PROFESSIONAL EVALUATION
IPD - COMPETENCY-BASED ASSESSMENT
ENGLISH QUESTION PAPER
6 MAY 2017

TIME: **4h30min**
MARKS: **200**

CASE STUDY		MARKS
	MULTIPLE CHOICE QUESTIONS	50
	CASE STUDY QUESTIONS	150
TOTAL		200

INSTRUCTIONS TO CANDIDATES

1. Answer all the questions.
2. **<u>BEGIN EACH QUESTION ON A NEW PAGE.</u>**
3. The multiple choice questions must be answered in pencil on the schedule provided. (MCQ answersheet)
4. The case study questions must be answered in the answer book.
5. No pencil (with the exception of MCQ's) or tippex may be used.
6. Financial calculators are permitted.
7. Cellular phones may **NOT** be used as calculators.
8. If you wish any part of your work not to be marked, draw a clear line through it.
9. The question paper may be taken with you at the end of the examination.

CASE STUDY

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

Background:

In the south of Johannesburg, you will find Lenasia, a small town typical of most Gauteng communities of its size with a thriving central business district. Cheslin "The Doc", Dolfie "The Chemist" and Billings "The Beef" are three childhood friends who have always shown an entrepreneurial streak from a young age. 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 because of good behaviour and was surprised to find his friends planning their social entrepreneurship venture. 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 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, development, health care and fitness into a one-stop-shop. The vision of this one-stop shop will 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, in order for him to apply his competencies in pharmacy and health care.

(b) 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 actively promotes a healthy lifestyle.

(c) 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 sportsman.

The social entrepreneurs leased premises in a shopping complex in the area. 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 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 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 to take on the added responsibilities. Mulla had trust in Sarafina and would usually allow her to take on the added duties and responsibilities.

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 and Mulla agreed.

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. 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 protective of the various tasks she performed; and this was noticed by the others when they were not allowed to input information or obtain free access to the accounting data base. When an employee needed to work with the data only Sarafina handled this. She would find it, extract it from the file and personally hand it to the employee who would need to give it back to her. In addition, after the daily reconciliation was completed and cash receipts had been placed into the bank deposit bag, only Sarafina was allowed to make change for queries from customers. It was also noticed by the other employees that Sarafina would become very nervous and agitated and would not enter the tax information into the computer whenever another employee was in close proximity.

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

In addition to the changes in Sarafina's behavior in the performance of her duties, employees noticed that she carried large amounts of cash in her purse and would pay for business expenses using this cash, but she would never request reimbursements. In September 2015, Sarafina's husband, Charles became very ill which required her taking family leave. During this time her work was performed by other employees. They did not take note of anything unusual regarding the cash sheets, deposit or reconciliations. However, on a Monday the employees noticed that the computer had an error message, which indicated that it had been turned on but not shut down correctly. Sarafina is the only one who comes into the office on a Saturday to enter the tax receipts so they realized it was her. The clerk who had prepared the cash sheet on Friday noted that changes had been made to it. 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 on previous cash sheets that she had prepared and when she questioned Sarafina (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 should not be too concerned. However, this time she was certain she had not made a mistake since her cash sheet and cash receipts had balanced which could be testified by another clerk. The clerk was disturbed because whoever had made the changes was trying hard to make the writing similar to the previous receipts, which reflected the unchanged numbers. The clerk asked Mulla about why the change was made and Mulla could not give a reason. A 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 about the change and as previously, she 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. Mulla further discovered that during the current reporting period Sarafina had taken more than R 200,000 so she had no choice but to file a complaint with the police against Sarafina. She then proceeded to file a lawsuit and lawyers instructed her to tally as much of the losses. She also contacted SAIPA to initiate a disciplinary investigation.

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 be:
(a) destroyed and a new cash sheet should be prepared
(b) initial be the person checking the cash sheets
(c) initialled 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 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 the SAIPA Legal Department, Mulla appointed Sizwe Moloi, Professional Accountant (SA) 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 classified as 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 above 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 completed learnership registration number 20391, giving rise to the Professional Accountant (SA) designation, is a currently registered qualification with SAQA at:
(a) not recognized on the NQF
(b) NQF Level 7
(c) NQF Level 8
(d) the same NQF Level as all professional accounting organisations

MCQ 15:
A supplier to Health Buzz (Pty) Limited requested a BBBEE certificate for Health Buzz (Pty) Limited. Which of the following statement/s is/are correct?

(a) As Mulla is a Professional Accountant (SA), and in the employ of Health Buzz, she is entitled to issue a level 1 BBBEE certificate
(b) As all the shareholders are black South Africans, the annual turnover is not a consideration for BBBEE certification purposes
(c) Both (a) and (b) is correct
(d) Neither (a) nor (b) is correct

MCQ 16:
Health Buzz (Pty) Limited was incorporated and issued with a Certificate to Commence Business by the 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 an Annual Return and calculated Annual Duties on its anniversary date each year, with the CIPC
(b) As Health Buzz 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

Read the following section and use it to answer MCQ 17 to MCQ 23:

Dolfie’s sister-in-law, a trial period member of the gym, injured herself while using the new gym equipment and required major surgery. She then 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 a legal channel. The attorney, indicated there was a possibility of a 50% chance of winning the case against the member, or
(b) negotiate an out-of-court settlement for a reduced compensation amount.

Billings was of the opinion that the member performed exercises recklessly and so the terms and conditions do not cover the injuries suffered. He decided to pursue the legal route as he was confident of winning the case and has accordingly appointed attorneys (registered VAT vendors) to pursue the matter. At the reporting date, 28 February 2017, the organisation’s attorneys estimated that the organisation has a 40% chance of being ordered to pay the member compensation of R 180,000 and a 60% chance of being ordered to pay compensation of R 400,000. The ruling for the case is expected to be finalised 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 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 the Compensation Fund:
(a) all the members of the gym are covered against injury
(b) only the employees of the Company are covered against on-the-job injury
(c) only the directors of the Company are covered against injury on duty
(d) None of the above statements are true

MCQ 23:
Sarafina stated future lawsuits, due to injuries in the gym, can be avoided by implementing 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 Accountants (SA) providing professional services in the Republic of 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 in the Employment 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 service
(d) All of the above

[GRAND TOTAL: 50]

CASE STUDY QUESTIONS

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	-

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]

Read the following section and answer questions 3 to 7:

Health and meals supplements segment:

The health meals prepared were the brainchild of Dolfie and changed constantly due his experimentation. These experiments were regularly conducted in order to improve the quality, taste and health benefits of the different meals. He developed a healthy diet meal which would ensure a minimum weight loss of 4 kg per week without any rigorous exercise. He had been working on this recipe before the business was officially established, but increased his efforts since the incorporation of the business. During the current reporting period the recipe was finalised and the results proved that 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 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 to inform the franchiser that the extension option would be exercised and placed the R 2 million as 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.

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]

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

[7 marks]

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

[2 marks]

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]

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]

Read the following section and answer question 8 – 11:

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 head ache tablet that was called “PainAway”. The bars are wrapped and packed in cartons containing 50 tablets with each carton as 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 assumed to represent the costs and productive efficiency that may be expected in the next few quarters. There were 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

Question 8:
Calculate the fixed and variable cost components for cost of sales and expenses using the High-Low method.

[8 marks]

Question 9:
Management would like to know the break-even point in terms of quarterly carton sales for the tablets (in units).

[5 marks]

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]

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]

Read the following section and answer question 12 – 14:

> ***Expansion strategy:***
>
> After a strategic meeting between the directors and the CFO, it was decided 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. 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 shopping complex which had a higher level of consumer traffic and fulfilling 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 the lease agreement should continue up 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.

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]

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]

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

[3 marks]

Read the following section and answer questions 15 – 19:

Health & Fitness:

In the old premises Billings had designed and constructed a home-made gym with training equipment. So for the new premises he decided to take responsibility for the layout and design. He designed and constructed the gym to blend in with the image of the new design in which 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 R600 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 attract the niche market of young professionals.
- The gym contract costs R250 per person every month and loyalty points will be rewarded based on the period of the contract taken out by the client. An additional month would be granted for every six months. 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 for more than a year would 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.

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]

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]

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]

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]

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]

Read the following section and answer questions 20 – 24:

Corporate image

The executive directors approved the new corporate image as recommended by the marketing consultants. Billings stated that the executives should also reflect the corporate image 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 447 800 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 further recognised all the expenses as part of motor vehicle expenses. The executive directors were not required to keep logbooks.

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, of 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 Rulebook states 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.

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]

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]

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

[5 marks]

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

[7 marks]

Question 24:
Record the journal entry relating to the fringe benefit arising from of the motor vehicle by Billings (Director) in the accounting records of Health Buzz (Pty) Ltd for the 2017 year of assessment.

[4 marks]

[GRAND TOTAL: 150]

ANNEXURE

TABLE 1

RATES OF NORMAL TAX PAYABLE BY PERSONS OTHER THAN COMPANIES AND TRUSTS (BUT INCLUDING SPECIAL TRUSTS AS WELL AS INSOLVENT AND DECEASED ESTATES) IN RESPECT OF YEARS OF ASSESSMENT ENDING 28 FEBRUARY 2017

Taxable Income		**Rates of Tax**
From **R**	**But does not exceed** **R**	**R**
0	188 000	0 + 18% of each R1
188 001	293 600	33 840 + 26% of the amount above 188 000
293 601	406 400	61 296 + 31% of the amount above 293 600
406 401	550 100	96 264 + 36% of the amount above 406 400
550 101	701 300	147 996 + 39% of the amount above 550 100
701 301		206 964 + 41% of the amount above 701 300

TABLE 2

TURNOVER TAX DUE BY MICRO BUSINESSES IN RESPECT OF YEARS OF ASSESSMENT ENDING 28 FEBRUARY 2017

Turnover		Rates of Tax
From R	But does not exceed R	R
0	335 000	0
335 001	500 000	0 + 1% of the amount above 335 000
500 001	750 000	1 650 + 2% of the amount above 500 000
750 001	1 000 000	6 650 + 3% of the amount above 750 000

TABLE 3

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

Financial years ending during the period of twelve months ending 31 March 2017

Type of company	Rate of tax
Small business corporations	
Taxable income:	
R0 – R75 000	0%
R75 001 – R365 000	7% of the amount over R75 000
R365 001 – R550 000	R20 300 + 21% of the amount over R365 000
Exceeding R550 000	R59 150 + 28% of the amount over R550 000
Personal service provider companies	28%
Companies	28%
Dividends Tax (effective from 1 April 2012)	15%
Dividends Tax (effective from 22 February 2017)	20%

TABLE 4

REBATES: YEARS OF ASSESSMENT ENDED LAST DAY OF FEBRUARY

	2017 **R**
Primary	13 500
Secondary (65 years of age or older)	7 407
Tertiary (75 years of age or older)	2 466

TABLE 5

MEDICAL SCHEME FEES TAX CREDITS: YEARS OF ASSESSMENT ENDED LAST DAY OF FEBRUARY

Under 65 years	**2017** **R**
Taxpayer only	286 per month
Taxpayer plus one dependent	572 per month
Additional dependants	192 per month

TABLE 6

SCALE OF VALUES - TRAVEL ALLOWANCE

Value of the vehicle	Fixed cost	Fuel cost	Maintenance cost
R	**R per annum**	**c per km**	**c per km**
0 – 80 000	26 675	82.4	30.8
80 001 – 160 000	47 644	92.0	38.6
160 001 – 240 000	68 684	100.0	42.5
240 001 – 320 000	87 223	107.5	46.4
320 001 – 400 000	105 822	115.0	54.5
400 001 – 480 000	125 303	132.0	64.0
480 001 – 560 000	144 784	136.5	79.5
Exceeding 560 000	144 784	136.5	79.5

TABLE 7

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

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

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

TABLE 8

TABLE OF TAX LIABILITY ON RETIREMENT FUND LUMP-SUM BENEFITS IN RESPECT OF YEARS OF ASSESSMENT ENDING 28 FEBRUARY 2017

Taxable amount	**Rate of tax**
Up to R500 000	0% of taxable income
Exceeds R500 000 but not R700 000	R0 + 18% of taxable amount above R500 000
Exceeds R700 000 but not R1 050 000	R36 000 + 27% of taxable amount above R700 000
Exceeds R1 050 000	R130 500 + 36% of taxable amount above R1 050 000

TABLE 9

TABLE OF TAX LIABILITY ON RETIREMENT LUMP-SUM WITHDRAWAL BENEFITS IN RESPECT OF YEARS OF ASSESSMENT ENDING 28 FEBRUARY 2017

Taxable amount	**Rate of tax**
not exceeding R25 000	0% of taxable income
Exceeds R25 000 but not R660 000	R0 + 18% of taxable amount above R25 000
Exceeds R660 000 but not R990 000	R114 300 + 27% of taxable amount above R660 000
Exceeds R990 000	R203 400 + 36% of taxable amount above R990 000

TABLE 10

PRESCRIBED INTEREST RATES FOR FRINGE BENEFITS (per annum)

From 1/03/2011	6.5%
From 1/08/2012	6%
From 1/02/2014	6.5%
From 1/08/2014	6.75%
From 1/08/2015	7%
From 1/12/2015	7.25%
From 1/02/2016	7.75%
From 1/04/2016	8%