CASE STUDY

Read the following case study and answer the questions under Multiple Choice Questions and Case Study Questions:

Background:

Situated about 20 kilometers south of Johannesburg, Gauteng is the small community of Lenasia. This community is typical of most Gauteng communities of its size. It has a thriving central business district, a town square, four high schools and a strong sense of friendliness within the community. The residents of this town enjoy playing soccer and many of the social activities center around community events. There is a strong sense of community engagement and very few things pass by the community members. It seems as if everyone who lives in Lenasia knows everyone else.

Cheslin "The Doc", Dolfie "The Chemist" and Billings "The Beef" are three childhood friends who schooled at the same institutions, but unfortunately, unlike his two friends, Billings, did not complete his tertiary education. These three friends have always shown an entrepreneurial streak from a very young age. They started off with buying and selling sweets and other consumer items at school and in the area.

The three friends are regarded as up-standing community members and so when news broke in November 2006 about the arrest of Billings, the community was shocked. The Hawks arrested him and he was charged with the embezzlement of tax receipts and subsequently was convicted to three years imprisonment without the option of a fine. This news devastated the other two friends who agreed that they would establish a business in order, to help their friend upon his release from prison and hopefully this would help him redeem his position in the community.

Business Structure

Billings was released early due to good behavior and was surprised to find his friends planning their social entrepreneurship venture. He immediately got involved. They agreed that the business should be driven by a common passion and from this Health Buzz (Pty) Limited was incorporated on 09 September 2011. Cheslin and Dolfie each hold 35% of the issued share capital and Billings holds 30%, and were duly appointed as directors. It was decided that the company has a financial year end on the last day of February. The business operations will integrate their passions for research and development, health care and fitness into a one-stop-shop. The vision of this one-stop shop would be to provide the following services to the community:

(a) A pharmacy – medication and health care products/services at affordable prices to community members. This segment will be managed by Cheslin where he could apply his competencies in pharmacy and health care.
(b) Health and fitness – a gym facility, fitness programs and training that will encourage healthy living habits amongst community members. This segment will be managed by Billings, an active and avert sportsman.
(c) Health care supplement and meals – health supplements, healthy meals and dietary services that will improve the wellness of the community members at affordable prices. This segment will be managed by Dolfie who has been actively promoting healthy lifestyles in the community.

The social entrepreneurs leased premises in a shopping complex in the area. The premises consisted of an upper floor area which was converted into a gym facility and the ground floor was arranged to cater for the activities of the pharmacy, a health store and a restaurant for the health meals. The friends approached a long-term colleague, Madea Mulla Professional Accountant (SA) (hereafter referred to as Mulla) to assist them in formalizing their business. The legalities were complied with and the business was officially launched and opened by the community leader, Mr. Rajah Dadoo.

Financial and operating structure:

After operating for four years, the growth of the business and the trust the community placed in the governance with which the business was conducted, the directors decided to structure the organization along corporate principles. They agreed that they would appoint Mulla as the CFO as they wanted to develop a strong financial ethical culture for the business. Mulla then appointed her close friend Sarafina van der Merwe, Professional Accountant (SA) (hereafter referred to as Sarafina) as Financial Manager. Her motivation was based on the trust and confidence that Sarafina would duly carry out her duties in an ethical, honest and professional basis. Sarafina was then accordingly appointed.

As a result of this trust and confidence, Sarafina was allowed to carry out her function as Financial Manager with minimal supervision and oversight. Mulla would review reports as they were prepared by Sarafina, but rarely, if ever, reconciled any of the accounting data in the reports to supporting documentation. Budget constraints necessitated changes in job duties and responsibilities. Any time such changes occurred, Sarafina was always anxious take on the added responsibilities. Mulla had trust in Sarafina and would usually allow her to take on the added duties and responsibilities. Sarafina appeared to be a willing, dedicated, hard-working employee who was not afraid to do whatever was necessary to get the job done!

It was during one of these changes in job duties that Sarafina was provided with an opportunity to begin her embezzlement scheme. Sometime during 2014, a data entry clerk responsible for entering information from the tax receipt forms to the VAT data base retired. Prior to her retirement, the clerk was often absent due to her husband's serious illness. The input of VAT information is an important task and so the clerk taught Sarafina. When the clerk retired, Sarafina informed Mulla that she could take over the responsibilities without impairing her current workload and thereby save the time and money involved in hiring and training a new clerk. Mulla quickly agreed to Sarafina's suggestion given their close relationship.

In taking over the responsibilities of the retired clerk Sarafina now had sole responsibility for reconciling the total daily receipts (including cash), preparing the daily cash sheet, preparing the daily bank deposits and reconciling the tax receipts to the computer summary report. Shortly thereafter, she took over the VAT submission function including the validation of the information to the supporting accounting records. Sarafina therefore, had quite a lot of important responsibilities. Mulla decided to give Sarafina's work the "once over" and she discovered that Sarafina was throwing away the supporting and so questioned her. Sarafina responded that she was under the impression that the VAT 201 submissions did not require any supporting documents. Mulla informed Sarafina that she was wrong and that all supporting documentation should be filed with immediate effect.

Sarafina appeared to be jealous and overly protective of the various tasks she performed; and this was noticed by the others when none of the other employees were ever allowed to input information into or obtain free access to the accounting data base. Whenever an employee needed to work with the data base Sarafina would personally find the receipt, pull it out of the file and hand it to the employee. When the employee was finished with the document, it had to be returned to Sarafina who then refiled it. In addition, after the daily reconciliation was completed and cash receipts had been placed into the bank deposit bag, no one except Sarafina was allowed to make change for queries from customers. One employee remarked that if another employee came in early, Sarafina would become very nervous and agitated and would not enter the tax information into the computer whenever the employee was in close proximity.

Sarafina was also responsible for the handling of employee time sheets, a duty which she took seriously as employees would write onto the time sheet the hours they worked. If she believed the employee had improperly recorded hours worked, she would take it upon herself to change the time sheet to the hours she felt right. Naturally, these changes to other employee time sheets caused numerous arguments between herself and the affected employees. These disgruntled employees wondered if Sarafina was as strict with her own time sheet because it was common knowledge that she would take numerous days off as well as taking off every Thursday afternoon and the whole of Friday. When these employees managed to obtain copies of Sarafina's time sheet they noted that she never docked herself for the time she was away from her job. Employees also noted that Sarafina would routinely steal "little things", such as, using the postage machine for her personal mail, using the business phone to make personal long distance calls, stationery and many other items.

In addition to the changes in Sarafina's behavior in the performance of her duties, employees noted specific behavioural changes. They noticed that she always seemed to have large amounts of cash in her purse and would pay for business expenses using this personal cash, but she would never file a voucher requesting reimbursements. In September 2015, Sarafina's husband, Charles became very ill which required her taking family leave to tend to him. During this time her work was performed by other employees in the department. The employees did not take note of anything unusual regarding the cash sheets, deposit or reconciliations. However, on Monday the employees noticed that the computer had an error message, which indicated that it had been turned on but not shut down in the correct manner. Since Sarafina was the only one who would come into the office on Saturdays to enter the tax receipt, they realized that she had been in the office on Saturday. The clerk who had prepared the cash sheet on Friday also noted that changes had been made on the cash sheet. It seems the clerk's original numbers had been "tippexed-out" and changed to reflect lower balances. Although the clerk was curious about the changes, she had seen similar changes before on previous cash sheets that she had prepared and when she questioned Sarafina about these changes (since it had been preached to her the cash sheet had to be 100% correct, with no changes showing), the clerk was informed that she made a mistake and that she should not be concerned about it. However, this time she was certain she had not made a mistake on that specific Friday since her cash sheet and the cash receipts had balanced. This could also be testified by another clerk. She was also disturbed by the fact that whoever had made the changes was trying very hard to make it appear that the handwriting was the same as on the unchanged numbers. The clerk asked Mulla why the change was made and Mulla indicated she had no idea about this change. The second clerk informed Mulla that everything had balanced on the Friday and still balanced on Monday, except that the numbers were different, showing the office had taken in less cash than had been shown on Friday. Sarafina was subsequently approached as to why the change was made; and as before, simply commented that a mistake had been made and she had changed the numbers.

Mulla became suspicious and decided to conduct an in-depth investigation and noted the amount on the receipt was R 2,500 or R 5,000 greater than what had been recorded on the printouts. Since Sarafina was responsible for the data entries, Mulla realized that her close friend was responsible for stealing a great deal of money. Finally, she filed a suit and lawyers who instructed her to tally as much of the losses that SAIPA would initiate a disciplinary investigation. When Mulla discovered that during the current reporting period Sarafina had taken more than R 200,000, she had no choice but to lay out a complaint against Sarafina with the police.

MULTIPLE CHOICE QUESTIONS

MCQ 1:
The appointment of Billings as a director of Health Buzz (Pty) Limited is;
(a) illegal, as Billings is a convicted criminal
(b) valid, as Billings has completed his prison time
(c) invalid, as Billings only has 30% of the issued shareholding
(d) none of the above

MCQ 2:
The Health Buzz (Pty) Limited is best described; as
(a) a community Based Non-Profit Organization
(b) an Unincorporated, free association of persons for gain
(c) an Owner-Managed entity
(d) a widely-held entity

MCQ 3:
The registration number of the Health Buzz (Pty) Limited, as allocated by the CiPC shall end with;
(a) 07
(b) 23
(c) 21
(d) 08

MCQ 4:
To avoid the risk of amounts being "tippexed out" and change on the cash sheets which may result in mismanagement of, the sheets should must be:
(a) destroyed and a new cash sheet should be prepared
(b) initial be the person checking the cash sheets
(c) initialed by the person preparing and checking the cash sheets
(d) allow "tippexed out" sheets as no one is perfect

MCQ 5:
Cash reconciliations should be carried out daily to ensure the accuracy of the accounting records as well as the safeguarding of cash resources. Mulla implemented as a quality control process which complies with ISQC 1 by:
(a) having the cash reconciliation checked by a senior
(b) investigating errors and risks when they are brought to her attention
(c) appointed suitably qualified staff to perform critical functions
(d) trusting the competencies and ethics of Sarafina as a Professional Accountant

MCQ 6:

In order to improve the quality of the financial information produced by the organization, especially the accounting/finance department, it is important that Mulla (head of the Finance Department) implement the following:

(a) International Financial Reporting Standards
(b) ISRS 4410 – Agreed upon Engagements
(c) ISQC 1 – International Quality Control Standard
(d) Code of Professional Ethics

MCQ 7:

In order to improve the quality of the work produced in the department and the trust and camaraderie amongst the staff, it is important that Mulla implement the following policies:

(a) whistle blowing
(b) rotation of Functions
(c) regular social functions
(d) social and Ethics Committee policies

MCQ 8:

On the advice of SAIPA Legal Department, Mulla appointed Sizwe Moloi a Professional Accountant to assist in the investigation of the possible embezzlement committed by Sarafina. The work conducted by Moloi must comply with the following:

(a) S29 and s30 of the Companies Act 71 of 2008
(b) ISRE 2400 – Independent Review
(c) ISRS 4410 – Agreed upon Engagements
(d) ISA – International Auditing Standards

MCQ 9:

The report to be completed by Moloi for the work performed in relation to the investigation of the embezzlement represents:

(a) an Accounting Officer's Report
(b) a factual findings report
(c) a factual finding report with recommendation
(d) a factual finding report with an opinion on the embezzlement

MCQ 10:

Mulla calculated the PI score of Health Buzz (Pty) Ltd to be 335. The company therefore required:

(a) independent review
(b) an audit
(c) compilation
(d) compilation if the MOI does not required an audit or review

MCQ 11:

As both Mulla and Sarafina are members of SAIPA, their status can only be classifies being "good standing" if:

(a) they CPD satisfy the prescribed requirements for CPD's and paid their fees
(b) they have no disciplinary matters pending
(c) get approval from the CE
(d) (a) and (b)

MCQ 12:

The following was extracted from the Accounting Officer's Report *"We have also reviewed the accounting policies, which have been presented to us as having been applied in the preparation of the annual financial statements and consider it to be appropriate to the business, and are in conformity with the International Reporting Standards for Small and Medium-sized Entities".* The statement implies that:

(a) the policies are aligned with that permitted in terms of the Income Tax Act
(b) the policies were evaluated for its relevance in compiling financial statements
(c) the policies comply with the appropriate accounting standards
(d) the policies were prepared by the Professional Accountant

MCQ 13:

From time-to-time Mulla and Sarafina compile Financial Statement summaries, as is demanded by Health Buzz's bankers, in order to review the Company's overdraft facilities. As these are typically called management accounts, such financial statements may contain:

(a) deliberate misleading information
(b) the words " internally compiled"
(c) the words "professionally compiled"
(d) all of the above

MCQ 14:

The Professional Accountant (SA) designation is registered with SAQA at:

(a) NQF Level below that of a CA(SA)
(b) NQF Level 7
(c) NQF Level 8
(d) the same NQF Level as all professional accounting organisations

MCQ 15:

A supplier of Health Buzz (Pty) Limited requested a BBBEE certificate for Health Buzz (Pty) Limited. Which of the following statements are correct?

(a) as Mulla is a Professional Accountant (SA), and is in the employ of Health Buzz (Pty) Limited, she is entitled to issue a Level 1 BBBEE certificate
(b) as all the shareholders are black South Africans, the annual return is not considered for BBBEE certification purposes
(c) both (a) and (b) is correct
(d) nether (a) or (b) is correct

MCQ 16:
Health Buzz (Pty) Limited was incorporated and issued with a Certificate to Commence Business by CIPC on 11 September 2011. In order to remain marked as "in business" the Commissioner – CIPC requires:
(a) electronic filing, in the prescribed format of Annual Return and calculated Annual Duties on its anniversary date each year, with CIPC
(b) as Health Buzz (Pty) Limited is a small-,micro and medium enterprise, it is exempted from filing annual returns with CIPC
(c) all companies pay the exact same annual duty once every three years
(d) all of the above

Use the following information to answer MCQ 17 to MCQ 25:

A member, the sister-in-law of Dolfie, was injured during the trial period on implementing the new member policy while using the gym equipment which resulted in the member requiring major surgery. Billings was of the opinion that the member performed exercises reckless and therefore the terms and conditions does not cover the injuries suffered.
The member initiated a lawsuit against the organisation for the personal injury suffered at the gym. After consultations with the attorney of the organisation the organisation had the following actions available:
(a) continue and pursue the matter via legal channel. The attorney indicated that there was a possibility that there is 50% change of winning the case against the member.
(b) negotiate an out-of-court settlement for a reduced compensation amount.

Billings decided that the legal route is the best option as he was confident of winning the case and has accordingly appointed the attorneys (registered VAT vendors) to pursue the matter. At the reporting date, 28 February 2017, the organisation's attorneys estimated from experience that the organisation has a 40% change of being ordered to pay the member compensation of R 180,000 and a 60% change of being ordered to pay compensation of R 400,000. The ruling for the case is expected to be finalised during the within a period of nine months from the reporting date. The attorneys estimated their fees to represent the organisation to be R 100,000 of which 25% had to be paid as a deposit.

MCQ 17:
The accountant should recognise the claim by the member against the organisation as:
(a) a liability as the lawsuit exist at the reporting date
(b) a provision as there is a 50% chance of winning the case
(c) a contingent liability as a future obligation will arise when judgement is passed
(d) an onerous contract as the lawsuit may cause reputational damage to the organisation

MCQ 18:
At the reporting date the obligation should be measured at:

(a) the lower of R 180,000 and R 400,000
(b) the higher of R 180,000 and R 400,000
(c) an average of R 290,000
(d) and average of 312,000

MCQ 19:
The deposit paid to the attorneys in respect of the legal costs to defend the case will be recognised at the reporting date as:
(a) legal expenses at R 25,000
(b) legal expenses at R21,930
(c) prepaid expenses at R 25,000
(d) prepaid expenses at R 21,930

MCQ 20:
The information relating to the lawsuit should be disclosed in the financial statements in the following manner:
(a) as an event after the reporting date by way of a note
(b) as a provision in the statement of financial position
(c) as a future financial commitment note to the financial statements
(d) as a contingent asset in the statement of financial position

MCQ 21:
Mulla recommended that the risks of the company being sued by members for being injured using the gym or suffering side effects from meals purchased from the restaurant can be minimized and reduced by:
(a) placing signs "patrons/members bears personal risks" on the premises
(b) having public liability insurance
(c) having PI insurance
(d) creating a reserve fund for settling out of court

MCQ 22:
As the Company is duly registered with Compensation Fund:
(a) all the members of the gym is covered against injury
(b) only the employees of the Company is covered against on-the-job injury
(c) only the directors of the Company is covered against injury on duty
(d) none of the above is true

MCQ 23:
Sarafina stated future lawsuits due to injuries in the gym can be avoided by implemented the following control procedures:

(a) members must take out a specific injury policy – additional cost to the members
(b) install close-circuit cameras to monitor members using the gym
(c) employees qualified gym instructions to assist members while training
(d) recommend members to doctors when injuries occur

MCQ 24:
An Engagement Letter is a written instrument between the Professional Accountant in Practice and his/her client. Which of the following statements is/are false?
(a) Engagement Letters are mirror copies of each other and thus need not be signed by the parties thereto
(b) for Professional Accountant (SA) providing professional services in the Republic od South Africa, the Consumer Protection Act replaces the need for Engagement Letters
(c) Professional Accountants in Business employed by an entity, an Engagement Letter must be signed for each and every task/assignment not specifically covered in the Engagement Contract
(d) all of the above are false

MCQ 25:
Professional Competence and Due Care is an ethical value that ought to be entrenched in every Professional Accountant (SA). Identify the possible threat to Professional Competence and Due Care.
(a) complying with Continuous Professional Education (CPE) requirements
(b) keeping updated with changes in Legislation
(c) taking on more clients than what one or one's firm is able to serve
(d) all of the above

CASE STUDY QUESTIONS

<u>**You are required to:**</u>

Question 1:
Calculate the cash received from customers and cash paid to suppliers and employees using the information in the drafted statement of cash flow and additional information.

[8 marks]

Figures are in R'000:

	2017	**2016**	**2015**
Cash generated from operating activities			
Cash received from customers	**??**	3 295	1 256
Cash paid to supplies & employees	**??**	-2 543	-822
Cash flows from operations		752	434
Interest paid	-187	-91	-34
Taxation paid	-223	-127	-76
Net cash flows from operating activities		534	324
Cash flows for investing activities			
Acquisition of assets	-2 876	-120	-235
Proceeds on disposal of assets	290	-	78
Net cash flows for investing activities	-2 586	-120	-157
Cash flows from financing activities			
Increase in short-term loans	236	76	28
Increase in long-term loans	2 000	50	112
Repayment of loans	-265	-80	-80
Dividends paid	-800	-	-
Net cash flows from financing activities	1 171	46	60

Movement in cash & cash equivalents		460	227
Balance of cash & equivalents at beginning	732	272	45
Balance of cash & equivalents at end		732	272

The following information were extracted from the drafted financial statements for the reporting period ended 28 February 2017:

	2017	**2016**
Revenue	7 259	
Profit on disposal on non-current assets	85	
Cost of sales	-2 189	
Depreciation	-408	
Operating expenses	-4 287	
Profit before interest and taxation	460	
Inventory	254	177
Trade receivable	354	109
Trade payables	187	398
Accrued expenses	119	76
Provision	350	-

SUGGESTED SOLUTION:

	2017	2016	2015	
Cash generated from operating activities				
Cash received from customers	7 014	3 295	1 256	**2**
Cash paid to supplies & employees	-6 371	-2 543	-822	**6**
Cash flows from operations	643	752	434	
Interest paid	-187	-91	-34	
Taxation paid	-223	-127	-76	
Net cash flows from operating activities	233	534	324	
Cash flows for investing activities				
Acquisition of assets	-2 876	-120	-235	
Proceeds on disposal of assets	290	-	78	
Net cash flows for investing activities	-2 586	-120	-157	
Cash flows from financing activities				
Increase in short-term loans	236	76	28	
Increase in long-term loans	2 000	50	112	

Repayment of loans	-265	-80	-80	
Dividends paid	-800	-	-	
Net cash flows from financing activities	1 171	46	60	
Movement in cash & cash equivalents	-1 182	460	227	
Balance of cash & equivalents at beginning	732	272	45	
Balance of cash & equivalents at end	-450	732	272	
				[max: 8]

Cash received from customers	7 259
Revenue per income statement	-245
Movement in receivables	7 014
Cash paid to suppliers and employees	
Expenses per income statement	-6 476
Movement in inventory	-77
Movement in trade payables	-211
Movement in accrued expenses	43
Movement in provisions	350
	-6 371
Profit before interest and tax	460
Non cash item – depreciation	408
Non-cash item - profit on disposal	-85
Movement in inventory	-77
Movement in trade receivables	-245
Movement in trade payables	-211
Movement in accrued expenses	43
Movement in provision	350
	643

Question 2:
Analyse the statements of cash flow presented by Mulla and draft a report commenting on the cash position of the organization over the past three reporting periods.

[12 Marks]

SUGGESTED SOLUTION:

The balance of the cash and cash equivalent over the past three years declined from a favourable balance of R 272,000 to and overdraft of R 450,000 – the	**1**

decrease for the current reporting period is even more drastic (from R732,000 to R 450,000) – decline of 162% in the current period	
Cash received from customers has increase exponentially over the three periods, viz. and increase from R 1,256,000 to R 7,014,000 or 458%	**1**
The cash paid for operating expenses increase exponential over the three periods, viz. increase from R 822,000 to R 6,371,000 or 675%	**1**
The net cash generated from operations fluctuated over the three years, but has increased over the past three periods, viz. increase from R 434,000 to R 643,000 or 48%. The reason for the lower increase in cash generated from operations can be attributed to the fact that the operating expenses increased at a higher rate than the cash generated from revenue activities (675% versus 458%).	**2**
The cash margin (operating cash to cash received from customers) decreased from 35% to 9%, indicating that the operating risks of the organization has increased – the business may face challenges to sustain operations from internal resources (not self-sustaining).	**2**
Interest paid increased consistently over the past three period, viz. increase from R 34,000 to R 187,000 or 450% - indicating that the business has increased in dependence on debt financing which increased the financial risks to the organization.	**2**
The interest cash cover declined from 8.26 to 3.44 indicating a significant increase in the risk of meeting interest payment obligations from operations – the ratio declined from being a safety margin to into an unacceptable level for debt providers.	**1**
There has been a significant investment in manufacturing assets, especially during the current period to meet expansion strategies. However, in periods prior to the current period the acquisition of non-current assets were financed from internal sources, but during the current period the internal sources only contributes to 8% of the acquisition – indicating the reliance on external debt finance to sustain the business.	**2**
The cash re-investment ratio (cash from operation compared to acquisition of non-current assets) 4.45 (fully funded from operations) to 0.08 (major acquisitions are externally funded) – indication of an increase in the business risk of the business.	**2**
The reliance on short-term debt financing (high interest obligations) increased from R 28,000 to R 236,000 or 742% - further indicating that the operations are highly financed by short-term debt.	**1**
The operating cash flow ratio (cash from operations/current liabilities) has also exceeded 1:1 indicating that the organization may not have and difficulty in meeting is short-term obligations. However the ratio decreased from 1.34 to 1.24 even though the trade payables balance decreased by more than 50% over the same period – indicating that challenges lie ahead.	**2**
	[max: 12]

Health and meals supplements segment:

The health and meals supplements segment of the business grew rapidly; especially the restaurant where the health meals were the "talk of the town". The health meals prepared were the brainchild of Dolfie and changed constantly due to the experiments he conducted. These experiments were regularly conducted in order to improve the quality, taste and health benefits of the different meals. Dolfie experimented in developing a healthy diet meal which would ensure a minimum weight loss of 4 kg per week without any strenuous or rigorous physical exercise. He had been working on this recipe before the business was officially established, but increased his work efforts since the incorporation of the business. During the current reporting period the recipe was finalised and the results proved that the minimum weight loss was assured. A major health and weight loss corporate came to know about the recipe and offered Health Buzz and amount of R 10 million for the recipe. The shareholders discussed the proposal and accepted the offer as the cash would finance the bigger picture and vision of the business. The accountant recommended that the total costs of the time spent, intellectual property applied and the materials used to develop the recipe should be recognised as an intangible asset in order to reduce the capital gains tax liability – the costs were not recorded separately and were written off as they were incurred. The accountant estimated the costs to be R 6.5 million which was supported by a detail cost analysis schedule, which was treated as expenses in terms of S11D and S12C for income tax purposes.

On 01 September 2016 Health Buzz purchased a franchise at an aggregate cost of R 800,000 for a period of two years with an option to extend the agreement for a further five years at a cost of R 2 million at the end of the initial period. At the date the franchise was purchased, management was not certain about the commercial value of the franchise as this would introduce a new product line. However, the results for the six months of implementation exceeded expectation and management decided with immediate effect that the extension option would be exercised. Management informed the franchiser that the extension option will be exercised and placed the R 2 million for payment in an investment account. The accountant stated the cost of extending the franchise period should be recognised as part of the cost on initial recognition of the intangible asset as the decision to extend the period was taken before the initial period expired.

<u>You are required to:</u>

Question 3:
Discuss whether the recipe can be recognised as an intangible asset and measured at the estimated cost recommended by the accountant.

[5 marks]

<u>SUGGESTED SOLUTION:</u>

The recipe represents an internally generated assets without any Research & Development plan – it was a consequence of carrying out the ordinary business activities. Internally generated intangible asset cannot be recognised as an asset as the cost cannot be measured reliably.	**3**
Once the cost associated with the development of an intangible asset has been recognised as an expense prior to the recognition of the intangible asset, then such expenses cannot be reversed and capitalised unless the classification as an expenses represents a correction of a fundamental error.	**2**
Conclusion: as no costing records were maintained as well as no structured plan was implemented, the recipe cannot be recognised as an intangible asset.	**1**
	[max: 5]

Question 4:
Discuss the income tax and VAT implications for the disposal of the recipe as an intangible asset.

[7 marks]

<u>SUGGESTED SOLUTION:</u>

VAT: The recipe represents a **supply** as it will be used **in the course or furtherance of an enterprise –** Health Buzz (Pty) Ltd **continuously or regularly carries on the activities of health care supplements or meals**. Furthermore, as Health Buzz (Pty) Ltd is a registered vendor, the sale of the recipe will be regarded as a taxable supply charged at standard rate. The consideration received represents the amount inclusive of VAT – output tax will amount to **R 1,228,070** [R 10 million x 14/114].	**1** **1**
Income tax: The issue is whether the sale of the recipe is **capital or revenue in nature**. Alternate 1 - The income received is of a capital nature (**frequency of the transaction** and the **intention of the business**) and will therefore attract capital gains tax. As no intangible asset was recognised (**expenses were treated as**	**1** **1** **1** **1**

deductions in previous years of assessment), the tax value is zero. The capital gain will amount to R **8,771,930** (exclusive of VAT) which will be included in the 2017 year of assessment at **80%**. The amount will be subject to normal tax of **28%** or **SBC tax rates.**	**1P** **1,1**
Or Alternate 2 - The **intention** of the sale of the recipe was a **profit making scheme** The sale of the recipe would therefore be revenue in nature and the **R8 771 930** would be **included in gross income** of Health Buzz (Pty) Ltd for the 2017 year of assessment. The related expenses have **been treated as expenses for income tax purposes.** The amount will be subject to normal tax of **28%** or **SBC tax rates**.	**1,1** **1** **1** **1** **1**
	[max: 7]

Question 5:
Record the journal entries on the disposal of the recipe as an intangible asset.

[2 marks]

SUGGESTED SOLUTION:

	Debit	Credit	
Bank	10,000,000		**0.5**
Output VAT control		1,228,070	**1**
Other Income		8,771,930	**0.5**
[Recognition of the disposal of the recipe]			
			[max: 2]

Question 6:
Discuss whether the recommendation of the accountant in respect of the recognition of the costs relating to the extension of the franchise period is acceptable in terms of the accountant standards.

[5 marks]

SUGGESTED SOLUTION:

An asset can only be recognised is the transactions is probable and the amount can be measured accurately – both of these are satisfied as a decision has been made to exercise the extension option and the amount is fixed.	**2**
For any transaction to be recognised, it must result from a past event – in this case the past event will only occur when the initial contract period expires. The decision made by management to extend the period before the expiry date does not represent a past event.	**2**

Conclusion: the cost for extension can only be recognised when the contract is concluded (expiry of the initial period) and thus the future cost of extending the contract cannot be recognised as part of the existing intangible asset.	**1**
	[max: 5]

Question 7:

Discuss the income tax and VAT implications in the appropriate periods of assessment for the acquisition and extension of the franchise/patent agreement.

[8 marks]

SUGGESTED SOLUTION:

VAT: Health Buzz (Pty) Ltd is a registered vendor. The purchase of the franchise provided it was purchased from a registered vendor is supplied to Health Buzz (Pty) Ltd **for the purpose of making taxable supplies**. The consideration paid represents the amount inclusive of VAT; and the input tax will be claimed based on **the earlier of the payment or the invoice issued**. Therefore the input tax that can be claimed is R800 000 x 14/114 = **R98 246**	**1** **1** **1**
The extension of the franchise is also supplied to Health Buzz (Pty) Ltd for the purpose of making taxable supplies and thus the input tax is based on **the earlier of the payment or the invoice issued -** this is for the service of extending the franchise and not the acquisition of the franchise. Therefore the input VAT that can be claimed is R2 000 000 x 14/114 = **R245 614**	**1** **1** **{Max 4}**
Or	
Health Buzz (Pty) Ltd is a registered vendor. The purchase of the franchise although purchased from a non-vendor is supplied to Health Buzz (Pty) Ltd **for the purpose of making taxable supplies**. However, no input VAT may be claimed. The **consideration paid represents the amount excluding VAT** as it is purchased from a **non vendor**. Therefore and **no input VAT will be claimed**.	**1** **1** **1**
The extension of the franchise is also supplied to Health Buzz (Pty) Ltd for the purpose of making taxable supplies however no input tax can be claimed as it is purchased from a **non vendor -** this is for the service of extending the franchise and not the acquisition of the franchise.	**1**

Therefore and **no input VAT will be claimed**.	**1** **{Max 4}**
Income tax: The **initial purchase of the franchise** (period of two years) is of a capital nature and can be recognised as **an intangible asset**. As the **cost exceeds R 5,000** the intangible assets will be subject to a capital allowance of **5%** on cost without any apportionment [800,000/1.14 = R701 754 x 5%] or R800 000. The **extension of the franchise** period **does not represent a new intangible asset**, but the cost of extending the contract will be recognised as maintaining the contract. The **cost of extending the contract** will be recognised as a **deduction** based on the cash paid or incurred [R2 million/1.14 = **R1 754 386**] or **R2 000 000**.	**1,1** **1** **1** **1** **1** **{Max 4}**
	[max: 8]

Pharmacy segment:

Cheslin was concerned with the level of complaints received from customers about body aches and pains. Health Buzz entered into a joint-venture with a pharmaceutical company to produce a particular head ache tablet that was called "PainAway". The bars are wrapped in aluminum foil and packed in attractive cartons containing 50 tablets. A carton is, therefore, considered the basic sales unit. Although management had made detailed estimates of costs and volumes prior to undertaking this venture, new projections based on actual cost experience are now required. The income statements for the last two quarters are thought to be representative of the costs and productive efficiency we can expect in the next few quarters. There was no inventories on hand at the end of each quarter.

The income statements reveal the following

	First Quarter	Second Quarter
Sales (50 000 x R24) (70 000 x R24)	1 200 000	1 680 000
Cost of Sales	700 000	880 000
Gross Profit	500 000	800 000
Expenses	650 000	690 000
Taxation	60 000	44 000
Net Profit/(loss)	(90 000)	66 000

<u>You are required to:</u>

Question 8:

Calculate the fixed and variable cost components for cost of sales and expenses using the High-Low method.

[8 marks]

<u>SUGGESTED SOLUTION:</u>

The costs and expenses changes with the different level of output indicating that there is a variable cost components – the variable component can be calculated using the high-low technique.			**1**
Cost of sales - Variable cost component per unit	(180,000/20,000)	R 9	**2**
Cost of sales – fixed cost component	[700,000 – (50,000 x 9)]	R 250,000	**2**
Expenses – Variable cost component per unit	(40,000/20,000)	R 2	**2**
Expenses – Fixed cost component	[650,000 – (50,000 x 2)]	R 550,000	**1**
			[max:8]

Question 9:

Management would like to know the break-even point in terms of quarterly carton sales for the tablets (in units).

[5 marks]

<u>SUGESSTED SOLUTION:</u>

Contribution per unit	[24 – (9 + 2)]	R 13	**2**
Break-even point (cartons)	[(250,000 + 550,000)/13]	61,539	**3**
			[max: 5]

Question 10:

Management estimates that there is an investment of R 3,000,000 in this product line. What quarterly carton sales and total revenue are required in each quarter to earn an after-tax return of 20% per annum on investment?

[6 marks]

<u>SUGGESTED SOLUTION:</u>

Management expects a total target profit from the sale of the tablets – treated as fixed cost when determining the break-even point			**1**
Estimated targeted profit	[20%/(100% - 28%)]	25,64%	**2**
Estimated/target quarterly profit	[(3,000,000 x 25,64%)/4]	R 192,300	**2**
Break-even point (cartons)	[(800,000 = 192,300)/13]	76,331	**2**
			[max:6]

Question 11:

The firm's marketing people predict that if the selling price is reduced by R1.50 per carton and a further R 150,000 advertising campaign on the over the counter head ache suffers is mounted, sales will increase by 20% over the second quarter sales. Should the plan be implemented?

[6 marks]

SUGGESTED SOLUTION:

Change in contribution per unit	[(24 – 1.50) - 11]	R 11.50	**2**
Break-even point (cartons)	[(800,000 + 150,000)/11.50]	82,609	**2**
Increase in sales volume	[70,000 + 20%]	84,000	**1**
The changes as recommended by the marketing department will result in sales marginally higher than the break-even point indicating that a profit will be realized at R 11.50 per unit for 1,391 units. This may not be as profitable as expected.			**1**
			[max:6]

Expansion strategy:

After a strategic meeting between the directors and the CFO, it was decided that the organization has outgrown its current image and premises. The strategic objective is to increase the brand of the organization by attracting a customer base beyond the current community which it currently serves. At 01 October 2016 Health Buzz had eight months remaining on the lease of the existing premises with a monthly rental payable, in advance, of R 24,000 (excluding VAT). On the same date the business concluded a five year lease agreement in an upmarket business/shopping complex which had a higher level of consumer traffic, but also the premises met the requirements of the shareholders expansion plans. The new lease agreement required immediate occupation in order to obtain the first three months of the lease period without any costs. The monthly rental for the premises was R 40,000 (excluding VAT) with an escalation clause of 10% per annum. The shareholders decided against terminating the lease agreement of the old premises as the penalties far exceeded the outstanding rental payments, and therefore recommended that the lease agreement should continue to the termination date even though the premises would not be used. The

accountant advised the shareholders that the rental payments for the old premises should be treated as normal, i.e. recognised as expenses and deduction for income tax as incurred.

You are required to:

Question 12:

Discuss with the advice of the accountant regarding the recognition and treatment of the rental payments relating to the old premises. Support you discussion with reference to the Income Tax Act.

[5 marks]

SUGGESTED SOLUTION:

Financial Reporting: As the premises and the lease bears no benefit to the business, it must be recognised as a loss. However, when applying the prudence concept (not part of the accounting standards any longer) losses should be recognised when management is aware of them and their occurrence is probable. Thus the full amount for the future rental expenses must be recognised as a provision for potential losses with effect of 01 October 2016 – loss amounts to R 192,000 (24,000 x 8). As the rental payments are incurred it will be cancelled against the provision recognised.	**3 Bonus**
Income Tax: For any amount to be deductible in must be actually incurred – thus the deduction will only be allowed when the rental payment is paid or incurred. However, even though the rental payments was granted as a deduction previously, it will not be allowed in future as the expense is **not incurred in the production of income** – **premises will not be used (vacant).** Therefore the rentals of **R120 000**(R24 000 x 5) **will not be allowed as deduction for the 2017 year of assessment.**	**1 1 1 1 {Max 3}**
Conclusion: the **advice of the accountant is incorrect** for accounting purposes (recognise the loss immediately) as well as for income tax purposes **as the rental expense will not be allowed as a deduction** as it is not incurred in the production of income.	**1 1**

	[max: 5]

Question 13:
Advise the accountant on how the "rent-free" period should be recognised in the accounting records in compliance with the accounting standards.

[3 marks]

SUGGESTED SOLUTION:

In business nothing is free – the three months "free rental" will be recovered by the lessor – rental for the three months is built into the total rental for entire lease period. The rental amount for the entire period should be spread equally over the lease period – [40,000 x 57/60] expense per annum.	**2**
Similar the escalation relates to the same premises used (increase is not linked to additional capacity) and should also be used to determine the amount to be written off equally over the lease period. However, if the escalation is linked to inflation, then it can be excluded from using the average rental when determining the expense – not affect spreading the amount evenly over the period.	**2**
	[max: 3]

Question 14:
Discuss the deferred tax implication relating to the recognition of the rental payments for both lease agreements.

[3 marks]

SUGGESTED SOLUTION:

Deferred tax only arises if the treatment for accounting and tax purposes are not the same – a temporary difference arises.	**1**
Old lease: The total future rental is expenses immediately utilising the provision account (liability) while for tax purposes the rental payments are deducted as they accrue.	**2**

The provision for the loss (liability results in a temporary difference for which a deferred tax asset should be recognised.	
New lease: The rental expense for accounting purposes is spread equally over the lease period while the amount paid will be deducted for income tax purposes – giving rise to a temporary difference. The amount prepared/accrued will results in either a deferred tax liability/asset being recognised.	**2**
	[max: 3]

Health & Fitness:

Billings took responsibility for the layout and design of the new premises to provide the touch and feel of Health Buzz. Billings designed and constructed a home-made gym and training equipment which were housed in the old premises. In order to blend in with the image of the new design of the business, the majority of the gym equipment was replaced with modern electronic and monitoring equipment. The replacement equipment consisted of new as well as used equipment with aggregate costs of R 400 000 and R 2 100 000 respectively, which was purchased on 1 October 2016. The new equipment was purchased from a non-vendor and the used equipment was purchased from a vendor. The open market value of the used equipment was estimated at R2 000 000. The new equipment purchased was various weight lifting equipment while the used equipment was made up of R1 500 000 in treadmills and running equipment and R 600 000 in spinning equipment.

The following is a schedule of the equipment installed at the old premises:

	Cost	Carrying amount	Disposal value
Weight lifting equipment	R 750,000	R 380,000	R 500,000
Aerobic equipment	R 900,000	R650,000	R 1,000,000
Treadmills and running equipment	R 560,000	R 240,000	R 200,000
Specialised equipment	R 270,000	R 110,000	Transferred to new premises

The gym equipment is depreciated based on the capital allowances permitted in terms of the Income Tax Act Interpretation Note 47 which allows a write off period of four years, two years, one year and ten years for weight lifting equipment, treadmills and running equipment, spinning equipment and specialized equipment respectively

Some of the equipment were purchased by non-registered vendors. The accountant stated that the disposal of equipment is not recognised as a taxable supply because they are not sold as part of the ordinary business activities of the organisation.

Billings recommended the following as part of executing his portfolio:

- The business will render a 24 hour service in order to create a niche market that would attract young professionals.
- The gym contracts will provide loyalty points based on the period of the contract taken out by the client. So it would be an additional month for every six months. The value of a monthly contract is R 250 per person. Billings estimated that 80% of the members who take out the minimum contract of six months will extend their contract; while 100% of the members who take out a contract of more than a year will also extend their contract.
- All contracts should be paid in full on signing of the contract.

He projected the following membership contracts:

	Members	Contract value
Minimum six month contract	100	R 1,100
One year contract	150	R 2,000
Maximum two year contract	50	R 3,800

The transfer of membership contract from the old premises bears sufficient evidence that the membership targets are attained. All amount specified are exclusive of VAT unless otherwise stated.

You are required to:

Question 15:

Discuss the VAT implications for the acquisition of the equipment for the new premises in terms of the VAT Act. Support your discussion with calculations.

[6 marks]

SUGGESTED SOLUTION:

New equipment: **No VAT** would have been **levied on the transaction** as the new equipment is purchased from a non vendor. **Notional input tax** can be claimed if **second hand goods are purchased from a non vendor.** Even though the new equipment is purchased from a non vendor, it is not second hand therefore **no notional input tax can be claimed.**	**1** **1,1** **1**
Used equipment: Output tax of **R257 895**(R2 100 000 x 14/114) would have been levied on the transaction as the equipment was purchased from a **VAT vendor.** Therefore, Health Buzz (Pty) Ltd would **be able to claim the input tax** of R257 895 in the relevant tax period.	**1** **1** **1**

	[max: 6]

Question 16:
Discuss how the disposal of the equipment should be treated in order to minimise the income tax liabilities of the organisation.

[4 marks]

SUGGESTED SOLUTION:

If the assets are replaced and the major part of the cash received from the disposal of the assets sold are used to purchase the new assets, then the organisation can **elect to postpone the tax payable** on the assets sold.	1
The **recoupment and capital gains** (inclusive amount) can be postponed and	1
included in gross income on the same basis as the **capital allowances are granted**	1
for the new assets – the recoupment and capital gain is included in gross income at the **same rate as the capital allowance**.	1
However, the organisation will still be permitted to **claim the capital allowances on the existing assets for the current year of assessment**.	1
	[max: 4]

Question 17:
Calculate the capital allowances that can be claimed in the 2017 year of assessment for the new and used equipment that was purchased in the same year.

[4 marks]

SUGGESTED SOLUTION:

	Marks
- Wear and Tear	

- weight lifting equipment – **R400 000/4**= R100 000 x **5/12 or 151/365** = R41 668 or R41 369	**0.5,0.5,0.5**
- treadmills and running equipment – **R1 500 000/2**= R750 000 x **5/12 or 151/365 =** R312 500 or R310 274	**0.5,0.5,0.5**
- spinning equipment – **R600 000/1**=R600 000 x **5/12 or 151/365 =** R250 000 or R248 219	**0.5,0.5,0.5**
Or if regarded as SBC – s12E	
- weight lifting equipment – **R400 000** x **50%**= R200 000 (**not apportioned)**	**0.5,0.5, 0.5**
- treadmills and running equipment – **R1 500 000** x **50%** = R750 000(**not apportioned)**	**0.5,0.5, 0.5**
- More beneficial to use s12E than s11(e) - spinning equipment – **R600 000 x 50%**=R300 000(**not apportioned)**	**0.5,0.5,0.5**
	Max 4

Question 18:

Discuss how the loyalty points should be recognised for:

(i) financial reporting in compliance with the accounting standards;

(ii) VAT in compliance with the VAT Act; and

(iii) Income tax in compliance with the Income Tax Act.

[12 marks]

SUGESSTED SOLUTION:

Financial Reporting: Revenue transactions concluded with loyalty points consist of two performance obligations, viz. services to be rendered and the loyalty points attached to the sale.	**2**
The value of the revenue transaction should be separated between the fees for the services and the value of the loyalty points based on the fair value for each obligation – loyalty points is equal to the market value of R 250 per month and the service revenue will be R 850.	**2**
The revenue for the services rendered will be recognised when the services are rendered – usually monthly. The loyalty points will be recognised when the contract is extended but realised when the services are performed.	**2** **{Max 4}**
VAT:	

No consideration received therefore **no output tax** levied.	**1,1**
Income Tax: Gross income is recognised based on the earlier of receipt or accrual. Similar to VAT, there is **no gross income** when the loyalty points are redeemed.	**1**

- The issue at hand is whether the loyalty points have been - **actually incurred**, and - **during the year of assessment**.	 **1** **1**
- **Deductible expenditure is restricted to that incurred in the year of assessment**. It cannot be carried forward to a subsequent year or carried back to previous year. To determine if the 'during the year of assessment' criteria has been met, we need to consider when the expense was actually incurred.	**1**
- Expenditure actually incurred **does not mean expenditure actually paid during the year of assessment.** It means all expenditure for which a **liability has been incurred during the year**, whether the liability has been discharged during that year or not	**1** **1**
- Customers can redeem loyaly points only after 6 months of the contract has been completed. - **The obligation or liability to redeem loyalty points is therefore incurred only after 6 months of the contract has been completed.**	 **1**
- In the 2017 year of assessment **only 5 months or less of the contract will be completed** therefore the is **no liability that has been incurred.** Accordingly there is **no tax expense to deduct.**	**1** **1** **1**
	{Max 5}
Entire Question	**{Max 12}**

Question 19:
Record the journal entries for the reporting period ended 28 February 2017 for the membership contracts if the targeted figures were achieved during the first week of opening in October 2016 in compliance with the accounting standards.

[11 marks]

SUGGESTED SOLTION:

	Loyalty	Revenue	

Minimum six months contract	90,000	20,000	
One year contract	262,500	37,500	
Maximum two years contract	177,500	12,500	
75,000 + 109,375 + 36,97922	530,000	70,000	
	Debit	Credit	
October 2016			
Bank	684,000		**3**
Revenue in Advance – Services		530,000	**1**
Output VAT Control		74,200	**1.5**
Provision for loyalty Points		70,000	**1**
Provision for Output VAT		9,800	**1.5**
[Recognition of revenue with loyalty points]			
February 2017			
Revenue in Advance – Services	221,354		**3**
Revenue - Services		221,354	**0.5**
[Revenue recognised for the reporting period]			
			[max: 11]

Corporate image

The executive directors approved the new corporate image as recommended by the marketing consultants. Billings stated that the executives must also reflect the corporate image and thus they needed to "up their game" both in terms of looks and status. Cheslin recommended to the shareholders that the organisation should purchase vehicles that can be used by each executive. This was decided because the business was to operate 24/7. He further emphasised that the executives will be required to be on stand-by for any emergency in order to maintain the quality of customer service delivery which is at the core of any organisation's values.

The three executive directors decided to purchase the following motor vehicles on 1 December 2016 and were given right of use of these vehicles immediately :

- three Mecedes Benz SLK 200 at a cost of R 4478 800 each of which is the same as the retail market value.

The executive directors also decided that their personal vehicles should be traded-in as deposits for the acquisition of the vehicles. The average trade-in value of each vehicle was approximately R 80,000. The accountant recommended that the cost of the vehicles should be reduced by the trade-in values for both financial reporting and income tax purposes.

All the vehicles were acquired in terms of a financing scheme at an interest of 3% above the Repo rate. The financial advisor to the organisation, Ms Penny Tight, was concerned about the risk exposure of the business. The financial advisor presented the extract below from the financial statement immediately prior to the acquisition of the vehicles:

	Capital value	Expected return
Equity including retained earnings	R 9,800,000	22%
Debt financial (long-term debt)	R5,200,000	12.5%

The organisation issued each executive with a “garage card” as all operating costs would be borne by the organisation including insurance for each of the executive’s vehicles estimated at R 3,000 per vehicle. The accountant recognised all the expenses as part of motor vehicle expenses for the organisation. The executive directors did not keep logbooks of the business and private mileage travelled.

Billings smashed his vehicle on 31 January 2017 in an accident and the insurance company regarded the vehicle as a total write-off. An insurance claim of R 400,000 was paid to the organisation on 15 February 2017. In terms of the Interpretation Note 47, the write off period for passenger vehicles is five years.

As a result of the change in venue and premises the business grew exponentially resulting in a profit, before the salaries of executives, to be R 6 million rand. The accountant recommended the following:

- each executive should take a salary of R 700,000;
- a dividend of R 1,500,000 should be declared(this was paid on 15 February 2017 ; and the
- shareholders’ debit loans of R 150,000(credit balance) should be written off as this represented the sacrifice made when the organisation did not make any profits.

The organisation pays medical aid costs amounting to R 6,000 per month on behalf of each executive. “The Chemist” incurred out-of-pocket medical costs of R 3,400 for his wife.

The Health Buzz Provident Fund Rules state that the employee contributes 7.5% of his/her basic salary and that the employer contributes 10% of the employees’ basic salary to the Health Buzz Provident Fund.

Aphiwe, an employee of Health Buzz had a basic salary of R45 000 per month, which remained constant for the entire 2017 year of assessment.

Aphiwe’s taxable income before any retirement contribution, tax deductions and retirement fringe benefit inclusions is R675 000 (correctly calculated) for the year of assessment ended 28 February 2017.

Aphiwe’s remuneration as defined in paragraph 1 of the Fourth Schedule, correctly calculated, amounted to R594 000 for the year of assessment ended 28 February 2017.

All amounts are exclusive of VAT unless otherwise stated.

<u>You are required to:</u>

Question 20:

Discuss whether the statement made by the accountant relating to the trade-in of the personal vehicles is correct in terms of the accounting standards and the Income Tax Act.

[4 marks]

<u>SUGGESTED SOLUTION:</u>

Financial reporting: The cost of an asset should represent the aggregate cost to acquire control of the asset and prepare it for its intended purposes. The trade-in of the value cannot reduce the cost of the asset but must be recognised as proceeds on disposal of the assets – however, as it was not the assets of the organisation, it should be recognised as a loan from the shareholders.	**3**
Income Tax: **No income tax consequences** as the trade in on their personal vehicles will be shown as a **liability (shareholders loans) raised against the purchase of the vehicle.**	**1** **1**
Therefore, the **statement made by the accountant** is **incorrect.**	**1**
	[max: 4]

Question 21:

Discuss the income tax implications for Health Buzz (Pty) Ltd of the distribution of the profits as recommended by the accountant.

[10 marks]

<u>SUGGESTED SOLUTION:</u>

Salaries - deduction of R700 000 x3 = **R2 100 000**	**1**

Dividend of R1 500 000 Dividends are exempt from dividends tax for certain beneficial owners listed in section 64F. Dividends to **natural persons are not exempt from dividends tax**. Health Buzz would have to withhold R1 500 000 x **15%/20%**= R225 000/R300 000 in dividends tax. As the **shareholders** are **natural persons, they are liable for the dividends tax**. The dividends paid by an unlisted company are deemed to be paid on the **earlier of the date on which the dividend is paid or becomes due and payable**. **Declared does not mean due and payable** therefore the earlier is the date the dividend was paid. Therefore the dividends are deemed to be paid on **15 February 2017**, the dividends tax of R225 000/R300 000 must be paid to SARS by **31 March 2017**; the last day of the month following the month in which the dividend is paid. If the dividends tax is paid after 31 March 2017 by Health Buzz (Pty) Ltd, **interest and penalties** will be incurred by them.	**1** **2 or 1** **1** **1** **1** **1** **1** **1**
Payback of Loan - **No income tax consequences** as there is **no income tax deduction**	**1,1**
	[max: 10]

Question 22:
Calculate and discuss the effects the financing strategy of the organisation on the weighted average cost of capital (WACC).

[5 marks]

SUGGESTED SOLUTION:

	Capital	Ratio	Expected return	After tax return	WACC	
Equity	9 800 000	60%	22%	22,0%	13,2%	**1.5**
Debt financial	5 200 000	32%	13%	9,0%	4,0%	**1.5**
Additional financing - debt	1 343 400	8%	14%	9,0%	1,2%	**2**
	16 343 400				18,3%	**1**
						[max: 5]

Question 23:
Calculate Aphiwe's taxable income for the 2017 year of assessment.

[7 marks]

SUGGESTED SOLUTION:

Taxable income before adjustments - given	**675 000**	**1**
Fringe Benefit – Employer Contributions to provident fund – R540 000 x 10% = R54 000	**54 000**	 **1**
	729 000	
Less : s11(k) (R54 000 + (R540 000 x 7,5%) = **R40 500**) = R94 500	-94 500	**1**
Lower of **R350 000** or 27,5% of the higher of Remuneration of **R594 000** and Taxable Income of **R729 000** (R729 000 x **27,5 %** = R200 475) -Lower of R350 000 and R200 475 = **R200 475** but limited to actual contributions of **R94 500**		 **1** **1,1P** **1** **1P** **1** **{Max 4}**
Taxable Income	634 500	
		[max: 7]

Question 24:

Record the journal entry relating to the fringe benefit arising from of the motor vehicle by Aphiwe in the accounting records of Health Buzz (Pty) Ltd for the 2017 year of assessment.

[4 marks]

SUGGESTED SOLUTION:

	Marks
Dr. Salaries and Wages (Expense) R330	**1**
Cr. VAT Control (Output tax) R330	**1**
R447 800 x **0.003** x **14/114** x **2 months** = R330	**1,1,1,1**
	Max 4