PROFESSIONAL EVALUATION
ENGLISH QUESTION PAPER
03 November 2012

WRITING TIME: **4 HOURS**
READING TIME: **30 minutes**
MARKS: **200**

SECTION A	**MULTIPLE CHOICE**	**2 MARKS EACH**	**Recommended Time Allocation**
	TOTAL SECTION A	**50**	60 min
SECTION B	CASE STUDY 1	35	42 min
	CASE STUDY 2	30	36 min
	CASE STUDY 3	35	42 min
	CASE STUDY 4	20	24 min
	CASE STUDY 5	30	36 min
	TOTAL SECTION B	**150**	**180 min**
TOTAL		**200**	**240 min**

INSTRUCTIONS TO CANDIDATES

1. 30 minutes of reading time is provided
2. You are NOT allowed to make any notes or commence with the paper during reading time
3. Answer all the questions
4. Please begin each question on a new page
5. Section A must be answered in pencil on the card provided
6. Section B must be answered in the answer book
7. Suggested allocation times per questions have been provided in the table above
8. No pencil (with the exception of Section A) or tippex may be used
9. Financial calculators are permitted. Cellular phones may NOT be used as calculators
10. If you wish any part of your work not to be marked, draw a clear line through it
11. The question paper may be taken with you at the end of the examination

SECTION A MULTIPLE CHOICE QUESTIONS [50 MARKS]

Use the information below to answer question 1 to 3:

An entity operates Stick and a Just-in-time production system [produce to order] and thus carry no finished goods. The entity is currently operating at a production capacity 80%. The selling price per unit is R75.00 yielding a contribution per unit of R24.98. The total fixed costs at the current capacity is R1 827 000.

1. The current production capacity of the entity is 120 000 units. What amount of profit will the entity earn for the period:

(a) R2 997 600
(b) R1 170 600
(c) R7 173 000
(d) None of the above

2. Management is of the opinion that the production capacity and sales volume can be increased to 90% of total capacity if the selling price is reduced by 12.5%. The decision of management to increase the production capacity and sales volume will result in profits earned of:

(a) R279 675
(b) R1 545 300
(c) R1 024 275
(d) R965 349

3. In order to operate at maximum capacity and realize a profit of R1 500 000, what is the minimum selling price per unit that the entity should charge:

(a) R93.75
(b) Remain unchanged
(c) R77.75
(d) R72.20

Use the information below to answer the questions 4 – 5:

Management is in the process of finalising its capital expenditure budget for the upcoming financial period. The following is a summary of the capital expenditure projects forwarded by the various departments:

	Project A	**Project B**	**Project C**	**Project D**
Initial cost of investment	1,800,000	2,100,000	1,800,000	760,000
Net present value	558,700	512,500	576,800	(17,600)
Useful life	6 years	5 years	7 years	4 years
Expected rate of return	18%	22%	16%	15%

4. Based on the above information, the management should select the following project to maximize the benefits and returns to the business:

(a) Project A
(b) Project B
(c) Project C
(d) Project D

5. If the capital expenditure budget of the entity is limited to R4 million for the upcoming financial period, management should select the following projects to maximize the profit of the entity:

(a) Project A and B
(b) Project A and C
(c) Project B and C
(d) Project A, B and C

6. Which of the following best describes variable costs?

(a) varies with the level of activity
(b) varies as the price of changes
(c) fixed per unit but varies in total in relationship to the level of activity
(d) actual expense incurred varies in relation to the budget

7. The production overhead costs of the entity are classified as:

(a) fixed costs
(b) variable costs
(c) semi-variable costs
(d) prime cost

Use the information below to answer the questions 8 -9:

On 01 March 2008, the carrying amount of plant and machinery was R700 000 [the original cost was R900 000] with an estimated residual value of R100 000 and an estimated useful life of 8 years. At 28 February 2009 and 2011 the recoverable amount of the plant and machinery were R540 000 and R420 000 respectively. There was no change in the estimated residual value and useful life of the machinery since it was acquired. The entity uses the cost method of accounting for plant and machinery. The entity depreciates plant and machinery on a straight-line basis to its residual value over its estimated useful life.

8. The depreciation expense for the reporting period ended 28 February 2011 amounted to:

(a) R112 500
(b) R88 000
(c) R100 000
(d) R140 000

9. **The recoverable amount of the plant and machinery at 28 February 2011 had the effect of:**

   (a) Reversal of an impairment loss of R60 000
   (b) Reversal of an impairment loss of R56 000
   (c) Reversal of an impairment loss of R36 000
   (d) Increase in the carrying amount of the asset by R20 000

10. **On 01 July 2010, an entity acquired a factory plant. The local municipality required that the entity commit itself to restore the surrounding environment before it will be granted an operating license. Management estimated that the cost of rehabilitating the environment at the end of the useful life of the factory plant to be R670 000. The cost of rehabilitating the environment shall be presented in the financial statements at 28 February 2011 as:**

(a) A long-term liability
(b) A contingent liability
(c) A provision
(d) An additional note to the financial statements

11. **An entity made the following sale offer to its customers "Money back guarantee if the item can be purchased at any other store at a lower price". The offer only last for one month from the date of sale and provided the lower price is not a discounted sale price. This type of sale transaction should be recognised as:**

(a) A normal sale at the transaction date
(b) A deferred sale until the offer expires
(c) A sale together with a provision for the refund at the transaction date
(d) A sale at the transaction date and the refund as an expense at the date it occurs

12. **Who of the following may be a director of a Company?**

(a) A juristic person
(b) A person without qualifications specifically set out in the Memorandum of Incorporation of a Company
(c) A person who have been removed from an office of trust on the grounds of misconduct, involving dishonesty
(d) A rehabilitated insolvent

13. **Section 88 of The Companies Act, No 71 of 2008 details the duties of the Company Secretary. Which of the following is not a duty expected of the Company Secretary?**

(a) Providing the directors of the company collectively and individually with guidance as to their duties, responsibilities and powers;
(b) Making the directors aware of any law relevant to or affecting the company;
(c) Reporting to the company's board any failure on the part of the company or a director to comply with this Act;
(d) Must personally take the minutes at all shareholders' meetings, board meetings and the meetings of any committees of the directors, or of the company's audit committee;

14. **Which of the following persons, duly registered as an Auditor with the Independent Regulatory Board for Auditors, are not precluded from being appointed as auditor to a Company?**

(a) An employee or consultant of the company who has, or has been engaged for more than one year in the maintenance of any of the company's financial records,
(b) An employee or consultant of the company who has, or has been engaged for more than one year in the preparation of any of its financial statements;
(c) A person who does not regularly perform the functions of an accountant, bookkeeper or secretary of the company
(d) A director, officer or employee of a person appointed as company secretary;

15. **With reference to Annual Returns to be filed with CIPC, which of the following statements are correct?**

(a) Annual Returns may be filed manually
(b) Annual Duties payable to CIPC is based on the Annual Turnover achieved by the Company or Close Corporation
(c) Non Profit Companies are automatically exempt from filing an Annual Return with CIPC
(d) All of the above

16. **Which of the following are not factors that contribute to the Public Interest score to be calculated in determining the type of report to be included in the Annual Financial Statements of companies.**

(a) The number of individual creditors and third party liability beneficiaries
(b) Annual turnover
(c) Aggregate staff head count for the year
(d) Total number of individuals with a direct or indirect beneficial interest

17. A sectional title scheme consists of 14 units belonging to 9 different owners. Which of the following are correct?

(a) In terms of the Sectional Titles Act only Registered Auditors may be appointed and there exist no other options available to owners
(b) As the sectional title scheme has less than 10 owners, an Accounting Officer may be appointed
(c) Subject to procedurally correct resolution amending the management rules an Accounting Officer in stead of a Registered Auditor may be appointed
(d) None of the above

18. Like any other entrepreneur, the Professional Accountant in Practice has to evaluate his/her business risk. Which of the following activities contribute to the minimization of the business risks of running a practice.

(a) Acquiring professional indemnity cover
(b) Participating in Continuous Development Education programs
(c) Developing a quality assurance model for your practice
(d) All of the above

19. Jakes Meyer Professional Accountant (SA) is a newly qualified professional and decided to practice for his own account as from 1 July 2012. He decided to take on a trainee accountant and the start date of the learner is also 1 July 2012, with a learner allowance of R4,000 per month. Jakes Meyer Professional Accountant (SA) is obliged, amongst other things to;

(a) Register as an employer with SARS, by submitting an EMP101
(b) Register as an employer with the Office of the Compensation Commissioner
(c) Register as an Approved Training Center (ATC) with SAIPA
(d) Only (b) and (c) above

20. Internal control systems have some inherent limitations. Which of the following is an example of such inherent limitations?

(a) Incompatible duties amongst staff and management
(b) Lack of segregation/division of duties
(c) Faulty human judgment calls
(d) Absence of an Audit Committee

21. Which of the following describes how the objective of an independent review of financial statements differs from the objective of a compilation engagement?

(a) The primary objective of a review engagement is to test the completeness of the financial statements prepared, but a compilation tests for reasonableness.
(b) The primary objective of a review engagement is to provide positive assurance that the financial statements are fairly presented, but a compilation provides no such assurance.
(c) In a review engagement, accountants provide limited assurance, but a compilation expresses no assurance.
(d) In a review engagement, accountants provide reasonable or positive assurance that the financial statements are fairly presented, but a compilation provides limited assurance.

22. An Accounting Officer's principal objective in analyzing repairs and maintenance expense accounts is to:

(a) Determine that all obsolete plant and equipment assets were written off before the year-end.
(b) Verify that all recorded plant and equipment assets actually exist.
(c) Discover expenditures that were expensed but should have been capitalized.
(d) Identify plant and equipment assets that cannot be repaired and should be written off.

23. The standard report issued by an Accounting Officer after performing his/her duties should state that the financial statements of a Close Corporation;

(a) Is limited to presenting in the form of financial statements information that is the representation of management.
(b) The presented accounting policies have been implemented and is appropriate for the business.
(c) The accounting officer does not express an opinion or any other form of assurance on the financial statements.
(d) The accounting officer did not obtain an understanding of the entity's internal control or assess control risk.

24. In any case in which the Professional Accountant (SA) is not qualified to perform the work, a professional obligation exists to

(a) Acquire the requisite knowledge and skills.
(b) Suggest someone else who is qualified to perform the work.
(c) Refer the Client to SAIPA to grant the consent to accept the engagement.
(d) Decline the engagement.

25. In terms of the Non Profit Organizations Act, Act 71 of 1997 a Professional Accountant (SA) may accept appointment as Accounting Officer;

(a) Despite the fact that the Trust Deed of a Trust registered as an NPO requires an audit
(b) For a universitas, free association of persons not for gain, registered as an NPO with its own constitution not requiring an audit
(c) A youth group registered as a Public Benefit Organization only
(d) All of the above

Total [50 Marks]

SECTION B

CASE STUDY QUESTIONS

CASE STUDY 1 Total [35 marks]

Khulu (Pty) Ltd is a manufacturer of quality leather handbags situated at Woodmead. The financial yearend of the company is 31 December.

Plant

A plant was acquired on 1 March 2009 from Xing Limited in China and the following costs were incurred and paid on that date:

- Supplier invoice amounted to R53 600;
- Delivery fee amounted to R1 000;
- Staff training costs on how to use the machine totalled R1 200;
- Import duties amounted to R900; and
- Installation costs of R500 were also incurred.

The estimated useful life at acquisition date was 10 years and the estimated residual value was R8 000.

Production commenced on 15 April 2009, even though the plant was available for use on 1 April 2009.

During 2010 a burst pipe in the building resulted in significant damage to the plant. As a result the directors performed an impairment test and determined that the recoverable amount of the plant was estimated to be R34 400 at 31 December 2010.

During January 2011 repairs and maintenance on the plant were carried out at a cost of R3 000 paid for by Khulu. As a result of this maintenance, another impairment test was performed as at 31 December 2011 and the fair value of the plant was R46 000, cost to sell R1 600, and value in use was R47 000.

Khulu has pledged this plant as a security for a loan with the Standardised Bank, valued at R40 000.

<u>Additional information</u>

- Khulu's turnover is less than R1 million per annum and therefore it is not a registered VAT vendor.

- Khulu uses the cost model to account for its plant.

SARS grants a wear and tear allowance of 20% per annum on the plant (not apportioned for time).

The tax rate changed from 29% in 2010 to 28% in 2011.

You are required to:

a) Prepare all the journal entries relating to the plant from the date of its acquisition to 31 December 2011. Do not provide journal entries relating to current or deferred tax. Journal narrations are not required **(12 marks)**

b) Provide the journal entry to account for the tax rate change and briefly, in no more than two sentences, explain why this entry is necessary. **(5 marks)**

c) Prepare the accounting policy note for plant for the year ended 31 December 2011. **(3 marks)**

d) Prepare the following notes to the financial statements of Khulu (Pty) Ltd for the year ended 31 December 2011:

    i. Plant **(11 marks)**

    ii. Deferred tax **(4 marks)**

Comparative figures are not required except for the deferred tax note. All disclosures should be made in accordance with International Financial Reporting Standards (IFRS)

Total [35marks]

CASE STUDY 2 Total [30 marks]

Studio (Pty) Ltd (Studio) is a company that prints maps and atlases of the world. The financial accountant has recently resigned and the financial manager has requested that you assist in the preparation of some sections of the financial statements for the year ended 30 September 2011.

You have been provided with the following information:

1. Information specific to the income earned and expenses incurred during the 2011 financial year:

    a. Profit before tax was correctly calculated as R4 285 500.

    b. Actual gross profit earned during the 2011 financial year amounted to R12 973 500. This was R526 500 less than expected due to inventory stolen during the year. Studio expects to earn a consistent gross profit percentage on sales of 50%.

    c. The only other income earned during the year was dividend income of R1 417 500.

    d. Distribution, administration and operating expenses were split in the ratio 20%, 35% and 45% respectively.

2. Revaluation of plant during the year

    a. On 30 September 2011 plant with a carrying amount of R2 250 000 was revalued to its fair value of R3 000 000. This will be realized through use over the plant's remaining useful life of 5 years.

    b. This plant originally cost R3 600 000 when purchased on 1 October 2008.

3. The net deferred tax liability as at 30 September 2010 amounted to R115 500 and it was made up as follows:

    a. Property, plant and equipment R98 700 (Credit)

    b. Provision for doubtful debts R33 600 (Debit)

    c. Prepaid rent R50 400 (Credit)

4. The following information is relevant in completing the tax expense calculation for the 2011 financial year:

    a. The correct deferred tax closing balance as at 30 September 2011 was a credit balance of R434 700.

    b. Donations amounting to R450 000 were made and SARS considered these as non-deductible expenses.

    c. Depreciation on plant for the 2011 financial year was R450 000 and the corresponding wear and tear allowance was R900 000.

    d. The provision for doubtful debts balance at 30 September 2010 amounted to R150 000 and at 30 September 2011 it amounted to R135 000. SARS grants 20% of these provisions as a tax deduction.

    e. The prepaid rent balance at 30 September 2010 was R180 000 and at 30 September 2011 it amounted to R108 000.

    f. The company tax rate remained constant at 28% for all periods under review.

You are required to:

Part A

Prepare the Statement of Comprehensive Income of Studio (Pty) Ltd for the year ending 30 September 2011 in accordance with IAS1.

(Hint: use the function method) (24 marks)

Comparative figures are not required.

Part B

Explain under which circumstances and to what extent will SARS allow the R450 000 donations made as a tax deductible expense (4 marks)

Part C

Provide the reasons as to why Studio must be a VAT Vendor (2 marks)

Total [30 marks]

CASE STUDY 3 Total [35 marks]

Donna Chu is a fashion buyer for Gucci Designs Ltd, a South African company and a registered VAT vendor. She has been working for Gucci Designs Ltd for the last five years. She is a South African resident and lives in Hout Bay in Cape Town. Donna, age 35, is married to Jimmy, age 39 and they have two children that are school-going. Donna and Jimmy are married out of community of property. She worked for Gucci Designs Ltd throughout the year of assessment ended 29 February 2012.

The following information relates to Donna Chu's employment at Gucci Designs Ltd for the year of assessment ending 29 February 2012:

1. Donna receives a cash salary of R28 000 per month

2. She also received a performance bonus of R90 000 and a thirteenth cheque, equivalent to one month's cash salary.

3. Donna was provided with exclusive use of a motor vehicle (a motor car as defined for VAT purposes) from 1 February 2011 and in addition she also received a travel allowance of R2 400 per month on the same vehicle. It was purchased by Gucci Designs Ltd for R198 000 (excluding VAT) on 1 February 2011. Gucci Designs Ltd also paid 14% VAT of R27 720 when it purchased this motor vehicle. The motor vehicle was purchased with a full maintenance plan. Donna does not contribute towards the maintenance costs. All other costs in respect of the motor vehicle are borne by her employer. She is allowed to take the motor vehicle home each night and also has unlimited weekend use of it. Donna travelled a total of 21 654 kilometers in this motor vehicle up to 29 February 2012, of which 3 897 kilometers were travelled for business purposes as shown by her log book.

4. Donna is a member of her employer's provident fund. Both her employer and herself contribute 6% of her cash salary only to a provident fund.

5. Donna contributed R1 800 per month towards a retirement annuity fund and Gucci Designs Ltd also contributed R1 800 per month. An amount of R28 000 relating to disallowed current retirement annuity fund contributions was carried forward from the 2011 year of assessment.

6. She is also a beneficiary on her husband's medical aid fund. Contributions made to the medical aid by Jimmy for the entire year amounted to R36 000 (R3 000 per month for Jimmy, Donna and their two children). Jimmy paid R29 330 in qualifying medical expenses during the 2012 year of assessment. The medical aid refunded him an amount of R18 140 for the medical expenses that he paid.

7. A reimbursive entertainment allowance was given to Donna as she is required to entertain clients on a regular basis. She was reimbursed for entertaining expenses actually incurred of R 13 890.

8. Gucci Designs Ltd requires Donna to be a member of 'Fashion Designers South Africa', a professional body that maintains standards in fashion design. Her annual subscription amounted to R2 600, which was paid by Gucci Designs Ltd.

9. She also receives a cell phone allowance of R900 per month. Donna estimates that she uses her cell phone for 80% business use. Her actual cell phone costs amounted to R8 747.

10. Donna receives a subsistence allowance of R350 per night away from home due to local travel. Donna spent 12 days away from home on local travel. The subsistence allowance is paid to Donna to cover the costs of meals and other incidental costs while away from home. Donna has kept an accurate record of her meals and incidental costs that she spent while away from home. The total amount of these costs amounted to R4 500.

11. During September 2011, Gucci Designs Ltd settled a debt of R4 300 that Donna owed to a clothing store.

12. Gucci Designs Ltd has its own library and allows employees to take books home for private use. Donna made use of books from 1 November 2011 to 30 November 2011 which cost her employer R912 (including VAT) and which had a market value of R684 (including VAT).

13. Gucci Designs Ltd granted each of Donna's two children a bursary. Donna's son, Vernon, was granted a bursary of R25 000 towards his high school fees, while Donna's daughter, Suri, was granted a R15 000 bursary towards her junior school fees. Only children of employees qualify as beneficiaries of a bursary. The Commissioner regards this bursary scheme as a 'closed' scheme.

Other information:

- Donna received an annuity of R1 500 a month for the entire 2012 year of assessment. She purchased the annuity on 1 March 2005 for R240 000 for a 20 year period.

- Donna is a very benevolent individual. She contributed R20 000 towards the Cancer Association of South Africa which is a registered PBO. She received the required certificate for her donation.

- On 30 September 2011, Donna sold her holiday apartment in Knysna for R1 850 000. She purchased the holiday apartment five years ago for R1 200 000. She spent R60 000 on improvements to the apartment before selling it. She also paid agent's commission of R90 000 on the sale of the apartment.

- Donna has an assessed capital loss of R40 000 from the 2011 year of assessment.

You are required to:

Calculate the normal tax liability of Donna Chu for the year of assessment ended 29 February 2012.

Show all calculations either by showing the calculation next to the description of the item or by way of a number in a notes column, and a corresponding note.

Total [35 marks]

CASE STUDY 4 Total [20 marks]

Ms Juju Sisulu trading as Fancy Handbags manufactures a variety of handbags and accessories. The handbags and accessories are sold locally only. The Commissioner has accepted the manufacturing of handbags and accessories, as a process of manufacturing as defined. Fancy Handbags is not a registered VAT vendor.

The abridged Income and Expenditure Statement for Fancy Handbags for its current reporting period ended 29 February 2012 was as follows:

	Notes	**R**
Income		
Sales		910 000
Purchases of trading stock	1	(330 000)
Gross profit		**580 000**
Other income		
Profit realised on machine A	3	126 875
Expenses		
Rental expense	2	84 500
Advertisement	4	25 000
Depreciation	3	97 834
Restraint of trade	5	20 000
Repairs	6	80 000
Packaging machine	7	36 000
Salaries		45 000
Insurance on business assets		7 500
Refreshments	8	2 500
Provision for bad debts	9	22 000

Notes

1. The total purchase cost relates to materials that Fancy Handbags used to manufacture the handbags. There was no trading stock on hand at the beginning of the year or at the end of the year.

2. Fancy Handbags entered into a lease agreement on 1 August 2011 with Ricci (Pty) Ltd. According to the agreement, Fancy Handbags leases an office building at R3 500 per month from Ricci (Pty) Ltd for the next 10 years.

It provided for a premium of R60 000 to be paid at the commencement of the lease. It also contained an improvements clause, whereby the F&H must convert a very large boardroom into three separate smaller offices for their employees to use, to the value of R165 000. The improvements were completed on 31 August 2011 at a cost of R180 000. Fancy Handbags started using three new offices from 1 September 2011.

3. Fancy Handbags owned the following assets during the year:

Asset	**Purchase date**	**Price**	**Depreciation period (straigt line method)**	**Wear- and-tear period**	**Note**
Delivery vehicle	01/08/2009	R210 000	5 years	Refer to Interpretation Note 47 (Table 7 in this paper)	a)
Machine A	1/06/2009	R315 000	6 years		b)
Machine B	01/12/2011	R400 000	6 years		b)
Machine C	01/02/2011	R300 000	6 years		c)

a) The delivery vehicle is used to deliver handbags to local clients.

b) Machine A was destroyed in a fire on 1 November 2011. The following information relating to this machine is provided:

Original cost of the second-hand asset	R315 000
Amount received from insurance company	R315 000

The machine was not replaced. A machine which is more efficient, Machine B, was newly purchased and brought into use on 1 December 2011. Both machines A and B were used in a process of manufacturing.

Machine C was purchased second-hand by Fancy Handbags from Promo Bags Limited on 1 February 2011 and brought into use by Fancy Handbags in a process of manufacturing immediately.

4. The following expenses were incurred as part of a vigorous marketing campaign:

Permanent advertising board erected on 1 October 2010	R10 000
Placement of advertisement in local newspaper for one full week	R15 000
Total	**R25 000**

5. An amount of R20 000 was paid to the former head designer of the handbags on 1 May 2011 when he resigned. This was to prevent him from working for the competition for the next two years and designing similar handbags to sell to the public.

6. On 21 October 2011 a fire in the factory building of Fancy Handbags caused irreparable damage to the roof of the factory building. The original iron roof was replaced with a tile roof at a total cost of R80 000. Unfortunately Fancy handbags had not taken out any insurance on the factory building and had to pay the R80 000 in cash.

7. Fancy Handbags paid R36 000 on 1 January 2012 for a packaging machine which they want to rent for the next 12 months, until Fancy Handbags has saved enough money to buy its own packaging machine which will cost substantially more compared to renting the machine for a year. The payment was therefore made for the period 1 January 2012 to 31 December 2012.

8. Refreshments consists of the following:

Coffee, tea and sugar for personnel	R2 500

9. Donna annually prepares a list of debtors which, according to her, might not be recoverable. SARS grants an allowance of 25%, of the balances of debt considered to be irrecoverable at the end of the year, as a deduction. You are provided with the following balances from these lists:

Date	Balance
31 March 2011	R26 000
31 March 2012	R48 000

YOU ARE REQUIRED TO:

Calculate the net profit or loss arising from Fancy Handbags for the year of assessment ended 29 February 2012.

Total [20 marks]

Refer to annexure with tax table where necessary

Case Study 5 [30 marks]

Pharma Ltd is a pharmaceutical company involved in the manufacture and sale of both ethical and generic pharmaceuticals supplied primarily to the government.

The company is looking to expand into South America where pharmaceutical research and production costs are significantly lower. The expansion plan entails the acquisition of a controlling interest in Pharma Brasilia, an established pharmaceuticals manufacturer and retailer of pharmaceutical products which holds trading rights in Brazil, Cuba and Argentina.

Pharma Ltd will require financing to acquire the shares. Pharma Ltd has approached its bankers to obtain the required financing and have been requested to present a ratio analysis to the bank detailing specifically it's liquidity and working capital ratios.

Included below are details pertaining to the ratio analysis to be performed:

	2012	**2011**
	Rm	**Rm**
Turnover	2 065.0	1 788.7
Cost of sales	1 478.6	1 304.0
Gross Profit	586.4	484.7

Current assets		
Inventories	119.0	109.0
Trade and Other Receivables (note 1)	400.9	347.4
Short-term investments	4.2	18.8
Cash at bank and in hand	48.2	48.0
	572.3	523.2

Payables: amounts falling due within one year

Loans and overdrafts	49.1	35.3
Tax	62.0	46.7
Dividends	19.2	14.3
Trade and Other Payables (note 2)	370.7	324.0
	501.0	420.3
	Rm	Rm
Net current assets	71.3	102.9

Notes

1.	Trade receivables	329.8	285.4
2.	Trade payables	236.2	210.8

REQUIRED:

A. **Calculate and analyse the liquidity and working capital ratios.** **(15 marks)**

B. **In your opinion, do you think the Bankers will award the required loan?**

Motivate your answer **(5 marks)**

C. **Detail the audit procedures to be performed to verify the existence assertion of the trade receivables.** **(10 marks)**

Total [30 marks]

END OF EXAM

Applicable Tax tables to follow on next page

ANNEXURE A

TABLE 1

RATES OF NORMAL TAX PAYABLE BY PERSONS OTHER THAN COMPANIES AND TRUSTS (BUT INCLUDING SPECIAL TRUSTS AS WELL AS INSOLVENT AND DECEASED ESTATES) IN RESPECT OF YEARS OF ASSESSMENT ENDING 29 FEBRUARY 2012

Taxable Income		Rates of Tax
Exceeds R	But does not exceed R	R
0	150 000	0 + 18% of each R1
150 001	235 000	27 000 + 25% of the amount above 150 000
235 001	325 000	48 250 + 30% of the amount above 235 000
325 001	455 000	75 250 + 35% of the amount above 325 000
455 001	580 000	120 750 + 38% of the amount above 455 000
580 001		168 250 + 40% of the amount above 580 000

TABLE 2

TURNOVER TAX DUE BY MICRO BUSINESSES IN RESPECT OF YEARS OF ASSESSMENT ENDING 29 FEBRUARY 2012

Turnover		Rates of Tax
Exceeds R	But does not exceed R	R
0	150 000	0
150 001	300 000	0 + 1% of the amount above 150 000
300 001	500 000	1 500 + 2% of the amount above 300 000
500 001	750 000	5 500 + 4% of the amount above 500 000
750 001	and above	15 500 + 6% of the amount above 750 000

TABLE 3

RATES OF TAX FOR COMPANIES AND CLOSE CORPORATIONS (OTHER THAN MINING COMPANIES AND LONG-TERM INSURERS AND RETIREMENT FUNDS)

Financial years ending during the period of twelve months ending 31 March 2012

Type of company	Rate of tax
Small business corporations	
Taxable income:	
R0 – R 59 750	0%
R 59 750 – R 300 000	10% of the amount over R59 750
R300 000 +	R24 025 + 28% of the amount over R300 000
Personal service provider companies	33%
Non-resident companies with a branch in the Republic	33%
Other companies	28%
Secondary tax on companies until 31 March 2012	10%
Dividends Tax(effective from 1 April 2012)	15%

TABLE 4

REBATES: YEARS OF ASSESSMENT ENDED LAST DAY OF FEBRUARY

	2012
Primary	10 755
Secondary (65 years of age or older)	6 012
Tertiary Rebate (75 years or older)	2 000

TABLE 5

SCALE OF VALUES - TRAVEL ALLOWANCE

Where the value of the vehicle		Fixed Cost	Fuel Cost	Maintenance Cost
Exceeds **R**	But does not exceed **R**	**R**	**c**	**c**
0	60 000	19 492	64.6	26.4
60 000	120 000	38 726	68.0	29.2
120 000	180 000	52 594	71.3	31.9
180 000	240 000	66 440	77.7	35.0
240 000	300 000	79 185	87.0	44.7
300 000	360 000	91 873	93.9	54.2
360 000	420 000	105 809	100.9	65.8
420 000	480 000	119 683	113.1	67.6
480 000		119 683	113.1	67.6

TABLE 6

Rental value of use of residential accommodation: $(A - B) \times \frac{C}{100} \times \frac{D}{12}$

S10A: Capital portion of a purchased annuity: $Y = \frac{A}{B} \times C$

S10A: Capital portion on termination or commutation: X = A – D

TABLE 7

Interpretation Note No 47 (previously Practice Notes No 15, 19 and 39)

Asset	Proposed write-off period (in years)
Adding machines	6
Air conditioners:	
Window type	6
Mobile	5
Room unit	10
Air conditioning assets (excluding pipes, ducting and vents):	
Air handling units	20
Cooling towers	15
Condensing sets	15
Chillers:	
Absorption type	25
Centrifugal	20
Aircraft: Light passenger or commercial helicopters	4
Arc welding equipment	6
Artefacts	25
Balers	6
Battery chargers	5
Bicycles	4
Boilers	4
Bulldozers	3
Bumping flaking	4
Carports	5
Cash registers	5

Cell phone antennae	6
Cell phone masts	10
Cellular telephones	2
Cheque writing machines	6
Cinema equipment	5
Cold drink dispensers	6
Communication systems	5
Compressors	4
Computers	
Main frame / servers	5
Personal	3
Computer software (main frames)	
Purchased	3
Self-developed	1
Computer software (personal computers)	2
Concrete mixers (portable)	4
Concrete transit mixers	3
Containers (large metal type used for transporting freight)	10
Crop sprayers	6
Curtains	5
Debarking equipment	4
Delivery vehicles	4
Demountable partitions	6
Dental and doctors equipment	5
Dictaphones	3
Drilling equipment (water)	5
Drills	6
Electric saws	6

Electrostatic copiers	6
Engraving equipment	5
Escalators	20
Excavators	4
Fax machines	3
Fertiliser spreaders	6
Firearms	6
Fire extinguishers (loose units)	5
Fire detection systems	3
Fishing vessels	12
Fitted carpets	6
Food bins	4
Food-conveying systems	4
Fork-lift trucks	4
Front-end loaders	4
Furniture and fittings	6
Gantry cranes	6
Garden irrigation equipment (movable)	5
Gas cutting equipment	6
Gas heaters and cookers	6
Gearboxes	4
Gear shapers	6
Generators (portable)	5
Generators (standby)	15
Graders	4
Grinding machines	6
Guillotines	6
Gymnasium equipment:	

Cardiovascular equipment	2
Health testing equipment	5
Weights and strength equipment	4
Spinning equipment	1
Other	10
Hairdressers’ equipment	5
Harvesters	6
Heat dryers	6
Heating equipment	6
Hot water systems	5
Incubators	6
Ironing and pressing equipment	6
Kitchen equipment	6
Knitting machines	6
Laboratory research equipment	5
Lathes	6
Laundromat equipment	5
Law reports: Sets (Legal practitioners)	5
Lift installations (goods/passengers)	12
Medical theatre equipment	6
Milling machines	6
Mobile caravans	5
Mobile cranes	4
Mobile refrigeration units	4
Motors	4
Motorcycles	4
Motorised chainsaws	4
Motorised concrete mixers	3

Motor mowers	5
Musical instruments	5
Navigation systems	10
Neon signs and advertising boards	10
Office equipment – electronic	3
Office equipment – mechanical	5
Oxygen concentrators	3
Ovens and heating devices	6
Ovens for heating food	6
Packaging and related equipment	4
Paintings (valuable)	25
Pallets	4
Passenger cars	5
Patterns, tooling and dies	3
Pellet mills	4
Perforating equipment	6
Photocopying equipment	5
Photographic equipment	6
Planers	6
Pleasure craft etc.	12
Ploughs	6
Portable safes	25
Power tools (hand-operated)	5
Power supply	5
Public address systems	5
Pumps	4
Race horses	4
Radar systems	5

Radio communication equipment	5
Refrigerated milk-tankers	4
Refrigeration equipment	6
Refrigerators	6
Runway lights	5
Sanders	6
Scales	5
Security systems (removable)	5
Seed separators	6
Sewing machines	6
Shakers	4
Shop fittings	6
Solar energy units	5
Special patterns and tooling	2
Spin dryers	6
Spot welding equipment	6
Staff training equipment	5
Surge bins	4
Surveyors:	
Instruments	10
Field equipment	5
Tape-recorders	5
Telephone equipment	5
Television and advertising films	4
Television sets, video machines and decoders	6
Textbooks	3
Tractors	4
Trailers	5

Traxcavators	4
Trolleys	3
Trucks (heavy duty)	3
Trucks (other)	4
Truck-mounted cranes	4
Typewriters	6
Vending machines (including video game machines)	6
Video cassettes	2
Warehouse racking	10
Washing machines	5
Water distillation and purification plant	12
Water tankers	4
Water tanks	6
Weighbridges (movable parts)	10
Wire line rods	1
Workshop equipment	5
X-ray equipment	5

PROFESSIONAL EVALUATION
SOLUTIONS

03 NOVEMBER 2012

MULTIPLE CHOICE QUESTIONS

1	b
2	a
3	d
4	b
5	b
6	a
7	a
8	b
9	c
10	c
11	c
12	d
13	d
14	c
15	b
16	a
17	c
18	d
19	d
20	c
21	c
22	c
23	b
24	d
25	b

CASE STUDIES

Question 1
Part A

1. Dr Plant	56,000		1
Cr Bank/Creditors		56,000	1
Initial costs of acquisition of plant			
2. Dr Depreciation	3,600		1
Cr Accumulated depreciation		3,600	1
3. Dr Depreciation	4,800		1
Cr Accumulated depreciation		4,800	1
4. Dr Impairment	13,200		1
Cr Accumulated depreciation and impairment		13,200	1
5. Dr Depreciation	3,200		1
Cr Accumulated depreciation		3,200	1
6. Dr Accumulated depreciation	11,600		1
Cr impairment reversal		11,600	1

Correct contra accounts 1 mark per entry
Correct amounts 1 mark per entry

Part B

1. Dr Deferred Tax	8		1
Cr Tax Expense		8	1
Rate Change Adjustment			1

This adjustment is necessary because the deferred tax opening balance was calculated on 29% however is relates to tax payable in the future and the rate has changed to 28%. 2

Part C

Accounting policy

1.2 Plant

Plant is stated at cost less accumulated depreciation and impairment. 1

The plant is depreciated using the straight line method with a residual value of R8000. 1

The useful life of the plant is estimated at 10 years. 1

Part D

(i)

3. Plant

	Plant	
Carrying amount at beginning of year	34,400	
Cost	56,000	1
Accumulated depreciation and impairment	21,600	1
Movements during the year		
Disposals	0	0.5
Additions	0	0.5
Depreciation	3,200	1
Reversal of impairment	-11,600	1
Carrying amount at end of year	42,800	
Cost	56,000	
Accumulated depreciation and impairment	13,200	1

The plant is pledged as security for a loan from the Standardised Bank valued at R40 000. 1

4 marks for workings

Part D

(ii) Deferred tax	**2011**	**2010**	
Deferred tax arises due to temporary differences on:			
Plant	5,712	232	2

2 marks for workings

Total marks 35

Workings

	HCA	CA	TB	TD	DT	
01-Mar-09	56,000	56,000	56,000	0	0	
Depreciation(From 01 April to 31 December 2009)/ Wear & Tear full year	3,600	3,600	11,200	7,600	2,204	
31-Dec-09	52,400	52,400	44,800	-7,600	-2,204	
Depreciation/ wear & tear	4,800	4,800	11,200	6,400	1,856	
31 December 2010 before impairment	47,600	47,600	33,600	-14,000	-4,060	
Impairment	0	13,200	0	-13,200	-3,828	
31 December 2010 after impairment	47,600	34,400	33,600	-800	-232	2
Rate Change					8	
Value after rate change					-224	
Depreciation/ wear & tear	4,800	3,200	11,200	8,000	2,240	
31 December 2011 before reversal of impairment	42,800	31,200	22,400	-8,800	-2,464	
Reversal of impairment		-11,600	0	11,600	3,248	
31 December 2011 after reversal of impairment	42,800	42,800	22,400	-20,400	-5,712	2
				-11,600		

QUESTION 2:
Part A

Studio (Pty) Ltd		
Statement of comprehensive income for the year ended 30 September 2011		1
	R	Marks
Revenue from sales ((12 973 500+526500)x100/50)	27,000,000	2
Cost of goods sold (27 000 000-12 973 500)	14,026,500	1
Gross profit	12,973,500	**1**
Other income	1,417,500	1
Distribution expenses (10 105 500*20%)	2,021,100	1
Admin expenses (10 105 500*35%)	3,536,925	1
Operating expenses (10 105 500*45%)	4,547,475	1
Profit before tax	4,285,500	1
Tax expense	819,840	10
Profit for the year after tax	3,465,660	1
Other comprehensive income	**540,000**	
Revaluation of asset (750 000x72%)	540,000	2
Total comprehensive income	4,005,660	1

24 marks

Working 1

Taxable income calculation	**2010**	**Marks**
Profit before tax (From SOCI in part 2)	4,285,500	½
Less exempt income	-1,417,500	½
Non deductible donations	450,000	½
Add depreciation	450,000	½
Less wear & tear	-900,000	½
Plus prepaid insurance – opening	180,000	1
Less prepaid insurance – closing	-108,000	1
Less provision – opening	-150,000	1
Plus SARS provision – opening	30,000	1
Plus provision – closing	135,000	1
Less SARS provision – closing	-27,000	1
Taxable income	2,928,000	½
X tax rate	28%	½
Current tax	819,840	½

Part B

Donations made to Public Benefit Organizations allow a deduction to a donor of funds to certain qualifying and approved PBOs. A deduction is granted to persons donating funds to an approved PBO or to certain organisations conducting, inter alia, scientific, technical or industrial research. A deduction is only granted if, in addition, the entity carries on an approved public benefit activity including PBOs which provide funds or assets to any of the approved entities.

These activities are listed in Part II of the Ninth Schedule of the Income Tax Act with the main categories being:

- welfare and humanitarian
- healthcare
- education and development
- conservation, environment and animal welfare
- land and housing

In addition to the above, donations to the following entities not listed in the Ninth Schedule are also tax deductible:

- any specialised agency overseas which carries on PBO activities under the aforementioned headings for example United Nations Agencies
- the Government, any provincial administration or municipality

Donations to South African branches of foreign PBOs do not qualify for a deduction under the rules governing donations to PBOs.

Limitation of the deduction of donations to PBOs

Deductions in respect of donations to qualifying PBOs are limited to 10% of the taxable income (before medical deductions and excluding any lump sum benefits from a retirement fund) of all taxpayers

Tag words:
Approved Public Benefit Organization
Excluding foreign Public Benefit Organization
9^{th} schedule listed organizations
Section 18A certificates/receipts
Limited to 10% of taxable income (4 marks)

Part C:

Turnover or projected turnover exceeds R1m over a 12-month period
Trading in or partially in South Africa (2 marks)

Solution Question 3
Taxable Income - Donna Chu

	Note	R	Marks
Salary (R28 000 x 12)		336,000	1
Performance Bonus		90,000	1
Bonus - Thirtheenth Cheque		28,000	1
Use of motor vehicle	1	72,188	
Subscriptions to Fashion Designers SA (nil value as condition of employment)		Nil	1
Provident Fund contribution by employer- not a fringe benefit		Nil	1
Retirement Annuity Fund Contributions by employer -(R1800x12)		21,600	1
Settlement of Debt		4,300	1
Use of Books - Use of Sundry Assets - nil value if assets consists of books, literature, recordings or works of art		Nil	1
Bursaries for children - Taxable benefit as Donna's salary exceeds R100 000 (R25 000 + R15 000)		40,000	1
Purchased annuity	3	6,000	
Less: Provident Fund Contributions (not deductible)		Nil	1
		589,488	
Less: Retirement annuity fund contributions	4	-71,200	
		518,288	
Add: Taxable capital gain	5	110,000	
Add: Re-imbursement Allowance (not taxable)		Nil	1
Travel Allowance- no deduction allowed - R2 400 x 12		28,800	1
Cellphone Allowance (R900 x 12) - no deduction permitted		10,800	1
Subsistence Allowance (R4 200 - R4 500)		Nil	1
		667,888	
Less: S18A deduction (R20 000 limited to 10% of R667888=R66788.80)		-20,000	1
less: S18 Medical deduction - no deduction- Jimmy can claim		Nil	1
Taxable Income		647,888	1

Tax Payable	168250 + 40% of 67888	195,405.20	1P
Less: Rebates		-10,755	1P
Normal Tax Liability		**184,650.20**	1P

Notes

1.) Use of a motor vehicle	72,188	
(R198 000 + R27 720) X 3.25% p.m. = R7 335.9		2
R7 335.9 X 12 months = R88 031-(R88 031 x 3897/21654)		2

3.) Purchased annuity		
Annuity received (R1500 x 12)	18,000	1
Less: Capital Portion (R240 000 / R360 000 x 1 500) x 12	-12,000	2
	6,000	

4.) Current RAF contributions - s11(n)	71,200	
RAF contribution(R1800 x 12 x2) + R28 000 = R71 200		
limited to the greater of:		
- R1 750 or		1
- R3 500 - R0 = R3 500 or		1
- 15% x (R937 709 - R336 000) = R90 256		1
therefore entire R71 200 allowed as a deduction		

5.) Taxable capital gain		
Proceeds	1,850,000	1
Less: base cost (R1 200 000 + R60 000 + R90 000)	1,350,000	1
Capital Gain	500,000	
Less: annual exclusion	-20,000	1
	480,000	
Less: assessed capital loss brought forward from previous year	-40,000	1
Net capital gain for the year	440,000	
Taxable capital gain (R440 000 x 25%)	110,000	1

Question 4:

(35 marks)

Gross Income

Sales to SA clients		910,000	0.50
Recoupment/Loss on involuntary disposal of Machine A			
- Selling price (R315 000) -> limited to original cost price	315,000		1.00
- Tax value (Cost price *less* allowances claimed)	126,000		1.00
2010 YOA	-63,000		
2011 YOA	-63,000		
2012 YOA	-63,000		
- Profit	189,000		
- Therefore s 8(4)(a) recoupment		189,000	1.00

Income		**1,099,000**	

Deductions

Purchases - section 11*(a)*		-330,000	0.50
Rental expense - section 11*(a)* (R3 500 x 7)		-24,500	1.00
Lease Premiuim - R60 000/10 x 7/12		-3,500	1.00
Leasehold Improvements - R165 000/119 x 6		-8,319	2.00
On additional cost of R15 000 - no S13(1) allowance - as S13(1) is only applicable to buildings used in the process of manufacture and no s13 quin - as this is only available to the owner			1.00
Newspaper advert - deductible section 11(a)		-15,000	1.00
Permanent advertising board - capital structure		-	0.50
Restraint of trade payment - Limited to the lesser of (s 11*(cA)*):			
R20 000 / 2 = R10 000; or			
R20 000 / 3 = R6 667		-6,667	2.00
Repairs to roof - section 11*(d)*		-80,000	1.00
Packaging machine - section 11*(a)* (R3 000 x 2)		-6,000	1.00
Section 23H - full amount of R30 000 deductible prepaid amount is less than R80 000 (prepayment portion is R30 000)		-30,000	1.00
Salary - section 11*(a)*		-45,000	0.50
Insurance - section 11*(a)*		-7,500	0.50
Refreshments - section 11*(a)*		-2,500	0.50

Provision for bad debt - section 11*(j)*			
Provision for bad debts 2010 - prior years deduction = 25% x R26 000		6,500	1.00
Provision for bad debts 2011 - current years deduction = 25% x R48 000		-12,000	1.00

Allowances

Depreciation - not deductible (accounting entry)		-	0.50
Delivery vehicle - section 11*(e)* (R210 000/**4**)		-52,500	1.00
Machine A - section 12C --> second hand asset (R315 000 x **20%**)		-63,000	1.00
Accelerated allowance not available - not new/unused when bought			
Machine B - section 12C --> new asset (R400 000 x **40%**)		-160,000	1.00
Accelerated allowance available - new/unused when bought			
Machine C - section 12C --> second hand asset (R300 000 x **20%**)		-60,000	1.00
Accelerated allowance not available - not new/unused when bought			
Advertising board - section 11(e) (R10 000/**10 x 6/12**)		-500	1.00

Taxable income		**198,514**	

Grand Total	**24.50**
MAX	**20.00**

(20 marks)

Question 5:
Part A

	2012	2011
1.Current ratio	572.3/501.0 = 1.14	523.2/420.3 = 1.24
Quick ratio	453.3/501.0 = 0.90	414.2/420.3 = 0.99
Receivables' payment period (days)	329.8/2 065.0 * 365 = 58	285.4/1 788.7 * 365 = 58
Inventory	119.0/1 478.6* 365 = 29	109.0/1 304.0 * 365 = 31
Payables' turnover period (days)	236.2/1 478.6 * 365 = 58	210.8/1 304.0 * 365 = 59

(10 marks)

As the company is involved in the manufacture and sale of pharmaceutical products, the company would be expected to have a relatively short receivables period however as the largest customer of the entity is the government a comparatively lengthy receivables' turnover period is expected, because of the relatively poor cash flow in the government sector. It is clear that the company compensates for this by ensuring that they do not pay for raw materials and other costs before they have sold their inventories of finished goods (hence the similarity of receivables' and payables' turnover periods).

(2 marks)

The company's current ratio is a little lower than the average of 1 but its quick ratio is better than average and very little less than the current ratio. This suggests that inventory levels are strictly controlled, which is reinforced by the low inventory turnover period. This is of great importance in the pharmaceutical industry where products often have an expiry date and shelf life.

(2 marks)

It would seem that working capital is tightly managed, to avoid the poor liquidity which could be caused by a high receivables' turnover period and comparatively high payables.

(1 mark)

Part B

No, Bankers will not support the loan to Pharma Ltd.

At the very minimum, the banker will expect you to provide realistic answers to the following questions:

- How much money do you need and how much will you contribute from your own resources?
  The loan amount you ask for should be "just right". If you borrow too much, you waste money on interest payments; if you borrow too little, you will soon face a cash crunch, and this could derail your plans.

  The amount payable for the shares or controlling interest in Pharma Brasilia is not clearly defined and Management has to provide clearer details of the purchase price payable for the acquisition of Pharma Brasilia

- What precisely do you intend to spend the money on?
  This is an important consideration for the banker, as it affects the value of the items bought (which can serve as collateral). If the equipment prescribed by your franchisor is highly specialised and does not have an established market, the value that can be realised in a forced sale may well be close to zero.

  Pharma Limited wants to buy the shares of Pharma Brasilia. This includes the trading licences in the specified South American countries. Political stability and predictability must be researched and presented.

- How do you plan to structure repayments to the bank and what alternatives can you offer should the business's cash flow fail to keep up with ongoing financial obligations?
  What the banker would ideally like to hear is that you have put aside a nest egg which you can liquidate should the need arise, or have arranged a soft loan facility "just in case".

  Pharma has a proven track record. In the ordinary course of business, the repayment plan will have to be substantiated by improved cash flows that will create greater profitability in South Africa. Year-on-year the 2012 gross profit margins have been suppressed.

- What can you offer as collateral?

  Modern bankers will tell you that collateral (surety) is no longer the deal breaker it once was. This notwithstanding, the availability of collateral remains an important consideration. It is a good idea to prepare a list of items you own and are willing to offer as collateral, their realistic market value and how much equity (market value less outstanding finance) you hold in each.

(5 marks)

Part C:

Audit Procedures

Existence

Debtor's circularisation

Obtain a debtors listing from your client.

Agree the list to the trial balance.

Select your sample of debtors from the list that you intend contacting after obtaining consent of the client.

Send out the positive circularisation and ensure that the circularisations are returned to you (the auditor).

Evaluate the findings of your circularisations and extrapolate any differences.
Discuss the differences with management and if they refuse to correct it, take it to the summary of unadjusted differences.

(6 marks)

Subsequent testing

Select a sample of receipts (payment reference numbers) from the bank statement immediately after year end.

Trace the sample (using the payment reference number) through to the invoice/delivery note to see what period the "debtor" originated.

In the event that the date on the invoice/delivery note indicates that the transaction occurred in the year under review, use the date on the invoice/delivery note and inspect the debtors' account and identify whether or not the debtor was in fact a recognised in the year under review.

(4 marks)