SOUTH AFRICAN INSTITUTE OF PROFESSIONAL ACCOUNTANTS™

YOUR WEALTH

SAIPA Professional Evaluation – Solution for May 2013 Exam

From the Moderator and Exam panel

The following proposed solution in not cast in stone. While marking the papers many variations and alternatives were considered and taken into account. It is therefore imperative that you use the proposed solution as a guideline and not as the "one and only" correct answer and or method of presenting the answer to the questions.

All the best with your preparation for the November 2013 PE

MULTIPLE CHOICE QUESTIONS
MAY 2013
SOLUTION

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

SOLUTION
QUESTION 1.1

GERRARD LTD 1/2

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 2011 1/2

	STATED CAPITAL		REVAL SURPLUS	RETAINED EARNINGS		TOTAL	
Balance 1 July 2010	750,000	(1000000 shares x R0.50) + (250000 shares x R1)	0	3,456,100	Given	4,206,100	**3**
Total comprehensive income			25,920	2,938,170		2,964,090	**4**
Capitalisation issue	75,000	(1000000/10xR0.50)+ (250000/10xR1)		-75,000	Indicate where funding comes from	0	**2**
Balance 30 June 2011	825,000		25,920	6,319,270		7,170,190	

10

To the Markers: Presentation marks given ½ for Company Name and ½ for appropriate statement heading
1 mark for each line item appropriately indicated
1 mark for correct amounts and where applicable, totals. Though might not be absolutely needed

QUESTION 1.2.1

GERRARD LTD LTD

NOTES TO THE FINANCIAL STATEMENTS AT 30 JUNE 2011

Profit before tax has been computed after taking into account the following:

Depreciation - equipment	123,750	2
Depreciation - machinery	270,000	
~ original estimate	78,000	2
~ change in estimate	192,000	2
Depreciation - delivery vehicles	240,000	2
Impairment loss on equipment	80,000	2
Loss on sale of delivery vehicles	290,000	2

Workings

Property, plant & equipment

Machinery	carrying amount	tax base	temp diff	deferred tax			Reval Surplus	Tax	net		
Balance 1 July 2010	468,000	156,000	312,000	87,360	L						2
Revaluation surplus	72,000		72,000	*20,160*			72,000	20,160	51,840		3
	540,000	156,000	384,000	107,520			72,000	20,160	51,840		
						31,920	36,000	10,080	25,920	realised	
Balance 3o June 2011	270,000	0	270,000	75,600	L		36,000	10,080	25,920		2

Depreciation = 540,000/2years
270000

Change in estimate:	Previous depreciation	78,000
	Current depreciation	270,000
	Effect of change in estimated useful life	192,000

Workings

Equipment	carrying amount	tax base	temp diff	deferred tax		reval surplus	tax	net	
Balance 1 July 2010	575,000	368,000	207,000	57,960	L				
Revaluation surplus	43,750		43,750	*12,250*		43,750	12,250	31,500	
	618,750	368,000	250,750	70,210		43,750	12,250	31,500	
						8,750	2,450	6,300	realised
Balance 3o June 2011	495,000	184,000	311,000	87,080		35,000	9,800	25,200	
Revaluation decrease	35,000					-35,000	-9,800	-25,200	
Impairment	80,000					0	0	0	
					5,530				
Balance 3o June 2011	380,000	184,000	196,000	54,880	L				

Depreciation

= 618,750/5years

123750

Delivery Vehicles	carrying amount	tax base	temp diff	deferred tax				
Balance 1 July 2010	840,000	650,000	190,000	53,200	L		1,300,000	
							-100,000	
Balance 3o June 2011	600,000	325,000		53,200	A	Reverse	1,200,000	
							120,000	6mths
Sale of delivery vehicles							1,080,000	
Proceeds	310,000	310,000					240,000	1 year
Loss on sale/scrapping	-290,000	-15,000					840,000	
allowance							240,000	1 year
							600,000	

Delivery Vehicles	carrying amount	tax base	temp diff	deferred tax	
Balance 1 July 2010	840,000	650,000	190,000	53,200	L
Balance 3o June 2011	600,000	325,000		53,200	A
Sale of delivery vehicles					
Proceeds	310,000	310,000			
	-				
Loss on sale/scrapping allowance	290,000	-15,000			

QUESTION 1.2.2

Change in estimate

The estimated economic useful life of machinery was changed from 10 years to 8 years.		1
The (increase)/decrease in profits caused by the change is as follows:		
~ current year's profits	192,000	1
~ Future profits	-192,000	1

QUESTION 1.2.3

Taxation

SA Normal tax			
- current	1,204,966	15+1	**16**
- deferred	-112,700	9+1	**10**
- overprovision	-183,736	2+1	**3**
	908,530		
Tax rate reconciliation			
Standard/applicable tax rate	28%		**1**
Tax effect of:			
profit before tax (3,846,700*28%)	1,077,076		**1**
overprovision	-183,736		**1**
Interest and penalties (54,250*28%)	15,190		**1**
	908,530		
Effective tax rate	21%	1+1	**2**

Workings

Current tax

Profit before tax	3,846,700	1
Add: depreciation	633,750	
Machinery	270,000	1
Equipment	123,750	1
Delivery vehicles	240,000	1
Impairment loss	80,000	1
Customer list	105,000	1
Loss on sale	290,000	1
Interest and penalties	54,250	1
Less: wear & tear	-691,250	
Machinery	-156,000	1
Equipment	-184,000	1
Delivery vehicles	-325,000	1
Customer list	-26,250	1
Scrapping allowance	-15,000	1
Taxable Income	4,303,450	1
Current tax @ 28%	1,204,966	1

Deferred tax

	carrying amount	tax base	temp diff	deferred tax		
Balance 30 June 2010			709,000	-198,520	L	1
Machinery				31,920		2
Equipment				5,530		2
Delivery vehicles				53,200		2
Customer List				22,050		2
				-85,820	L	
				112,700		9

Development of customer list (IAS 38 para 63)

	carrying amount	tax base	temp diff	deferred tax	
Balance 1 July 2010	0	0	0	0	
Balance 3o June 2011	0	78,750	78,750	22,050	A

2010 tax assessment

Provided in 2010	746,564	1
(2,666,300 x 28%)		
SARS assessment	562,828	1
(2,010,100 x 28%)		
Overprovision	183,736	2

SOLUTION
QUESTION 2.1
Purchase of second hand fixed property

- **No VAT was actually paid by Africa (Pty) Ltd** since Sasha Robbie is not a registered VAT vendor. (1)

- However, the commercial building constitutes **second hand goods** (it is owned and used by Sasha Robbie). (1)

- The buyer (Africa (Pty) Ltd), the seller (Sasha Robbie) and the goods are located in South Africa **(the commercial building is situated in central Johannesburg, the buyer and seller are South African residents).** (1)

- Because Africa (Pty) Ltd is a registered vendor and purchases second hand property from a non vendor (Sasha Robbie), a **deemed/notional input tax may be claimed** for the commercial building. *s16(3)(a)(ii)(bb)* (1)

- As the second hand property is **only used partly (60%) for taxable supplies, the permissible input tax should be apportioned.** *s17(1)* (1)

- The deemed/notional input tax is calculated as follows :-

  Tax fraction x **Lesser of purchase price (R4 500 000) and open market value (R4 400 000)** (1)
  14/114 x R4 400 000 **x 60%** = R324 211 (2)
  Not Limited to the amount **of transfer duty paid(R277 000)** (1)

- Office Africa (Pty) Ltd is a company and will therefore be **registered on an invoice basis**, thus the **full deemed input may be claimed on the date of registrationand** the **deemed input is claimable to the extent that payment is made**. As the date **of registration is 3 August 2012 and the full payment is also made in August 2012 (10 August) therefore the full deemed input tax of R 324 211 may be claimed in the VAT period ending 31 August 2012(Category B vendor – VAT period – July/Aug)**

  s16(3)(a)(ii)(bb) (4)

Possible: 13 marks
Maximum: 12 marks

QUESTION 2.2

- Office Africa (Pty) Ltd is a company and will therefore be registered on an invoice basis, thus the **full deemed input may be claimed on the date of registration** and the **deemed input is claimable to the extent that payment is made**. As **the date of registration is 3 August 2012,** therefore the **deemed input tax can be claimed to the extent of payment in the VAT period (only R1 000 00 paid on the 10 August) ending 31 August 2012 (Category B vendor – VAT period – July/Aug).** The amount of deemedinput tax that can be claimed is **R324 211 x R1 000 000/R4 500 000 = R72 047**

  s16(3)(a)(ii)(bb)

Possible:5 marks

Maximum: 5 marks

QUESTION 2.3

- There is **no deemed supply/indemnity payment** where the payment **relates to the total reinstatement of goods for which an input tax deduction was denied** and such goods are **stolen or damaged beyond economic repair**. (3)
- The payment of R120 000 received from Onesure Insurers therefore **does not represent an indemnity payment.** (1)
- As the Toyota Tazz is a motor vehicle as defined therefore the **input tax was denied** and **it was written off (damaged beyond economic repair)**. (2)
- Therefore there **are no VAT consequences for Fountain (Pty) Ltd** for the **VAT period ended 31 March 2012.** (2)

Possible: 8 marks

Maximum: 7 marks

QUESTION 2.4

- Even though the **input tax deduction was denied on the Toyota Tazz, a motor vehicle as defined, it was not stolen or damaged beyond economic repair.** (1)
- The payout of R5 000 received from Onesure Insurers therefore represents an **indemnity payment.** (1)
- An indemnity payment is a deemed supply, and therefore represents a Taxable supply. (1)
- Fountain (Pty) Ltd will therefore account for output VAT of R7 000 x 14/114 = R860 on the payout. (1)
- The timing of the supply is when the payment is received, therefore on 19 February 2012 (VAT period ending on 31 March 2012). (1)

Possible: 5 marks

Maximum: 5 marks

QUESTION 2.5

PART B. ADVICE

	Company Car	Travel Allowance	Marks
PAYE - Monthly Taxable Amounts			
Company Car(**R510 000 x 3,25% x 80%**)- par 1 - par(cB)Fourth Schedule	13,260		**3**
Travel Allowance(**R13 000 x 80%**) - par 1- par (cA) Fourth Schedule		10,400	**2**
Right of use of Motor car			
Annual Taxable Value			
Company Car - para 2(b) and 7 - Seventh Schedule			
Annual Value of Usage(**R510 000 x 3,25% x12)**	198,900		**1**
Less : Business Travelling - x **12 000/29 000**	-82,303		**1**
	116,597		
Less : Licencing **R1 320 x 17 000/29 000**	-774		**1**
Less : Cost of Private Fuel(**17 000** xR1.131**)**	-19,227		**1**
	96,596		
Travel Allowance- s 8(1)(b)		**156,000**	**1**
Less : Deemed Costs(Higher therefore select deemed costs)R5.9340 x 12 000		**-71,208**	**1P**
		84,792	
Travel Allowance			
TI inclusion: Actual Expenditure(R156 000 - R53 971)		102,029	
Allowance(R13 000 x 12)		R 156,000	
Actual Expenditure			
Wear and Tear R525 000 limited to 480 000/7=	**68,571**		**1**
Petrol	**R 38,600**		**0.5**
Insurance(R1 600 x 12)	**R 19,200**		**0.5**
Tracking System(R210 x 12)	**R 2,520**		**0.5**
Licensing	**R 1,540**		**0.5**
	R 130,431		
130 431/29 000 x 12 000 = 53 971			**1**

TI inclusion: Deemed Costs(R156 000 - R71 208)		R 84,792	
Allowance(R13 000 x 12)		R 156,000	
Fixed Cost of R525 000 Limited to R480 000 therefore			
119 683/ 29 000	**R 4.127**		**1**
Fuel Costs	**R 1.131**		**0.5**
Maintenance Costs	**R 0.6760**		**0.5**
	R 5.9340		
R5.934X 12 000km = R71 208			**1**
Therefore use deemed costs because inclusion in taxable income is lower.			**1**

Anele would **<u>pay less PAYE on the travel allowance option</u>** **0.5P**
on a monthly basis , and based on the overall annual tax inclusion in taxable income,
the travel allowance **<u>(R84 792 inclusion in Gross Income) is favoured</u>** **0.5P**
over the company car(R96 596 inclusion in taxable income)

Total	**20**
Max	**20**

SOLUTION

QUESTION 3.1

Initial Funds Outlay

Plant	- R1,200,000		1
Working Capital	-R350,000		1
Advertising Board	-R50,000		1
Sub-Total	-R1,600,000		
Tax Effect @ 30% on Advertising Board only	R15,000	recoupment	1
Net Initial Funds Outlay	R1,585,000		
			(4 marks)

QUESTION 3.2

Expected Net cash revenue from sales

YEAR 1		R4,200,000	given	½
YEAR 2 Add 5%	210,000	R4,410,000		1
YEAR 3 ADD 5%		R4,630,500		½
YEAR 4		R4,862,025		½
YEAR 5		R5,105,126		½
				(3 marks)

QUESTION 3.3

Working Capital Required

YEAR 0	R350,000	given	½
YEAR 1 must equal 10% of Revenue	R 70,000	(0.10*4200000)-350000	1
YEAR 2	R 21,000	(0.10*4410000)-420000	½
YEAR 3	R 22,050		½
YEAR 4	R 23,153		½
TOTAL	R486,203		1
			(4 marks)

QUESTION 3.4

WACC is given as 12%
It is the company's cost of capital 1
in which each category of capital is proportionately weighted. 1
All capital sources – shares and any other long-term debt - are included in a WACC calculation. 1
All else equal, the WACC of a firm increases as the beta and rate of return on equity increases, as an increase in WACC notes a decrease in valuation and a higher risk. 1
Businesses often discount cash flows at WACC to determine the Net Present Value (NPV) of a project, using the formula:
NPV = Present Value (PV) of the Cash Flows **discounted** at WACC. 1

The WACC equation is the cost of each capital component multiplied by its proportional weight and then summing:

$$WACC = \frac{E}{V} * Re + \frac{D}{V} * Rd * (1 - Tc)$$

1

(4 marks)
Possible 6 marks

QUESTION 3.5

Using Profitability Index

New Project (Tender 2)	1118500/1000000	2
	1.1185	1
Tender 1	1585000 + 79408/1585000	2
	1.0501	1
As Tender 2 has been calculated to be more profitable it is considered that Tender 2 should be accepted.		1
Other valid arguments		1
	Max	**8**

QUESTION 3.6

Risk Assessment at Financial statement level

Due to the following factors there is a risk that the entity may not be able to continue as a going concern:	1
Low Solvency and Liquidity ratios	1
Current strike with a reported no end in sight	1
Low profitability margins experienced in the Platinum industry	1
Profitability issues faced by Plats (Pty) Ltd	1
Demand of payment from creditors as the entity has exceeded credit terms	1
There exists a risk of fraud due to management oevrride of controls as there exists incentive for management to manipulate profits in the current climate due to the following:	1
Threatened business rescue proceedings	1
Available	**8**
	MAX 6

QUESTION 3.7

Audit Procedures to be performed

Enquire from management if they recognise a going concern issue to exist	1
Enquire from management any action plan in place to address the identified issue	1
Obtain cash flow forecasts from management regarding future profitability	1
Cast and cross cast cash flow forecasts to test for accuracy	1
Recalculate the cash flow forecast using the discount rate used by management to assess accuracy	1
Enquire from and obtain assumptions used by management in determining the cash flow forecast.	1
Obtain supporting data from management used for calculating and drawing up the cash flow analysis	1
Agree data as per the cash flow analysis to underlying data and follow up on discrepancies	1
Determine if assumptions used by management are appropriate	1
Determine, using prior knowledge of the client as well as through enquiries of management if prior targets have been met	1
Compare prior year budgeted forecast to current year results to assess reliability of budget	1
Inspect the cash flow analysis for any omissions	1
Enquire from management basis for calculation of discount rate, determine if appropriate	1
Calculate independent discount rate and compare to discount rate calculated by the client and follow up on differences	1
Recalculate cahs flow analysis using discount rate as calculated independently and follow up on differences with management	1
Perform sensitivity analysis on the cash flow analysis and follow up on results with management	1
Consider effect on financial statements and audit report if a going concern issue os found to exist	2
Report going concern issue identified to management and those charged with governance	1
Consider the use of a qualified audit opinion	1
Available	**20**
Maximum	**12**