identify and motivate the potential financial information risks in the preparation of financial statements that may result as a consequence of the recruitment of staff policy and the structure of the accounting department.

[8 marks]

Suggested solution:

The financial reporting risks caused by the structure of the accounting department:

Cause	*Risk*
Qualifications of the senior staff employed in the department (1)	*Lack of technical competence could affect compliance to the accounting standards (1)*
Appointment of family members to senior positions (1.5)	*Nepotism may cause friction and dissatisfaction in the department – low motivation and moral (1)* *Senior members may not be competent to perform the duties as accountants – information risk in the financial statements (1)* *Non-compliance to the accounting and reporting standards – negative effect on the reliability and faithful*

	representation of financial information (1) *Non-adherence to deadlines which may results in business and financial risks to the business – missed deadlines may result in penalties and fines (1)*
Resistance to the automation of the accounting system (1.5)	*Lack of accurate and reliable information for decision-making – incorrect and uninformed decisions made (1)* *Timeliness of the availability and type of information and reports presented – not be aware of the risks of the business (1)* *Limited access to information or information presented in silo/piece-meal format – management do not have a holistic view of the results of the business (1)*

[8 marks]

Question 7:

Discuss the factors/elements that must be taken into consideration when determining whether the company requires a compilation, independent review or audit pursuant to the requirements of financial reporting in terms of the Companies Act, Act 71 of 2008.

[5 marks]

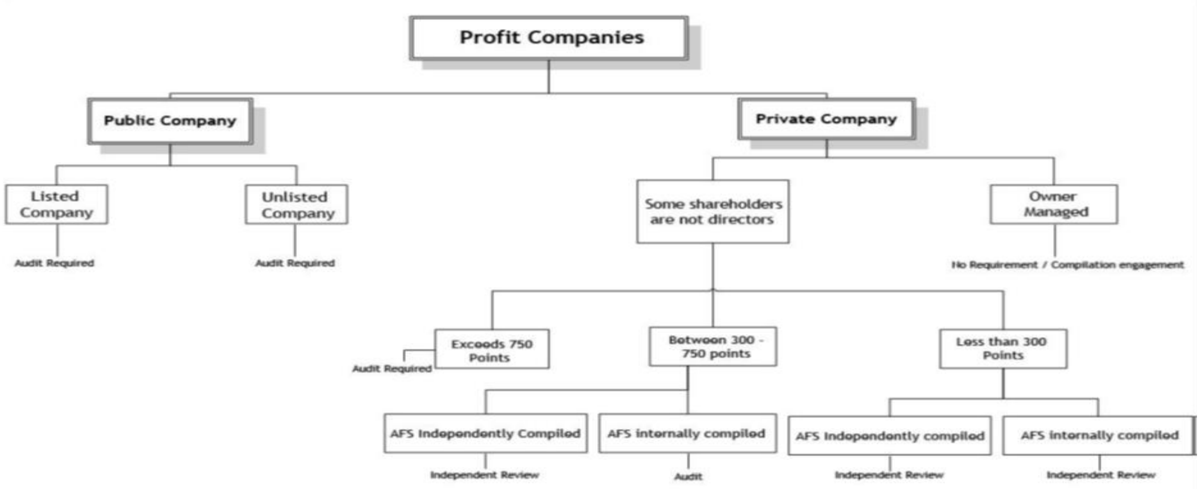
Suggested solution:

Compilation is compulsory for all engagements in preparation of financial statements (1). For all engagement the PI score be calculated to determine the type of engagement in the preparation of the financial statements (1). The type of engagement required will depend on (i) the memorandum of incorporation (MOI) (1) and (ii) the public interest score. The independent review can only be performed when the compilation is performed internally (1) while the compilation is prepared independently then and independent review may not be required (1)

The principle factors that affects the public interest score are:

- *Average number of employees for the year (1) - a number of points that equal the average number of employees during the financial year (1)*
- *Third party liability (1) - one point for every R 1 million (or portion thereof) in third-party liabilities at the financial year end (1)*

- *Revenue for the year (1) - one point for every R 1 million (or portion thereof) in turnover during the financial year (1)*
- *Beneficial interest (1) - one point for every individual who, at the end of the financial year, is known to directly or indirectly have a beneficial interest (1)*



[5 marks]

Question 8:

Discuss whether the Professional Accountants provide any type of "assurance" when performing a compilation engagement for their clients.

[3 marks]

Suggested solution:

"Implied" assurance (2) is provided when performing a compilation engagement based on the following:

- *Authority - the appointment of the professional accountant in in terms Companies Act (section 29(2) or section 30(2) (1) or the Close Corporations Act (section 58 of CC Act) (1)*
- *Reasonable man's test – the professional accountant is not protected by stated that management is responsible for the drafting of the financial statements and maintenance of the accounting records (reasonability tests must be applied to assess the reliability of the financial statements) (2)*
- *Verification procedures – the financial information presented in the financial statements must be verified using the procedures in terms of ISRS 4410 (2)*
- *Assessment of the accounting policies – professional accountant must apply professional judgement to determine if the accounting policies are appropriate for the business (2)*
- *Compliance with accounting standards – professional accountant states that the financial statements comply with the relevant accounting framework (2)*

[3 marks]

Question 9:

Provide a critique of the accounting policy for inventory included in the financial statements by Mr. Rajah Singh in terms of the financial reporting standards.

[6 marks]

Suggested solution:

The accounting policy for inventory has the following deficiencies:

- *Inventory cannot be measured using marginal costing (1) – full absorption costing must be used to reflect the asset at its aggregate cost (1)*
- *Inventory cannot be valued using the LIFO method of accounting (1) – LIFO is not an acceptable method in terms of the accounting standards (1) as FIFO or weighted average method are the accepted methods (1)*
- *Inventory must be tested for impairment (1) – inventory must be valued at the lower of cost or net realisable value (1)*

[6 marks]

Question 10:

Discuss the main differences between the marginal costing and absorption costing methods of valuing inventory in a manufacturing business.

[4 marks]

Suggested solution:

Absorption costing	*Marginal costing*
Cost takes into consideration both variable and fixed production costs (1)	*Cost takes into consideration variable production costs only (1)*
Fixed production costs are allocated to product cost using the overhead absorption rate (1)	*Fixed production costs are treated as period costs or expenses (1)*
Under or over absorbed costs are recognised as expenses/income via profit & loss (1)	*Not applicable (1)*

[4 marks]

Question 11:

Discuss whether the company can adopt marginal costing as a basis of measurement of inventory in the financial statements in order to comply with the accounting standards.

[3 marks]

Suggested solution:

The accounting standards does <u>not allow</u> (1) the entity to value inventory using the marginal costing methods as this violates the <u>measurement criteria of assets which state that assets should be measured at the aggregate costs to be bring the asset available for its intended purpose</u> (2), viz, total cost to produce the finished goods.

[3 marks]

Question 12:

Discuss the consequences and financial implications of using the marginal costing method of valuing inventory on the financial performance and financial position of the business.

[4 marks]

Suggested solution:

The effect of applying marginal costing for the valuation of inventory has the following effects on:

- *Financial performance: the cost of goods sold is understated (only based on variable costs) while the expenses are overstated (fixed production costs are expenses); the net effect is on the profit (generally profit is understated as a results of the fixed production costs not being deferred as part of the cost of inventory). (2)*
- *Financial position: the cost of inventory is understated as a results of the fixed production costs being expensed – cost per unit is understated by the overhead absorption rate. (2)*

[4 marks]

Question 13:

Discuss the income tax and VAT consequences, supported by calculations, of the purchase of the warehouse for the 2016 year of assessment.

[14 marks]

Suggested solution:

Second Hand Fixed Property – Warehouse –VAT and Income Tax implications	Marks
VAT Implications	
- **No VAT was actually paid** by Lekkerbek Foods, since Mr. Moyo is not a **registered VAT vendor**.	**1**
- However, the commercial building constitutes **second hand goods** (it is owned and **previously used** by Mr. Moyo).	**1** **1**
- The buyer (Lekkerbek Foods), the seller (Mr Moyo) and the warehouse are located in South Africa **(the commercial building/warehouse is situated in Rustenburg and the buyer and seller are South African residents).**	**1** **1**
- As Lekkerbek Foods is a registered vendor and purchases second hand property from a non-vendor (Mr. Moyo), a **notional input tax may be claimed** for the commercial building/warehouse.	**1**
- Lekkerbek Foods can claim the notional input tax subject to **registration in their name and to the extent of payment.**	**2**
- The full notional input tax will be claimed in the **VAT tax period ending May 2015.**	**1**
- Lekkerbek Foods will be able to claim a notional input tax equal to **R1 200 000** * **14/114** (Lower of consideration (R1 200 000 and open market value (R1 300 000) multiplied by tax fraction) = R147 368.	**2**
- Not limited to any transfer duty paid.	**1**
Income Tax Implications	
- **No annual building allowance (s13)** can be claimed as the warehouse is **not wholly and mainly used in the process of manufacture.**	**2**
- No annual allowance on commercial buildings (s13quin) can be claimed as the warehouse **is not new and unused**.	**2**
Available	**16**
Maximum	**14**

Question 14:

Discuss how the legal costs and penalties paid by the company to implement the recommendation to occupy the warehouse should be treated for income tax and VAT purposes for the 2016 financial year of assessment.

[6 marks]

Suggested solution:

Legal Costs and Penalties - VAT and Income Tax implications	Marks
VAT Implications	
- *The legal costs and the penalties are payments for services supplied by registered VAT vendors to Lekkerbek Foods, who is a registered VAT vendor* ***for the purpose of making taxable supplies****.*	***1***
- *VAT is accounted for on the* ***earlier of invoice or payment****.*	***1***
- *Therefore, Lekkerbek will claim an input tax of (R262 200 R68 400 +) x 14/114 =* ***R40 600*** *in VAT tax period of* ***ending January 2016***	***2***
Income Tax Implications	
- *The penalties for cancellation of the lease agreements and the legal fees* ***are incurred in the production of income*** *and* ***not of capital nature*** *therefore (R262 200 + R68 400) x 100114=* ***R290 000*** *will be allowed as deduction in the financial year of assessment ended 29 February 2016.*	***2*** ***1***
Available	***7***
Maximum	***6***

Question 15:

Discuss how the implementation of the recommendation affects the recognition and measure of the warehouse in the financial statements in compliance with the financial reporting standards.

[7 marks]

Suggested solution:

The warehouse was previously classified as Investment Property as the major part of the property was used to generate rental income (1). The recommendation of management will result in the warehouse being used primarily by the business (1) resulting it to meet the definition of Property, Plant & Equipment. The change in use will results in the re-classification (1) of the warehouse as follows:

- *Investment Property – must be valued using the fair value method and any gain or loss must be recognized via Profit & Loss (1). Before re-classification the warehouse should be valued at its fair value of R 1.75 million resulting in a gain of R 0.19 million which must be accounted for as a fair value gain in the Profit & Loss (1).*
- *Property, Plant & Equipment – the cost of the warehouse on re-classification must be measured at its fair value of R 1.75 million (1). The warehouse must be measured using the cost model (1), which implies that it should be depreciated at an appropriate rate over its estimated useful life (1).*
- *Expenses incurred – the expenses incurred to implement the recommendation must be recognized as an expense and cannot be capitalized as part of the cost of the warehouse (1).*

[7 marks]

Question 16:

Record the journal entries to implement the Board's decision relating to the warehouse, in compliance with the financial reporting standards.

[8 marks]

Suggested solution:

		Debit	Credit
Property, Plant & Equipment	*(1)*	*1,750,000*	
Investment Property	*(1)*		*1,560,000*
Fair value gain (P & L)	*(1.5)*		*190,000*
[Re-classification of warehouse]	*(0.5)*		
Lease cancellation costs	*(0.5)*	*198,421*	
Legal expenses	*(0.5)*	*60,000*	
Input VAT control	*(1)*	*36,179*	
Bank	*(0.5)*		*294,600*
[Expenses incurred to implement the decision]	*(0.5)*		

[8 marks]

Question 17:

Calculate the effects of the above transactions on the taxable income of Lekkerbek Foods (Pty) Ltd for the 2016 year of assessment. You may assume the taxable income of Lekkerbek Foods is R12 500 000 before taking the above transactions into account.

[11 marks]

Suggested solution:

Income Tax Effects – Delivery Vehicle	Note	Calculation	Marks
		R	
Taxable Income		12 500 000	
Add – Recoupment	1	12 916	
Wear and tear – Old delivery vehicle	2	(42 500)	
Wear and tear – New delivery vehicle	3	(35 625)	
Taxable income after adjustments		**12 434 791**	**1**
Notes			
1. Recoupment			
Old Delivery Vehicle			
Cost Price as at 1 August 2012		**340 000**	**1**
s11(e) – Wear and Tear R340 000 /4 x 7/12		**(49 583)**	**1**
28 February 2013		290 417	
s11(e) – Wear and Tear R340 000 /4		**(85 000)**	**0.5**
28 February 2014		205 417	
s11(e) – Wear and Tear R340 000 /4		**(85 000)**	**0.5**
28 February 2015		120 417	
s11(e) – Wear and Tear R340 000 /4 x 6/12		**(42 500)**	**1**
31 August 2015		77 917	
Selling Price (**R140 000** +(**R62 700 x 100/114**)		195 000	**2**
Tax Value		**(77 917)**	**1P**
Recoupment		117 083	**1P**
Proceeds (R195 000 – R117 083)		**77 917**	**1P**
Base Cost (R340 000 – R262 083)		**77 917**	**1P**
Capital Gain/Loss		0	
As this is asset is replaced, para 65 of the Eight Schedule is applicable.			**1**
New Delivery Vehicle			
s11(e) – Wear and Tear R342 000 /4 x 5/12		**35 625**	**1**
Deferred Recoupment			
R117 083 x **R35 625**/**R342 000**		12 196	**1.5P**
		Available	**14.5**
		Maximum	**11**

Question 18:

Record the journal entries to recognize the destruction (insurance claim) and disposal of the vehicle in compliance with the financial reporting standards.

[8 marks]

Suggested solution:

		Debit	Credit
Accumulated depreciation	*(0.5)*	*250,000*	
Bank (insurance claim)	*(0.5)*	*330,000*	
Profit on disposal of asset	*(0.5)*		*199,474*
Output Vat control	*(0.5)*		*40,526*
Motor vehicle (cost)	*(0.5)*		*340.000*
[Recognizing the insurance claim on vehicle destroyed]	*(0.5)*		
Motor vehicle	*(0.5)*	*52,632*	
Input VAT control	*(0.5)*	*7,368*	
Bank	*(0.5)*		*60,000*
[Acquisition of vehicle destroyed]	*(0.5)*		
Bank	*(0.5)*	*165,000*	
Profit on disposal of asset	*(1.5)*		*92,105*
Output VAT control	*(0.5)*		*20,263*
Motor vehicle	*(0.5)*		*52,632*
[Disposal of vehicle as scrap]	*(1)*		

[8 marks]

Question 19:

Discuss the difference, if any, between the revaluation and fair value methods of measuring the carrying amounts of assets in the financial statements.

[6 marks]

Suggested solution:

Fair value	*Revaluation*
Fair value method measures the assets to reflect them at the market value (1)	*Revaluation method is the restatement of the historical cost of the asset to a market value which reflects the future economic benefits (1)*
Assumption is that the fair value represents the future economic benefits under the prevailing economic conditions (1)	*Assumption is that the market value represents the true value of the future economic benefits embedded in the asset (1)*
Any impairment of the asset is incorporated into the fair value of the asset (1)	*Impairment is recognized separately from the revaluation adjustment (1)*
Fair value adjustment is recognized via the Profit & Loss (1)	*Revaluation adjustment is recognized via Other Comprehensive Income (1)*

[6 marks]

Question 20:

Record the journal entries to implement the revaluation of the machinery for the reporting period ended 28 February 2016 in compliance with the financial reporting standards.

[10 marks]

Suggested solution:

	Cost	*Revalued*	*Surplus*
Cost	*1 740 000*	*2 400 000*	*660 000*
Accumulated depreciation	*725 000*	*555 000*	*170 000*
Carrying amount	*1 015 000*	*1 845 000*	*830 000*
Depreciation	*111 333*	*222 000*	
Carrying amount	*903 667*	*1 623 000*	
Cost	*1 740 000*	*2 400 000*	*660 000*
Accumulated depreciation	*725 000*	*1 000 000*	*-275 000*
Carrying amount	*1 015 000*	*1 400 000*	*385 000*
Depreciation	*111 333*	*222 000*	
Carrying amount	*903 667*	*1 178 000*	
		Debit	*Credit*

Machinery (cost) (1)	*(1)660 000*	
Accumulated depreciation (1)		*(2) 275 000*
Revaluation surplus (OCI) (1)		*(1)385 000*
[Revaluation of machinery] (0.5)		
Depreciation expense (0.5)	*(1)222 000*	
Accumulated depreciation (0.5)		*222 000*
[Depreciation for the period] (0.5)		

[10 marks]

Question 21:

Advise the board how the revaluation surplus should be treated over the remaining useful life of the machinery in the financial statements to comply with the financial reporting standards.

[6 marks]

Suggested solution:

Subsequently recognition of the revaluation surplus:

- *amortised (1) over the remaining useful life of the machinery (1) – result in the effectively reducing the depreciation expense to that based the historical cost. The amortised amount of the revaluation surplus is transferred to retained earnings (1) via the Statement of Changes in equity (1)*
- *transfer the surplus to retained earnings (1) when the assets is sold or de-recognised (1). The revaluation surplus is transferred to retained earnings via the Statements of Changes in Equity (1).*

[6 marks]

Question 22:

Discuss, supported by calculations, the normal tax implications for Sikh Singh for the right of use of the iPad for the year of assessment ended 29 February 2016.

[3 marks]

Suggested solution:

Right of use of an iPad – Income Tax Implications for Sikh Singh	Marks
Income Tax Implications	
- The right of use of an iPad is **a taxable fringe benefit** in terms of para (i) of special inclusions.	**1**
- The value of the taxable fringe benefit is determined in terms of paras 2(b) and 6 of the Seventh Schedule	**1**
- As Sikh Singh has the right of use of the iPad for its useful life, the value is therefore the cost price of the asset to Lekkerbek Foods, which is R7 980 x 100/114 = **R7 000.** The value of the fringe benefit **excludes VAT as Lekkerbek Foods is able to claim the input tax on the iPad.**	**1** **1**
- Therefore, Sikh Singh will **include** R7 000 **in his gross income for the 2016 year of assessment**.	**1P**
Available	**5**
Maximum	**3**

Question 23:

Discuss, supported by calculations, the normal tax implications for Lekkerbek Foods of the trading stock taken for personal use by Sikh Singh, the managing director of the company.

[6 marks]

Suggested solution:

Trading Stock taken for personal use by Sikh Singh – Income Tax Implications for Lekkerbek Foods	Marks
Income Tax Implications	
- The **closing stock figure as at 29 February 2016, will not include** the trading stock taken for personal use with the cost of **R7 500**.	**1**
- Lekkerbek Foods will have a **recoupment included in gross income** of the market value of **R10 000** of the trading stock taking for personal use.	**1** **1**
- As the trading stock is given to an employee(Sikh Singh), Lekkerbek Foods is **consuming the trading stock in their carrying on of their trade** and can therefore **claim a deduction** of **R10 000** in terms of s11(a) **for salaries.**	**1** **2** **1**
- **Employees' tax** (PAYE) will have to be withheld on the fringe benefit(trading stock given to Sikh Singh)	**1**
- There is **no change in use adjustment** as the goods are still used to make taxable supplies.	**1**
- **Output tax on the fringe benefit**(trading stock given to Sikh Singh) needs to be accounted for by **Lekkerbek Foods**.	**1**
Available	**10**
Maximum	**6**

Question 24:

Why might a company use various sources of finance?

[5 marks]

Suggested solution:

Sources of long-term and short-term financing strategies in the context of the financing model of the organisation. Sources of funds can be internal or external. Internal sources the company has control over compared with external funding. Short term decisions involve expenditure over predominately working capital issues and thus is dependent on the operating needs and the ability to meet the financing obligations from the cash generated from operations. Short term financing here could include overdraft facility, revolving credit agreements, incurring of tax penalties (this is illegal), suppliers, credit cards, preference share issues. Long term sources of financing are usually for the procurements of capital expenditure such as for property plant and equipment – sustainable and grow the business. Sources here would include share issues, finance lease agreements, long terms loans and so forth. A firm should consider the short term and long term implications before considering the various sources of financing. The decision here needs to be taken with an optimal mix of debt and equity, the tax benefits and maintained of an optimal capital structure

[5 marks]

Question 25:

Using examples, explain why it is important that potential investors should consider non-financial factors before making their investment decision

[5 marks]

Suggested solution:

The financial information is a quantitative measure of the outcome of the activities of the organisations and does not reflect the nature or complexity of the activities (qualitative information). The following should be taken into consideration:

(i) Internal factors: the competence of managements and the decisiveness with which decisions are made, the operating systems and infrastructure of the operations, the competence of the staff, the technology used in the operating system, the condition of the machinery (operating due diligence).

(ii) External factors: the market conditions, level of competition, legislation and regulations, Porter's 5 forces (market conditions); customer loyalty and changes and preferences; economic and financial conditions, political conditions (market analysis).

(iii) Financial factors: access to finance, funding strategies, capital structure, potential obligations, business and financial risks (financial due diligence).

Examples other than financial help to give a fuller picture of the likely future performance of the company. For example it is important to look at the previous performance of the company to identify trends and compare them with what is happening in the market place. For example if company sales are increasing in a shrinking market, this should send alarm bells to a potential investor. Why is the market shrinking? The state of the economy might indicate the timing of investment, for example: is the economy entering a downturn or is the economy enjoying a boom?

[5 marks]