PROFESSIONAL EVALUATION

ENGLISH SOLUTIONS (SAMPLE SOLUTIONS)

12 November 2011

Please take note that this paper presents a SAMPLE of the November 2011 exam.

INSTRUCTIONS TO CANDIDATES

1. You may make notes on your question paper during the reading time but may not start answering questions in the answer book.
2. Answer all the questions.
3. Section A must be answered in pencil on the card provided.
4. Section B must be answered in the answer book.
5. No pencil (with the exception of Section A) or tippex may be used.
6. Financial calculators are permitted. Cellular phones may NOT be used as calculators.
7. If you wish any part of your work not to be marked, draw a clear line through it.
8. Start each question on a new page.
9. The question paper may be taken with you at the end of the examination.

SECTION A MULTIPLE CHOICE QUESTIONS

1. The company tax rate prior to the budget speech was 28%. On 11 April 2010 the Minister of Finance announced that the tax rate for business entities will be reduced to 25% with effect from 01 July 2010. The financial statements of the business entity for the reporting date ended 28 February 2010 was finalized on 25 July 2010. Which of following tax rates should be applied when calculating the tax expense for the reporting date ended 28 February 2010:

(a) **28% for both current tax and deferred tax**
(b) 25% for both current tax and deferred tax
(c) 28% for current tax and 25% for deferred tax
(d) 28% for current tax

2. During the period a business entity concluded a sales transaction with an invoice value of R342 000 [including VAT at 14%]. The customer is allowed a settlement discount of 4% if the payment is received before the terms allowed, viz. 60 days from the statement date. The revenue recognized in respect of this transaction amounts to:

(a) R342 000
(b) R300 000
(c) R288 000
(d) R288 000 if it is probable that the customers will exercise the right to claim the discount offered

3. During the reporting period ended 28 February 2011 a business entity sold machinery inclusive of a free three year maintenance plan for a selling price of R1 200 000 [excluding VAT]. The fees charged for the maintenance this type of machinery is estimated at R75 000 per annum with an estimated present value for the three years of R171 250. The revenue that should be revenue at the date the transaction is finalized amounts to:

(a) R1 200 000
(b) R1 028 750
(c) R975 000
(d) R1 125 000

Use the following information to answer questions 4 and 7.

The trainee prepared the following working paper relating to the construction of an office building constructed during the reporting period ended 28 February 2011:

	Cost	Interest paid
Total cost of land	824,600	88,000
Cost of civil works and clearing of land for construction	97,800	13,692
Total costs of constructing the building	1,235,800	130,426

After discussions with the trainee the practitioner discovered the following:

a. The construction of the building was completed over a seven month period.
b. The land was acquired on 01 March 2010 and was financed by a bond of R800 000 bearing interest at a rate of 11%.
c. The construction of the building was partially funded by a long-term loan of R1 100 000 bearing interest at a rate of 12.5%. The loan was raised on 01 May 2010. Interest for the reporting period ended 28 February 2011 amounted to R114 583.
d. All other costs were financed from the business entity business account which had a favourable balance throughout the period. The interest paid was estimated based on the interest charged on an overdraft facility.

4. The property is classified as a qualifying asset. The interest that should be capitalized as part of the cost of the property amounts to:

(a) R232 119
(b) R80 208
(c) R135 403
(d) R168 208

5. The construction of the building which will be used as the head office of the business entity should be measured at cost of under property, plant and equipment in the financial statements for the reporting period ended 28 February 2011 as follows:

(a) land at R824 600 and buildings at R1 565 719
(b) land at R1 024 092 and buildings at R1 366 227
(c) properties at R2565 319
(d) land at R922 400 and buildings at R1 316 008

6. Assume that the Seller of the land is not a VAT vendor, whereas the Purchaser is one. Which of the following is true?

(a) The transfer duty paid by the Purchaser must be capitalised as part of the cost of acquisition
(b) Transfer Duty was not paid as the Purchaser is registered for VAT
(c) Both (a) and (b) are true
(d) Neither (a) nor (b) are true

7. **With regards to the costs of civil works done to the land and the site clearing**;

   (a) The costs associated with the clearing of the site must be separately identified and be written off to the Income Statement as “Repairs and Maintenance”
   (b) Civil Works installed and site clearing adds value to the land and must be capitalized as part of the base cost of the land
   (c) Civil works installed and site clearing must add value to the buildings and must be capitalized as part of the base cost of the buildings
   (d) None of the above

8. **The following schedule relating to buildings which are depreciated on a straight-line over a period of twenty-five year [25] was drafted by the trainee:**

	28-Feb-10	28-Feb-11
Carrying amount based on the original cost	1,020,000	960,000
Estimated recoverable amount	910,000	1,150,000
Carrying amount - after impairment	910,000	856,471

The business entity does not apply the revaluation method to any of its assets. The reversal of the impairment loss for the reporting period ended 28 February 2011 amounts to:

   (a) R50 000
   (b) R110 000
   (c) R103 529
   (d) R293 529

9. **A business entity owns office premises with a total cost of R2 000 000. 75% (otherwise doesn’t match the numbers in (b) R1 500 000 = 75% of R2 000 000) and R500 000 = 25% of R2 000 000) of the premises are leased to tenants with a minimum lease period of 5 years. The remaining part of the premises is used by the business entity for its own purposes. The building should be classified in the financial statements for the reporting period ended 28 February 2011 as:**

   (a) total cost of R2 000 000 as investment property
   (b) R1 500 000 as investment property and R500 000 as property, plant and equipment
   (c) apportioned between investment property and property, plant and equipment only if the portions of the office premises can be sold or leased out separately under a finance lease IAS 40 p.10
   (d) Total cost of R2 000 000 as property, plant and equipment

10. **During the reporting period ended 28 February 2011, an entity acquired a factory plant in a rural area. The entity was granted concession by the government to commence operating subject to the entity rehabilitation the surrounding environment at the end of the useful life of the factory plant which was estimated to be 10 years. Management estimated that the rehabilitation costs at the end of the useful life of the plant to be R240 000 with a present value of R111 166. The rehabilitation costs should be recognized in the financial statements by:**

(a) only disclosing the commitment by way of a note to the financial statements
(b) capitalizing R240 000 to the cost of the factory plant with a corresponding liability
(c) capitalizing R11 166 to the cost of the factory plant with a corresponding liability
(d) capitalizing R111 166 to the cost of the factory plant with a corresponding provision

11. The total variable production overhead costs for the period ended 30 June 2010 amounted to:

(a) Rnil
(b) R260 000
(c) R20 000
(d) R60 000

12. The production overheads absorption rate for the period ended 30 June 2010 is:

(a) R13.00 per unit
(b) R14.00 per unit
(c) R13.69 per unit
(d) R9.00 per unit

13. The under/over absorbed production overhead costs for the period ended 30 June 2010 amounted to:

(a) R45 000 under absorbed
(b) R45 000 over absorbed
(c) R20 000 under absorbed
(d) R20 000 over absorbed

Use the following information to answer question 15 and 16.

The contribution per unit was estimated at R32.50 for a product produced by the business entity. The total production fixed costs amounted to R980 000 and the other fixed costs [administrative and selling] amounted to R850 000.

14. If the cost of direct raw material increased from R24.50 to R30.00 per unit of production, the increase in the break-even point in units will be:

(a) 6 143 units
(b) 11 470 units
(c) 5 000 units
(d) 8 149 units

15. Assume that there were changes in the budgeted costs and that the business entity intends to realize a net profit of R375 000 for the period, the break-even point in units will be:

(a) 56 308 units
(b) 11 539 units
(c) 41 693 units
(d) 67 847 units

Use the following information to answer question 16 and 17.

The following information was extracted from the production records for the first quarter ended 30 September 2010:

	Budget	**Actual**
Production volume	50,000	45,000
Direct materials:		
- Cost per unit of material	R35.00	R32.00
- Usage per unit of production	1.30	1.50
Direct labour		
- Cost per hour	R17.00	R21.00
- Usage per unit of production [minutes]	36	30

16. The direct material price variance for the period ended 30 September 2010 amounts to:

(a) R115 000 favourable variance
(b) R175 500 favourable variance
(c) R202 500 favourable variance
(d) R115 000 unfavourable variance

17. When preparing the financial statements of a close corporation, which does not require an audit in terms of the Companies Act of 2008, the accounting officer performs certain audit procedures to:

(a) protect him/herself against litigation or criminal procedures instituted by the members
(b) substantiate the increase in the accounting fees charged
(c) ensure the reliability and accuracy of the financial statements
(d) complete the recommended working papers of SAIPA

18. The Companies Act of 2008 requires the preparer of financial statements to ensure the liquidity of the business entity. The opinion expressed by the accounting officer on the liquidity of the close corporation reports on:

(a) the fact that the entity is considered to be a going concern
(b) the assets of the entity exceed its liabilities and obligations
(c) the entities ability to meet its short-term obligations
(d) working capital of the entity

19. The Companies Act of 2008 states that business entities have the option of having the financial statements "independently reviewed" or audited. The primary purpose of an independent review is to:

(a) perform an audit at a lower cost
(b) express an opinion that the financial statements contain no misstatements
(c) allow non-registered auditors to perform the audits of entities which have no public accountability
(d) improve the quality of financial statements of SME's

20. Accounting officers maintain the accounting records of many SME's and close corporations based on the bank statement, but conclude in the accounting officer's report that the financial statements are prepared based on the "accrual method" to comply with the Accounting Standards [IFRS or GAAP]. The accounting officer's report is correct in such situations because:

(a) adjustments are made to recognized receivables and payables at the end of the period
(b) financial statements are prepared for tax purposes which use that cash basis
(c) accrued and prepaid transactions are immaterial
(d) members of close corporations do not understand the "accrual method"

21. Assets, especially tangible assets such as property, plant & equipment and inventories should be physically inspected when preparing financial statements to:

(a) Verify that the assets exist
(b) assess the condition of the assets
(c) to complete working papers and substantiate the work performed
(d) (a) and (b)

22. Loans made to members of a Close Corporation which bears no interest and have terms of repayment should be classified and disclosed in the financial statements as:

(a) non-current liabilities
(b) part of member contributions
(c) separate line item between members contributions and non-current liabilities
(d) current liabilities

23. When the accounting officer obtains certification from the client's banker, the request is for the bank to:

(a) confirm the bank balance of the account requested
(b) confirm balance of all bank accounts registered in the name of the client
(c) confirm the bank balance in the bank reconciliation at the end of the period
(d) comply with the practices and policies of the practitioner

24. Amongst the advantages of creating a Trust, in terms of the Trust Property Control Act, Act 57 of 1988, is to protect assets. Which statement is incorrect?

(a) A beneficiary can sell a right in a trust much like a shareholder can sell shares in a company
(b) If a beneficiary becomes insolvent, the assets in the trust continue to be protected, unlike shares in a company
(c) If you, as the donor, or the trustee become insolvent, the trust's assets remain protected
(d) Trustees are not the owners of trust assets

25. Which of the following definitions best describe a Discretionary Trust?

(a) A trust that comes into being only after the death of a testator and in terms of a Will
(b) Payment of income and/or capital is subject to the discretion of the trustees and all non-allocated income is taxable in the hands of the trust
(c) The income and capital beneficiaries are already determined and described. The income is taxable in the hands of the income beneficiary, which could also be the capital beneficiary. The capital beneficiary thus gets immediate property rights, subject to the terms of the will or trust act
(d) A trust that comes into being during the lifetime of the Donor or founder with the signing and registration of a trust deed by the donor and trustees

26. In terms of section 62 of the Close Corporations Act, Act 69 of 1994 (as amended) a duly appointed Accounting Officer to a Close Corporation has a duty to inform the Registrar of Close Corporations by registered mail, if

(a) at any time knows, or has reason to believe, that the corporation is not carrying on business or is not in operation and has no intention of resuming operations in the foreseeable future
(b) that any change, during a relevant financial year, in respect of any particulars mentioned in the relevant founding statement has not been registered
(c) that the annual financial statements incorrectly indicate that as at the end of the financial year concerned the assets of the corporation exceed its liabilities, or has reason to believe that such an incorrect indication is given
(d) all of the above

27. Miss Sisipho Gunguluza qualified as a Professional Accountant (SA) and decided to practice for her own account. Therefore, she is contemplating to advertise her services in the community newspapers. Which of the following phrases are not acceptable in her advert?

(a) Member of the South African Institution of Professional Accountants (SAIPA)
(b) Gunguluzas – Your 1-stop accountancy shop
(c) Special for the week – Income Tax Returns for just R300
(d) Registered Tax Practitioner

28. Retreat Bioscopes (Proprietary) Limited, registration 1951/000786/07, was deregistered by the Commission for Intellectual Properties and Companies (CIPC) for failing to submit annual returns and pay annual duties. Which of the following statements are correct?

(a) Restoration of the Company is only possible on an order of a competent Court
(b) The Company is still liable to CIPC for all outstanding annual duties and penalties for late rendition of annual returns, prior to its re-instatement on the Companies Register
(c) Only the auditors of the Company is allowed to submit Annual Returns
(d) All of the above

29. On receipt of an enquiry from SAIPA's Investigation Committee, a Professional Accountant (SA),

(a) Must immediately formulate or cause to formulate a Replying Affidavit and send to the Investigation Committee
(b) Simply ignores the Investigation Committee's request as they can do nothing to do
(c) Contact the SAIPA Accreditation, Compliance and Disciplinary Department and tell them where to get off
(d) Will not do any of the above

30. On 1 April, 2011 Companies Act 2008 replaced both the Companies Act 1973 and Corporate Laws Amendment Act 2006. The Act introduces the concept of an "Independent Review". An Independent Review is best described as;

(a) An alternative form of external independent assurance of financial statements.
(b) A procedure that does not involve any audit procedures whatsoever
(c) A report that can be prepared by all persons who are Accounting Officers as defined in the Close Corporations Act (as amended)
(d) All of the above

31. An EMP501 is best described as;

(a) A monthly return to be filed at SARS for employee taxes withheld from employees
(b) An annual return to be filed at SARS reconciling VAT paid to SARS with the Salaries Control Account
(c) An annual return to be filed at SARS reconciling Employee Tax Certificates issued with monthly employee taxes paid over
(d) None of the above

32. Which of the following statements are correct with regards to registration as a VAT vendor with SARS

(a) Doctors in private practice do not ever need to register as VAT vendors as medical services are an exempt supply
(b) A partnership of 3 persons rendering a professional service is obliged to register as a VAT vendor when the turnover of such a 3-person partnership generated a turnover of R3-million over a 12-month period

(c) Any entity with a turnover of less than R50,000 per annum may not register as a VAT vendor on a voluntarily basis
(d) The Application for registration as a VAT vendor maybe submitted online on the SARS website

33. Identify the entities that may be considered a Small Business Corporation for Income Tax purposes, for the year ended 28 February 2011;

(a) Rose Corner Consulting Structural Engineers CC with a reported annual turnover of R10million
(b) Rose Corner Cafe a sole proprietorship with a reported annual turnover of R10million
(c) Rose Corner Café CC, a convenience store operating from premises owned by Rose Street Properties CC. Rose Chambers is the sole member of both Close Corporations and the combined annual turnover is R10million
(d) Rose Corner Café CC, a convenience store operating from premises owned by Rose Street Properties Trust. Rose Chambers is the sole member of the Close Corporation, sole trustee of the Trust and the combined annual turnover is R10million

34. Mzansi Rugby Academy is an unincorporated association of persons, not for gain with its own Constitution, which does not require that the books of account be audited. The organization was registered with the Director of Non Profit Organizations pursuant to the Non-Profit Organizations (NPO) Act. Which of the following statements are correct?

(a) As a member of SAIPA you may not accept appointment as Accounting Officer, as the NPO Act specifically requires that a Registered Auditor be appointed
(b) The NPO Act requires that Annual Financial Statements be prepared in conformity to Generally Accepted Accounting Practices
(c) Mzansi Rugby Academy pays Tutu de Villiers, a coach in its fulltime employment, R20, 000 per month. As an NPO Mzansi Rugby is exempted from retaining and contributing payroll taxes from Tutu de Villiers's monthly salary
(d) Mzansi Rugby Academy is automatically allowed to issue section 18A certificates for the donations they receive

35. Juju Malema has entered into a two-year learnership agreement with Zuma Gwede Consulting Incorporated, a firm of Civil Engineers with a gross monthly remuneration bill of R75, 000 (excluding learner allowances, but including directors' emoluments). Which statement(s) is (are) false?

(a) Zuma Gwede Consulting Incorporated is exempted from registering and contributing skills development levies
(b) As Juju Malema has a fixed term learnership agreement, Zuma Gwede Consulting Inc. may legally terminate such learnership agreement at the firm's discretion without following due process prescribed by the labour laws
(c) The learnership agreement need not be registered with any Sector Education and Training Authority (SETA)
(d) All of the above

36. Ms Dolly Saley, a Cape Town based non-executive director of Globetrotters Limited, travelled to Ethikweni for Globetrotters's 3-day Strategic Planning Board Meeting. As a VAT Vendor, Globetrotters;

(a) May not claim the input vat on Dolly Saley's airfare despite the fact that the Tax Invoice is properly annotated to Globetrotters Limited
(b) May claim the input vat on the reimbursed dinner bills claimed by Dolley Saley, which she substantiated with abridged tax invoices
(c) May not claim the input vat on the car hiring from a VAT Vendor as vat on motor cars is specifically excluded
(d) None of the above

37. An Engagement Letter is;
(a) A contract between a service provider and his client, detailing the terms and conditions, responsibilities and duties, fees and terms of payment for tasks to be performed signed by both parties
(b) A written instrument on the letterhead of a client, instructing that the service provider may commence with a job
(c) Not encouraged for Professional Accountants
(d) None of the above

38. On 20 August 2011, Zelda Grange, a 52 year old mother, consulted you with regards to her personal Income Tax affairs. Zelda worked as Personal Assistant to Dr Nelson Sexwale, who passed away on 21 July 2010. Which of the following items will be included in her Income Tax Return (IT12) income for 2011?

(1) Her salary paid to her from March 2010 to the date of Dr Sexwale's death was R50,000
(2) Her guaranteed pro-rata bonus of R5,000 has not yet been paid to her as it is a claim to the estate of the late Dr Sexwale
(3) She received unemployment insurance pay-outs of R22,500 up to 28 February 2011
(4) Interest earned for the 2011-tax year amounted to R14,000
(5) On 15 December 2010 she cashed in unit trusts and the proceeds thereof amounted to R51,000 with a base cost of R21,000
(6) Dr Sexwale bequeathed to her in his will R100, 000 which she has not yet received.

(a) Items 1, 3, 4, 5
(b) Items 1, 4, 5
(c) Items 1, 2, 4, 5
(d) Items 1, 2, 3, 4, 5, 6

39. Zelda Grange's Taxable Income for the 2011-tax year will be;
(a) R242,500
(b) R142,500
(c) R85,000
(d) R57,500

40. What does it meant to be a SAIPA member in good standing?

(a) A Member who has not complained about the service delivery of SAIPA, whose fees are paid up to date as well as their CPD hours has been captured.
(b) A member whose fees are fully paid up for the year and whose CPD hours have been captured for the previous year on the system and have the required hours.
(c) A member whose fees are fully paid up for the year and whose CPD hours have been captured for the previous year on the system and have the required hours for the 3 year period.
(d) A member whose fees are fully paid up for the year and whose CPD hours have been captured for the previous year on the system and have the required hours for the 3 year period, this must include the compulsory CPD sessions of tax and IFRs each year.

41. How does the SAIPA code of conduct explain "Professional competence and due care"?

(a) Members should perform their services with care and diligence, and have a duty to maintain their professional knowledge and skills.
(b) Members should perform their services with due care, competence and diligence, and have a continuing duty to maintain their professional knowledge and skills at a level sufficient to ensure that all relevant stakeholders, e.g. clients, employers, credit providers and other government departments/agencies receive the advantage of competent service based on the latest developments in the profession and in keeping with current legislation.
(c) Members should perform their services with care, competence and diligence, and have a continuing duty to maintain their professional knowledge and skills at a level sufficient to ensure that all relevant stakeholders.
(d) Members should have a continuing duty to maintain their professional knowledge and skills at a level sufficient to ensure that all relevant stakeholders.

SECTION B CASE STUDY QUESTIONS

<u>CASE STUDY 1:</u> **[35 MARKS]**

You have recently been appointed as accounting officer of Maak-‘n-Ras (Pty) Limited and have been assigned responsibilities with respect to the period ended 30 June 2011.

Whilst looking through prior year accounting files you have noted that deferred tax has not been provided for. On enquiry of management, you have received the following response:

> Date: 02 August 2011
> From: Jay Haripersad
> To: Accounting Practitioner
>
> Hi
>
> With regard to your query, we have not provided for deferred tax as per advise received from our previous accounting officer who has given us the following reasons for not providing for deferred tax:
>
> 1) The business has an assessed loss.
> 2) Deferred tax applies only to large entities.
>
> Kind Regards
>
> Jay Haripersad
>
> Financial Manager

After investigations the accounting officer discovered the following relating to the reporting period 30 June 2009:

1. The carrying amount of the net assets was R850 000 while the tax base of the net assets was R760 000.

2. The assessed loss carried forward amounted to R90 000.

The following information relates to the reporting period 30 June 2010:

	Carrying amount	Tax base
Property, plant & equipment	R980 000	R620 000
Prepaid expenses	R35 000	R15 000
Accrued expenses	R21 000	NIL

3. The profit before tax presented in the drafted statement of comprehensive income for the reporting period ended 30 June 2010 amounted to R640 000.

4. Included in the profit before tax above are the following:

Dividends Received on Investment in SATRIX Top 40:	R 22 000
Fines paid:	R 500
Dividends Received on Investment in Offshore investments:	R 12 000
Donations:	R 11 000

The company tax rate remained unchanged at 28%.

REQUIRED:

Please show all your workings. Presentation marks are awarded for neatness and clarity in calculations.

(1) You have been requested by management to advise on the following:

(a) Is it necessary to provide for deferred tax in light of the claims made by the previous accounting officer? 4 marks

(b) How should the company have accounted for the assessed loss as at 30 June 2009 assuming:

(i) At 30 June 2009 the entity does not expect to return to profitability.

(ii) At 30 June 2009 the entity does expect to return to profitability.

2 marks

(c) Discuss the conditions and circumstances whereby Maak-‘n-Ras (Pty) Ltd can be classified as a Small Business Corporation for Income Tax purposes with reference to section 12E(4) of the Income Tax Act (as amended). 4 marks

[10 marks]

(2) Calculate the current tax expense of the entity at 30 June 2010. [8 marks]

(3) Prepare the following disclosure for the period ended 30 June 2010 in accordance with IFRS assuming that at 30 June 2009 the assessed loss had been provided for in the deferred tax computation:

(i) The statement of comprehensive income 30 June 2010 beginning with the profit before tax.

(ii) Income tax expense note including the tax rate reconciliation and deferred tax note.
Comparatives are not required. [17 marks]

Suggested solution

QUESTION 1: [35 MARKS]

(1)

(a) All entities preparing financial statements in accordance with IFRS are required to comply with all the standards. Therefore it is necessary for all entities to provide for deferred tax as per IAS 12 if applicable to the entity. Deferred tax arises on temporary differences which may arise within an entity. Deferred tax is to be provided on all temporary differences in the period in which they arise. Consideration must not be given to the size of the entity.

4 marks

(b) Treatment of the assessed loss:

As per IAS 12, a deferred tax asset should be provided for an assessed loss to the extent that it is probable that future economic benefits will arise against which the assessed loss can be offset.

(i) Assuming the entity expects to return to profitability a deferred tax asset may be recognized for the full assessed loss.
(ii) Assuming the entity does not expect to return to profitability a deferred tax may be created to the extent that there is a deferred tax liability against which it can be set off.

2 marks

(c) For tax purposes a Small Business Corporation means a close corporation, co-operative or a private company, which complies with all the following requirements:

- All the shareholder/members must at all times during the year of assessment be natural persons (individuals);
- Shareholders/Members may not hold any shares/members interest in equity of any other company/close corporation. However a share or interest in the following entities are excluded from this requirement:

1. Listed Companies;
2. A participatory interest in a collective investment scheme;
3. A company contemplated in section 10(1)(e) of the Act (body corporate);
4. Less than 5% of the interest in non-business co-operatives such as consumer buy-aids, social co-operatives (such as child nursery facilities) or burial societies;
5. Friendly societies; and
6. Less than 5% of the interest in a primary savings co-operative bank or a primary savings and loans co-operative bank as defined in the Co-operatives Bank Act, 2007.

- The gross income for the year may not exceed R14 million;
- Not more than 20% of the total of all receipts and accruals (other than those of a capital nature) and all the capital gains may consist collectively of investment income and income from rendering a personal services. 4 marks

[10 marks]

(2) Calculation of current tax expense as at 30 June 2010

Profit before Tax	640 000	1 mark
Dividends Received:Local	(22 000)	1 mark
Dividends Received: Foreign	(12 000)	1 mark
Fines Paid:	500	1 mark
Accrued Expenses:	(0)	1 mark
Assessed loss brought forward	(90 000)	1 mark
Donations	11 000	1 mark
	527 500	
	x 28%	
	147 700	**1 mark**

[8 marks]

(3)

(i) Maak-'n-Ras (Pty) Ltd
Statement of Comprehensive Income for the period ended 30 June 2010.
½ mark

Profit before Tax	640 000	½ mark
Tax (147 700 + 94 920)	(242 620)	1 mark
Profit for the period	**397 380**	1 mark

(ii) Maak-'n-Ras (Pty) Ltd
Notes to the financial statements for the period ended 30 June 2010.
½ mark

Tax Expense

Current tax is provided for at the current tax rate of 28%. ½ mark

SA Normal Tax		
-Current Tax	141,700	1 mark
-Deferred Tax - Temporary differences	94,920	1 mark

Tax Rate Reconciliation

Profit before tax	640,000	½ mark
Applicable Tax Rate	**28%**	½ mark
Dividends Received	(34,000)	½ mark
Fines Paid	500	½ mark
Donations	11,000	½ mark
Assessed Loss utilized	(90,000)	½ mark
Effective Rate	**35.39%**	1 mark

Deferred Tax

Deferred tax has been provided for in accordance with IAS 12 on the balance sheet liability method. Deferred tax has been provided for on all temporary differences. Deferred tax assets have been provided for to the extent that it is expected that future economic benefits will flow to the entity. 2 marks

Deferred Tax Liability	94,920 L	1 mark

The deferred tax balance has been provided for on temporary differences arising on the following:

PPE	100,800	½ mark
Accrued Expenses	(5,880)	½ mark

WORKINGS:

DEFERRED TAX:

		CA	TB	TD	DT	
30/06/09	Balance	850,000	760,000	90,000	25,200L	1 mark
	Assessed Loss			90,000	25,200 A	1 mark
	Balance				0	
30/06/10						
	PPE	980,000	620,000	360,000	100,800 L	1 mark
	Accrued expenses	-21,000	-	21,000	5,880 A	1 mark
	Balance				94,920 L	

[max 17 marks]

MANAGEMENT ACCOUNTING AND AUDIT – PRACTICE QUESTIONS

<u>Case study 2:</u> [30 MARKS]

Global engineering is an engineering firm, established in 1956, specialising in the manufacture of customised engineering equipment for use in the construction industry. The company manufactures the pieces on site in Booysens, Johannesburg. Global engineering also runs a logistics fleet from its' premises in Booysens.

The company has a 31 December year end.

You have been appointed as a consultant to Global Engineering to advise management making the following decisions:

- Global Engineering has a piece of machinery which is 7 years old and is crucial to the manufacturing process. Management is unsure of whether they should replace the machinery or repair the existing machinery.

  The information presented below has been provided to assist you in advising Global Engineering.

	Old Machinery	New Machinery
Initial investment	R1,800,000	R2,400,000
Carrying amount at 01 Jan 2011	R900,000	-
Remaining estimated useful life at 01 Jan 2011	3 years	-
Estimated useful life	6 years	6 years
Net salvage value at 01 Jan 2011	R1,100,000	
Net salvage value – 31 Dec 2017	R90,000	R180,000
Net operating cash flows – Dec 2011	R320,000	R480,000
Net operating cash flows – Dec 2013	R450,000	R570,000
Net operating cash flows – Dec 2014	R500,000	R650,000
Net operating cash flows – Dec 2015	R500,000	R700,000
Net operating cash flows – Dec 2016	R500,000	R750,000
Net operating cash flows – Dec 2017	R500,000	R750,000

The old machine can be repaired and improved on 01 January 2011 at a total cost of R450,000 which would extend the remaining useful life of the machine to 31 December 2017.

Depreciation is allowed as a deduction for tax purposes. The income tax rate is 30%. The tax liability is paid one-year after the liability is recognized, cash flow time lag of one year.

Based on management calculations a discount rate of 20% has been considered to be appropriate.

- Management of Global Engineering had performed a capital budgeting exercise during the prior year and had reached the conclusion that the logistics division of the company does not fit into the long term strategy of Global Engineering.

  Management has therefore sold off the logistics division during the current financial year (date of transfer of control : 30 October 2011) including all the assets attributable to the division as a going concern to In-house Fleet management for an amount of R 12 000 000 payable as follows:

  R 7 500 000 payable on the date control passes to the purchaser (30 October 2011)
  R 4 500 000 payable on anniversary of the date control has passed (30 October 2012)

- During a discussion with the Financial Manager of Global Engineering, she has mentioned to you that she had been reading an article in the Financial Times stating that all firms are not required to have an audit performed as per the companies act any longer and can instead have a review performed. She is however unsure of the difference between a review and an audit.

REQUIRED:

(a) Discuss when it is appropriate to use the payback period as a tool to make investment decisions.

[3 marks]

(b) Advise management whether the old machinery should be repaired or replaced using the discounted cash flow method [DCF]. The Net Present Value of Cash Flows in replacing the existing machine with a new one is R582,708

[15 marks]

(c) Provide the audit procedures that would be performed to audit the sale of the logistics division.
Ignore Companies act requirements

[5 marks]

(d) Advise management on the difference between a review and an audit, including a discussion on the following:

(i) Which entities are required to have an audit performed and which entities can instead have a review performed?

(ii) The standards governing performance of a review.

(iii)The level of assurance provided in an audit engagement and a review engagement.

[5 marks]

SUGGESTED SOLUTION

CASE STUDY 2:

(a) PAYBACK PERIOD

The payback period is a useful decision making technique when:

1. The entity has limited resources or limited access to finance
2. The entity has a re-investment strategy or cycle
3. High risk investments with the objective of minimizing losses
4. The entity is developing its niche market or operate in a high changing business environment

[3 marks]

(b) NET PRESENT VALUE

REPAIR OLD MACHINE:								
	Period 0	Period 1	Period 2	Period 3	Period 4	Period 5	Period 6	Period 7
Cost of machinery	**-**							
Tax in respect of wear & tear			**90,000**	**90,000**	**90,000**			
Cost of repairs	**(450,000)**							
Tax relating to repairs			**135,000**					
Net cash flow		**320,000**	**450,000**	**500,000**	**500,000**	**500,000**	**500,000**	
Tax relating to net cash flow			**(96,000)**	**(135,000)**	**(150,000)**	**(150,000)**	**(150,000)**	**(150,000)**
Salvage value							**90,000**	
Tax on salvage value								**(27,000)**
Net cash flow	(450,000)	320,000	579,000	455,000	440,000	350,000	440,000	(177,000)
Discount Factor [20%]	**1.0000**	**0.8333**	**0.6944**	**0.5787**	**0.4823**	**0.4019**	**0.3349**	**0.2791**
Present value	**(450,000)**	**266,667**	**402,083**	**263,310**	**212,191**	**140,657**	**147,355**	**(49,397)**
Net present value	932,866							

½ mark for identifying each period Cash Flows max. 9 marks

½ mark for multiplying with factor to get present value per period max. 4 marks

CONCLUSION: REPLACE WITH NEW MACHINE AS THE NET PRESENT VALUE OF THE REPLACE MACHINE OPTION IS R582,708 WHEREAS THE REPAIR OF EXISTING MACHINE IS MORE EXPENSIVE AT R932,866

2 marks

[15 marks]

(c) Audit Procedures to be performed to audit the sale of the logistics division:

- Inspect the minutes of directors meetings for evidence of the decision to sell the divison.
- Inspect the sale agreement/contract for signatures of both parties (i.e Global Engineering and the purchaser)
- Inspect the contract of sale and ensure that the purchase price is R 12 000 000
- Inspect the contract of sale for any conditions relating to the sale and ensure these have been complied with
- Inspect the contract to ensure that the purchase price is payable as follows:
  R 7 500 000 payable on the date control passes to the purchaser (30 October 2011)
  R 4 500 000 payable on anniversary of the date control has passed (30 October 2012)
- Inspect the contract to ensure that control has transferred on 30 October 2011.
- Inspect the bank statements to ensure that R 7 500 000 was transferred into the bank account of Global Engineering on 30 October 2011.
- Inspect and reperform the discounting calculation as performed by management to ensure that the payment of R 4 500 000 has been discounted for 1 year at an appropriate discounting rate.
- Inspect the financial statements of the entity to ensure that at the end of the previous year the division had been classified as a discontinued operation in accordance with IFRS 5.
- Inspect the current year financial statements to ensure that only 10 months worth of profits of the division have been included in the Statement of Comprehensive Income and that the assets and liabilities of the division have not been included in the financial statements.

[Max. 7 marks]

(d) Audit vs review

(i) An audit is required for all public companies and all state-owned companies.
An audit is also required for all private companies with a public interest score in excess of 350 points.
Other entities with a PI score below 350 are required to have a review performed.

(ii) The performance of a review is governed by ISRE 2400.

(iii) An audit provides positive assurance whilst a review engagement provides negative assurance that nothing has come to the performers attention suggesting that the financial statements prepared are materially misstated.

[5 marks]

CASE STUDY 3:

The following financial statements and information relates to BLANTYRE CC:

Statement of Financial Position at 28 February:

	2011		2010
	R		**R**
Assets			
Current assets	**335,020**		**226,600**
Cash	67,500		31,850
Accounts receivable	154,320		96,500
Inventories	108,700		88,450
Prepaid expenses and other current assets	4,500		9,800
Non-current assets	**804,900**		**579,600**
Property, plant and equipment [cost]	1,065,000		735,600
Accumulated depreciation	(327,600)		(254,000)
Investments	67,500		98,000
Total assets	**1,139,920**		**806,200**
Liabilities and Stockholders' Equity			
Current liabilities	**229,930**		**160,220**
Accounts payable	89,650		57,630
Accrued expenses payable	12,100		18,830
Dividends payable	110,000		60,000
Income tax payable	18,180		23,760
Long-term liabilities			
Loans payable	160,000		215,000
Shareholders' equity	**749,990**		**430,980**
Ordinary share capital	620,000		400,000
Retained earnings	129,990		30,980
	1,139,920		**806,200**

Statement of Comprehensive Income for the reporting period ended 28 February 2011:

	2011
	R
Revenues	1,262,460
Cost of sales	576,540
Gross profit	**685,920**
Gain on sale of investment	9,260
Total Operating expenses	338,280
General operating expenses	216,500
Depreciation expense	121,780
Income from operations	**356,900**
Other expenses	35,870
Interest expense	27,530
Loss on sale of property, plant and equipment	8,340
Income before income tax	**321,030**
Income tax expense	34,520
Net Income	286,510
Dividends declared and paid	187,500
Retained earnings for the year	**99,010**

Additional information for 2011:

1. Old property, plant and equipment having an original cost of R59 800 were sold.
2. Investments were sold during the year. No investments were purchased.

YOU ARE REQUIRED TO:

Prepare the Statement of Cash Flows together with the note reconciling the profit to cash generated from operations for the reporting period ended 28 February 2011, using the direct method.

[25 marks]

SUGGESTED SOLUTION: FINANCIAL ACCOUNTING – PRACTICE QUESTIONS

case study 3: [25 MARKS]

BLANTYRE CC			
Statement of Cash Flow for the reporting period ended 28 February 2011			
	R	**Working**	**Marks**
Cash generated from operating activities			
Cash received from customers	1,204,640	1	**1**
Cash paid to suppliers and employees	(782,700)	2 & 3	**1**
Cash generated from operations	421,940		
Interest paid	(27,530)		**1**
Income tax paid	(40,100)	4	**1**
Net cash flow from operating activities	**354,310**		
Cash flows from investing activities			
Acquisition of property, plant and equipment	(389,200)	5	**1**
Proceed on disposal of investments	39,760	7	**1**
Proceeds on disposal of property, plane and equipment	3,280	6	**1**
Net cash used for investing activities	**(346,160)**		
Cash flows from financing activities			
Proceeds from an issue of shares	220,000		**1**
Repayment of bonds payable	(55,000)		**1**
Dividends paid	(137,500)	8	**1**
Net cash used for financing activities	**27,500**		
Reconciliation of cash and cash equivalents			
Movement in cash and cash equivalents for the period	35,650		**1**
Balance of cash and cash equivalents at beginning of period	31,850		**1**
Balance of cash and cash equivalents at end of period	67,500		

[max. 12 marks]

Notes to the Statement of Cash Flow for the reporting period ended 28 February 2010

1. Reconciliation of profit to cash generated from operations

Profit before tax	321,030		½
Add: Interest expense	27,530		½
Adjustments for non-cash items			
- Depreciation	121,780		½
- Loss on disposal of property, plant and equipment	8,340		½
- Gain on disposal of investments	(9,260)		½
Cash flow before working capital	469,420		½
Working capital movements			
- Increase in inventory	(20,250)		½
- Increase in trade receivables	(57,820)		½
- Decrease in prepaid expenses	5,300		½
- Increase in trade payables	32,020		½
- Decrease in accrued expenses payable	(6,730)		½
Cash generated from operations	421,940		

[MAX. 5 marks]

WORKINGS:

1. Cash received from customers:

Revenue	1,262,460	½
Movement in trade receivables [increase]	(57,820)	½
Cash flow	**1,204,640**	

2. Cash paid to suppliers

Cost of sales	(576,540)	½
Movement in inventory [increase]	(20,250)	½
Purchased	(596,790)	
Movement in trade payables [increase]	32,020	½
Cash flow	**(564,770)**	

3. Cash paid to employees

Expenses [total]	(374,150)	½
Adjustment for non-cash items		
- Depreciation	121,780	½
- Loss on disposal	8,340	½
Add: Interest expense [included in total]	27,530	½
Movement in accrued expenses [decrease]	(6,730)	½
Movement in prepaid expenses [increase]	5,300	½
Cash flow	**(217,930)**	

4. Income tax paid:

Income tax expense	(34,520)	½
Movement in tax payable [decrease]	(5,580)	½
Cash flow	**(40,100)**	

5. Acquisition of property, plant and equipment:

Movement in cost of assets [increase]	(329,400)	½
Cost of disposal [note 5]	(59,800)	½
Cash flow	**(389,200)**	

6. Proceeds on disposal - property, plant & equipment

Movement in accumulated depreciation	73,600	½
Depreciation for the year	(121,780)	½
Accumulated depreciation of asset sold	(48,180)	
Cost of asset sold	59,800	½
Carrying amount of asset sold	11,620	
Loss on disposal	(8,340)	½
Cash flow	**3,280**	

7. Proceeds on disposal - investments

Movement in investment	30,500	½
Loss on disposal	9,260	½
Cash flow	**39,760**	

8. Dividends paid

Movement in dividends payable	50,000	½
Dividends declared	(187,500)	½
Cash flow	**(137,500)**	

[Available: 12]

[Max: 8]

[12 + 5 + 8 = 25]