

**CASE STUDY 1****[55 marks]****PART A**

<ul style="list-style-type: none"> <li>• <i>Business must use either FIFO or weighted average to value inventory (cost formula)</i></li> </ul>	<b>1</b>
<ul style="list-style-type: none"> <li>• <i>Same cost formula must be used to value inventories which have a similar nature and use to an entity, memory cards for installation in cameras and tablets (raw materials) and that for sale are similar in nature (s13.18)</i></li> </ul>	<b>2</b>
<ul style="list-style-type: none"> <li>• <i>Memory cards installed in the cameras and tablets forms part of the cost of the finished product, and thus cannot be value separately – part of conversion costs (s13.8)</i></li> </ul>	<b>1</b>
<ul style="list-style-type: none"> <li>• <i>Therefore, Brooklyn Ltd could apply one cost formula to the memory cards sold as stand-alone to customers and another cost formula to the memory cards installed in cameras and tablets</i></li> </ul>	<b>1</b>
<ul style="list-style-type: none"> <li>• <i>This treatment is allowed since the memory card has a different use in each case</i></li> </ul>	<b>1</b>
	<b>(Max: 5)</b>

**PART B**

(a) Land & Buildings	
<ul style="list-style-type: none"> <li>• Land must be recognized separately from buildings, if their costs cannot be separately identified then the costs must be measured on a reasonable proportionate basis (s17.8)</li> </ul>	<b>2</b>
<ul style="list-style-type: none"> <li>• The property must be classified as an item of Property, Plant &amp; Equipment as it is used for business purposes – meets the definition (s17.2)</li> </ul>	<b>1</b>
<ul style="list-style-type: none"> <li>• The surplus resulting from the revaluation of the property based on the accounting policy, must be recognized as a revaluations surplus via the other comprehensive income (OCI) – surplus of R125 000</li> </ul>	<b>2</b>
<ul style="list-style-type: none"> <li>• Land must be valued at the residual amount of the total valuation of the property – R180 000 and R320 000 for land and buildings respectively</li> </ul>	<b>1</b>
	<b>(Max: 6)</b>

(b) Renovations		
• The renovations costs must be tested to determine whether its meets the definition of an asset – future economic benefits (s2.15(a))		1
• Renovations to the building increase its capacity and market value which contribute to the future economic benefits of the building		1
• Renovations must be capitalized as part of the cost of the buildings and not expensed as repairs and maintenance		1
• The cost capitalized is measured at the total amount paid, inclusive of VAT as the supplies was not from a registered vendor		<b>(Max: 3)</b>

(c) Damaged furniture		
Carrying amount at 01 Jan 2014	35,000	
Depreciation for 2014	<u>5,500</u>	
Carrying amount at 31 Dec 2014	29,500	
Recoverable amount – higher value	<u>26,000</u>	
Impairment loss	3,500	2
DR: Depreciation	5,500	
CR: Accumulated depreciation	5,500	1.5
DR: Impairment loss	3,500	
CR: Accumulated impairment loss	3,500	1.5
		<b>(Max: 5)</b>

(d) Disposal of motor vehicle		
Carrying amount at 1 Jan 2014	17,500	
Depreciation to 30 June 2014	<u>4,500</u>	
Carrying amount	13,000	
Selling price	<u>18,750</u>	
Profit on disposal	5,750	1
DR: Motor vehicle	18,750	
CR: Profit/Loss on Disposal	18,750	2

DR: Depreciation	4,500	
CR: Accumulated depreciation		4,500
DR: Accumulated depreciation	32,000	
DR: Profit/Loss on Disposal	13,000	
CR: Motor Vehicle		45,000
		<b>2</b>
		<b>(Max: 5)</b>

(e) Disclosure		
<b>BROOKLYN LTD</b>		
<b>STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2014</b>		
<b>ASSETS</b>		
<b>Non-current assets</b>		
Property, plant and equipment	778,990	<b>1</b>
<b>BROOKLYN LTD</b>		
<b>NOTES FOR THE YEAR ENDED 31 DECEMBER 2014</b>		
<b>1. Accounting policy</b>		
<b>1.1 Property, plant and equipment</b>		
Property, plant and equipment is stated at cost less accumulated depreciation, except for land which is not depreciated and which is carried at cost. The remaining assets are depreciated according to the following methods and rates:		<b>2</b>
• Furniture at 10% per annum according to the straight line method		
• Motor vehicles at 20% per annum according to the straight line method		
• Machinery at 20% per annum according to the diminishing balance method		<b>2</b>

**2. Property, plant and equipment**

	Land	Buildings	Machinery	Furniture	Vehicles	Total
Cost	135 000	240 000	37 500	55 000	150 000	617 500
Accumulated depreciation at 31 December 2013	-	-	16 700	20 000	77 500	114 200
Carrying amount at 31 December 2013	135 000	240 000	20 800	35 000	72 500	503 300
Revaluation surplus	45 000	80 000	-	-	-	125 000
Additions	-	-	157 500	-	-	157 500
Capitalition of renovation costs	-	68 400	-	-	-	68 400
Carrying amount of disposals	-	-	-	-	13 000	13 000
Depreciation	-	-	27 710	5 500	25 500	58 710
Impairment loss	-	-	-	3 500	-	3 500
Carrying amount at 31 December 2014	180 000	388 400	150 590	26 000	34 000	778 990

*Land consist of stand 130, Germiston purchased in 2010. On 31 December 2014 the fair value of the land was estimated at R500 000.*

1

2

2

1

1

1

4

1

2

1

(Max: 23)

**PART C****[8 MARKS]**

	2014	2013	
	2014	2013	
Leased asset	45 000	36 000	
Finance lease creditor	-47 250	-28 750	
Accrued interest	-4 850	-2 950	
Temporary difference	-7 100	4 300	
Deferred tax balance	-1 988	1 204	<b>2</b>
Movement for the period	3 192		<b>2</b>
31/12/13 DR: Taxation expense	1,204		<b>1</b>
CR: Deferred tax		1,204	<b>1</b>
31/12/14 DR: Deferred tax	3,192		<b>1</b>
CR: Taxation expense		3,192	<b>1</b>
			<b>(Max: 8)</b>

**CASE STUDY 2**

**[50 marks]**

**PART A**

**30 Marks**

	Marks
1. The <b>output tax on the export sales</b> has been <b>accounted for incorrectly</b> . <b>s11(1)(a)(i)</b> The <b>export sales will meet the criteria for zero rating</b> , therefore the output VAT at <b>0%</b> should be accounted for And not <b>R84 000 which is at the standard rate</b> .	1 1 1 1
2. The <b>output tax on the receipts from debtors</b> has been <b>accounted for incorrectly</b> . Receipts from debtors in respect of invoices relating to prior periods will have <b>no VAT implications as the _____ VAT output would have been accounted for in the November/December 2014 tax period</b> . <b>VAT is accounted for on the earlier of invoice or receipt of payment</b> . <b>s9(1)</b>	1 1 1
3. The <b>output tax on the insurance settlement with respects to the motor vehicle stolen</b> has been <b>accounted for incorrectly</b> . There is <b>no deemed supply/indemnity payment</b> where the payment relates to the <b>total reinstatement of goods for which an input tax deduction was denied</b> and such goods are <b>stolen or damaged beyond economic repair</b> . As the motor vehicle is a motor car as defined therefore the <b>input tax was denied and it was stolen, there are no output tax consequences for Design Limited</b> . However, the trading stock even though it was stolen, <b>the input tax was not denied, therefore there are output tax consequences</b> . <b>The output tax on the insurance settlement relating to the trading stock has been correctly accounted for</b> . <b>s8(8)</b>	1 1,1,1 1,1 1,1 1
4. <b>Output tax is levied on goods imported</b> ; however where a clearing agent is used no output tax will reflected on the VAT 201 as the clearing agent collects the VAT from Design Limited and pays the VAT levied on the transaction over to SARS. Therefore, <b>no VAT output on the VAT 201 return on the importation of the machine is correct</b> . <b>s7(1)(b)</b> As Design Limited is a registered vendor, they will be able to claim an input tax deduction on the importation of the machine. However even though the <b>input tax deduction has been claimed correctly, the amount is incorrectly calculated</b> . <b>s16</b> The correct input tax deduction is based on the customs duty value of <b>R450 000</b> and the amount is $R450\ 000 + (R450\ 000 \times 10\%)$ $= R495\ 000 \times 14\%$ $= R69\ 300$ . The correct amount to have claimed was R69 300 and not the R44 688 <b>s13(2)(a)</b>  The <b>export sales are zero rated</b> and <b>s11(1)(a)(i)</b> <b>Zero rated goods are regarded as taxable supplies</b> . Therefore Design Limited is making a 100% taxable supplies. As Design Limited is making a 100% taxable supplies, therefore R69 300 <b>is not apportioned to the extent of taxable supplies</b> . <b>s16</b>	1 1 1,1 0,5 0,5 0,5 0,5 1 1 1
5. The <b>input tax deduction on the Toyota double cab bakkie</b> has been <b>claimed incorrectly</b> . The Toyota double cab bakkie is a <b>motor car as defined</b> and therefore an <b>input tax deduction is denied</b> . <b>s17(2)(c)</b>	1 1
6. Originally an input tax deduction of $R31\ 920 \times 14/114 = R3\ 920$ was <b>claimed</b> in the January/February 2014 _____ VA period.  <b>Outstanding creditor's balances that are not settled within 12 months from the end of the tax period in which the input tax deduction was claimed (end of February 2014), consequently VAT output must be _____ levied on the transaction</b> . <b>s22(3)</b>  <b>The VAT output of R3 920 must be paid in the tax period following the expiry of the 12 months, which is _____ the March/April 2015 tax period</b> . <b>s22(3)</b>  <b>Therefore, the VAT output on the outstanding creditors balances longer that 12 months has been _____ accounted for incorrectly</b> .	1 1 1 1
7. The <b>input tax deduction on the petrol</b> has been <b>claimed incorrectly</b> . <b>Petrol is zero rated</b> and the <b>input tax deduction is claimed at a standard rate</b> . <b>s11(1)(h)</b>	1 1,1
<b>Available</b>	<b>33</b>
<b>Maximum</b>	<b>30</b>

## PART B

20 Marks

	Notes	R	Marks
Salary (R120 000 X 12)		1 440 000	1
Employer's contribution to provident fund - <b>not a fringe benefit or para 2(h) and 13 of Seventh Schedule</b>		nil	1
Employer's contribution to medical aid - para 2(i) and 12A (R3 700 x12)		44 400	1
Right of use of a motor vehicle para 2(b) and 7	1	135 013	
Housing subsidy - para 2(g) and 12 (R1 600x12)		19 200	1
Re-imbursed cell phone and internet allowance - <b>not taxable as reimbursive allowance or s8(1)(a)(ii)</b>		nil	1
Bursary - <b>not taxable in Ashley's income or para 16 of Seventh Schedule not applicable</b>		nil	1
		1 638 613	
Less: Provident fund contributions - <b>no deduction allowed or s11(k)</b>		nil	1
<b>Taxable Income</b>		1 638 613	
<b>Normal tax payable</b>			
R195 212 + ((R1 638 613 - R673 100) * 40%)		581 417	1P
Primary rebate		-12 726	1
Medical scheme fees tax credit - s 6A			
Medical rebate - s 6A ((R257 *2) + (R172 *3) * 12)) - Jeff,Kate and the 2 children are dependants on the medical aid.		-12 360	2.5
Additional medical expenses tax credit - s 6B		0	
In terms of S6B, the definition of dependant- (c)- any other member of a person's family iro whom he or she is liable for family care and support. Therefore Kate is a dependant for the purposes of s6B.	s6B(3)(b)		
Step 1: Total Contributions to Medical Scheme ((R3 700 *12) + (R3 500 *12))	86 400		1
Step 2: LESS 4 x Section 6A rebate (4 x 12 360)	-49 440		1P
	36 960		
Step 3: PLUS qualifying medical expenditure - paid (R30 560 + R45 000)=	75 560		1+1
	112 520		
Step 4: LESS 7.5% of Taxable Income(R1 638 613)	-122 896		1P
	0		
Step 5: Multiply BALANCE by 25%	0		1
<b>Normal tax liability</b>		556 331	
<b>Notes</b>			
<b>1. Use of a motor vehicle</b>	par7(6)	135 013	
- Operating lease			
12 x (R10 260 + R6 000) = R195 120	par 7(4)(a)(ii)		2
Less : R195 120 x 9 200/29 685 = -R 60 107	par 7(7))		2
		<b>Total</b>	<b>21.5</b>
		<b>Max</b>	<b>20</b>

**CASE STUDY 3****[45 marks]**

(a) Statement of Cash Flow		
THE FRIENDLY CROCER		
Statement of cash flow for the reporting period ended 28 February 2015		
<b>CASH GENERATED FROM OPERATING ACTIVITIES</b>		
Cash received from customers	1 465 300	1
Cash paid to suppliers and employees	1 000 500	3
Cash generated from operations	464 800	1
Interest paid	18 000	1
Taxation paid	146 850	1
Cash generated from operating activities	299 950	1
		<b>(Ma: 8)</b>



<p>(b) Professional Accountant</p> <ul style="list-style-type: none"> <li>• Lack of sufficient resources: Based on the size of the company, i.e. 5 distribution outlets, a single professional accountant working part time is insufficient to provide an adequate finance function.</li> <li>• Lack of segregation of duties: The professional accountant is responsible for preparing the budget, preparing payment requisitions, authorising all payments, identifying and presenting variances to the budget to management indicating a lack of segregation of duties. This could also pose a fraud risk to The Friendly Grocer.</li> <li>• Work ethic of professional accountant: From the scenario, there are potential red flags which indicate a potential fraud risk. These include that Bruce often works unusually long working hours for a part time employee, he has refused assistance in his role and has refused to be made a full time employee and has also not taken leave in three years. Bruce is also a single dad with great financial responsibility and is pressured to meet month end expenses.</li> <li>• Inappropriate and inaccurate documentation/budgets being maintained: Bruce prepares the budget using his own excel spreadsheets and management has often complained about errors and discrepancies. This is as a result of a lack of standardised management accounting systems and procedures.</li> <li>• Management incentive to commit fraud: The individual bonus of sales managers is based on sales targets which incentivises management to manipulate sales figures to meet targets.</li> <li>• Lack of goal congruence: The Friendly Grocer has found that often the managers secure work from several major clients early in the year and reach their targets well before the year has ended. They then make little effort to secure extra fees for the company for the rest of the year. This indicates that the personal goals of managers to achieve their bonus is not aligned to sustainable growth goals of the entity.</li> </ul>	<p>2</p> <p>3</p> <p>2</p> <p>2</p> <p>2</p> <p>2</p> <p><b>(Max: 10)</b></p>
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(c) Audit steps to follow- Sales and returns

Cut-off

- Agree the last ten transactions per the till slips to the sales journal to ensure it has been recorded in the correct period.
- Agree the first ten transactions of the new period per the till slips/invoices to the sales journal to ensure it has been recorded in the correct period and not in the 2014 records.
- Understand whether there is any deliveries in progress at year end and if so how have these transactions been accounted for. Ensure that these are recorded in the correct period.

Occurrence

- Agree a sample of transactions per the sales journal to invoices/till slips to ensure that these have occurred.

Accuracy

- Agree a sample of sales invoices to customer order to verify that the correct product has been included on the invoice.
- Agree the per unit price on a sample of invoices to an authorised price list to confirm the accuracy thereof.
- Inspect a sample of invoices and recast for accuracy.
- Inspect a sample of invoices and ensure that VAT has been correctly accounted for and trace to the sales journal to ensure this has not been included.
- Agree a sample of invoices to the sales journals to ensure the correct amount has been recorded.

Sales returns

- Understand the sales returns process of the entity.
- Perform cut off tests and accuracy tests as above for sales returns to ensure all returns are recorded in the correct period and at the correct amounts.

**(Max: 10)**

(d) Financial Analysis

Average Inventory holding period :

$$2015 = \frac{(180\,000+160\,000)/2}{860\,000} \times 365$$

= 72 days

$$2014 = \frac{(160\,000+130\,000)/2}{540\,000} \times 365$$

=98 days

The average inventory holding period appears excessively long even though it has decreased from 2013 to 2014. In 2014 inventory is held for approximately 72 days which is in excess of the useful life of most perishable goods which are sold at a grocer. This may be indicative of incorrect financial information being reported.

4

Average settlement period from receivables

$$2015 = \frac{210\,500}{1500\,000 \times 65\%} \times 365$$

= 79 days

$$2014 = \frac{175\,800}{900\,000 \times 65\%} \times 365$$

=110 days

The average settlement period for receivables has decreased from 2013 to 2014 which will have a positive impact on cash flows of The Friendly Grocer however this may still be improved. As it is shorter than the average settlement period for payables this is acceptable.

4

Average settlement period for payables

$$\text{2015} = \frac{234\,500}{(860\,000+180\,000-160\,000)} \times 365$$

= 97 days

$$\text{2014} = \frac{260\,000}{(540\,000+160\,000-130\,000)} \times 365$$

= 167 days

The average settlement period for payables has decreased quite significantly from 167 days to 97 days. This may indicate a deteriorating relationship with suppliers and should be further investigated as it can put pressure on cash flows. However as the average settlement period for payables is longer than the average period for receivables the ratio is acceptable.

4

Acid Test Ratio

$$\text{2015} = \frac{(494\,900 - 180\,000)}{492\,000} = 0.64:1$$

$$\text{2014} = \frac{(433\,500 - 160\,000)}{490\,800} = 0.56:1$$

The acid test ratio has increased from the prior year from 0.56:1 to 0.64:1 however these ratios are indicative of the company's ability to convert its current assets to pay off its current liabilities and as the ratio is below 1 it indicates that the current liabilities will not be settled only with current assets. The Friendly Grocer should aim to reduce current liabilities to enhance the ratio.

4

Debt: Equity Ratio

$$\begin{aligned} \mathbf{2015} &= \frac{(223\,000+492\,000)}{939\,900} \\ &= 0.76:1 \end{aligned}$$

$$\begin{aligned} \mathbf{2014} &= \frac{(490\,800+187\,000)}{1581\,000} \\ &= 0.43:1 \end{aligned}$$

The debt to equity ratio has increased from 0.43:1 to 0.76: 1 in the current year indicating that the company has taken out more debt in the current year. This should not be viewed necessarily in a negative light as it would depend on what the debt is to be used for. If the debt is cheaper to employ compared to equity and the company intends to expand this would be positive. However in light of the weak acid test ratio the entity should consider its debt commitments. Additionally consideration must be given to any existing debt covenants to ensure they are not breached.