PROFESSIONAL EVALUATION
IPD - COMPETENCY-BASED ASSESSMENT
ENGLISH QUESTION PAPER
4 November 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. **BEGIN EACH QUESTION ON A NEW PAGE.**
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 all questions

COMPANY BACKGROUND

Penny-Dreadful (Pty) Limited (hereafter referred to as Penny Dreadful) is over a 160 year-old company that operates a large number of national departmental stores. It was instrumental in establishing the mushrooming concepts of shopping malls. Penny Dreadful is known as the "Harrods of South Africa". The departmental chain stores of Penny-Dreadful are located at all the trendy malls of Johannesburg, such as Sandton City Shopping Centre, Melrose Arch and Rosebank, to name a few. When entering any one of these stores customers feel like they are shopping in some of the most exclusive shopping destinations of the world, like New York, London or Paris.

The image development of the company was led by former CEO, Ahmed Essop. His main objective was to reposition the stores as a high-end retailer which showcased international brands such as, Gap, Ben Sherman, Ted Baker, Banana Republic and Tommy Hilfiger. Over the last couple of years the company has become the go-to department store in the country, like Bloomingdale's in New York or Selfridges in London. Prior to 2008 and approximately during the early part of 2011 market conditions were favourable as retailers eagerly dished out credit to consumers. The domestic economy had a growth rate above 4% with the Rand trading between R6.38 and R8.65 to the dollar. Penny-Dreadful imports most of its merchandise and at the time the relative strength of the Rand supported its current business strategy.

Ahmed Essop adopted an authoritarian style in the management of the company, by forcing his plans and actions on senior management irrespective of the policies and procedures in the company as his ultimate goal was driven by the desire to achieve results. One such example of his management style, was that he instructed the Financial Manager and CFO to process a payment of R1 million to a supplier, even though no contract was concluded and the procurement procedures were not complied with. Fortunately, in this case, the payment of the supplier yielded positive results and contributed positively to the profits of the business. This was vital as the bonuses of the management team is based on these profits.

At the turn of the century, the fortunes of the company began to decline. This also affected other department store formats, which was as a direct result of globalisation and bi-lateral economic trade agreements. The company's problems were exacerbated in 2008 when management, led by former CEO Ahmed Essop, incurred large investments in upgrading its stores securing a footprint in more high-end shopping malls. The enforcing in sale of international brands at Penny-Dreadful was a huge failure and the company lost a considerable value in market share to its peers, Emam Dollous and his company. This coupled with South Africa's tough retail market took a considerable knock on Penny-

Dreadful. An analysis of the staffing logistics revealed that staff in every section of the store were often standing idle. It was also found that there were more security guards than shoppers. As one staff member states: “It is so quiet because there are no customers. It is as if we are not even heading into the busy festive season.”

The global financial crisis of 2008/9 severely affected Penny-Dreadful, as many cash-strapped consumers made drastic changes to their shopping behaviours, opting for lower-priced goods. The major shareholders were not satisfied with the performance of Ahmed Essop and rallied the other shareholders to dismiss him. They strongly felt that his behaviour was not protecting the interests and not focused on wealth creation for the shareholders. The CFO who was appointed as acting CE recommended that the additional equity capital be raised to re-establish the business based on its core competence. A proposal was received by a consortium led by the Omarjee-Nolus brothers and venture capitalist firm, Reddy’s and other angle investors to acquire the shares from the major shareholder.

FINANCIAL STATEMENT ENGAGEMENT:

The company required a Review of its financial statements in terms of the public interest score. The CFO (Mr. Letsgo) recommended that the firm of Professional Accountants (SA) be appointed to perform the Review as well as assist in preparing the financial statements. The firm was appointed due to its previous engagement with the company in providing advice to the company relating to tax and labour related matters which often resulted in the company complying with regulations and saving on penalties. The accountant, Ms. Georgie, stated that the accounting department prepared all the supporting schedules and working papers for the financial statement engagement. She, therefore, could not understand why the Professional Accountants firm claimed that the working papers are their property. Ms. Georgie also stated that if the accounting department misplaced the schedules or working papers then the Professional Accountants firm is obligated to provide them with copies thereof.

MARKETING EXPENSES

The CFO raised questions with the board about the expenses incurred by the company’s chief buyer (Ahmed Essop’s wife). She travelled to New York for 6 days to meet with overseas suppliers, such as, GAP and Banana Republic. He raised these concerns as it was clearly noted that the trip coincided with the music awards which was attended by the Essop family. The reason provided by Ahmed Essop, for the all-expense trip taken, was that the chief buyer needed to negotiate better prices and look at trendy merchandise that was suitable for the South African market. The CFO raised his concerns, because he consulted with a tax adviser Ms. Jessica Kamdow, who indicated that the costs may not be allowed in terms of Section 11(a) of the Income Tax Act.

Penny-Dreadful incurred the following as set out below:

Description	Rand value
Hotel accommodation in New York - $4 200 (inclusive of USA VAT @ 15%)	55 650
Car rental - $1 200 (inclusive of USA VAT of @ 15%)	15 900
Meals and alcoholic beverages - $1 500 (inclusive of USA VAT of @ 15%)	19 875
Total	91 425

The company also paid R16 000 (inclusive of VAT) to Virgin Airlines for the overseas airfare.

RISK MANAGEMENT

The Acting CE, Mr. Gigabantu recommended that the organisation should appoint a Risk Management team, under the leadership of Ms. Ragina, with the specific objective of ensuring the risk environment. Mr. Gigabantu stated that every employee of the organisation should embrace the concept of being risk champions. Ms. Ragina stated that, the governance and compliance aspects, are key to the development of a risk register and risk metrics. The risk register prioritises and ranks the risk based on the impact it has on the strategic goals and objectives of the organisation. The accounting and finance departments were requested that they should develop and implement quality control procedures in compliance with ISQC 1. Critical components of ISQC 1 are the competency of the staff and the monitoring and evaluation process (appraisal linked to key performance indicators – KPI). The chief accountant, a newly qualified Professional Accountant, stated that ISQC 1 is specifically for practitioners and therefore does not relate to the accounting departments in commerce and industry. Within the accounting department the appraisal of KPI’s are linked to the performance management system in respect of the performance of the staff and therefore does not refer to ISQC 1.

EXTRACT FROM THE FINANCIAL STATEMENTS:

ACCOUNTING OFFICER'S REPORT
To PENNY DREADFUL CC – AHMED J. ESSOP (CEO)

We have performed the duties of accounting officer to PENNY DREADFUL CC as required by Section 62 of the Close Corporations Act, 1984. Accordingly we do not imply or express an opinion or any other form of assurance on the annual financial statements.

Compilation engagement

In addition to our duties as accounting officer and on the basis of information provided by the member, we have compiled, in accordance with the International Standards on Related Services applicable to compilation engagements, the annual financial statements set out on pages 3 to 9 for the year ended 29 February 2016.

These annual financial statements comprise of the statement of financial position as at 29 February 2016, statement of comprehensive and other income and statement of cash flows for the year then ended. The members are responsible for these annual financial statements.

Duties of accounting officer

We have determined that the annual financial statements are in agreement with the accounting records, summarized in the manner required by section 58(2)(d) of the Act and have done so by adopting such procedures and conducting such enquiries in relation to the accounting records as we considered necessary in the circumstances. We have also reviewed the accounting policies which have been represented to us as having been applied in the preparation of the annual financial statements, and we consider that they are appropriate to the business.

It is our duty to report that the fair values of the liabilities of the company exceed its assets.

Essop Accounting Officers Inc.
14 October 2016

MULTIPLE CHOICE QUESTIONS

The information provided under the Company Background should be used to answer Question 1 to 7.

QUESTION 1:
The management style of Ahmed J. Essop ensures that the company remained competitive in achieving its projected results, but his management style also tends to encourage:
(a) conflict within the management team
(b) promoting the interest of the business at all costs
(c) bending of the rules to facilitate effective decision making
(d) non-compliance of corporate governance

QUESTION 2:
The fact that the financial manager and CFO (both qualified professionals) approved and processed the payment of R 1 million implies that they acted in:
(a) interest of the company in achieving its goals
(b) violation of the Code of Professional Conduct and Ethical Behaviour
(c) protection of self-interest
(d) compliance to culture of governance of the company

QUESTION 3:
The CFO approached you about the matter and requested your advice as to how the request for the payment should be managed to ensure that he does not jeopardise his professional designation and status. The procedures to follow should be in terms of:
(a) Provisions and Standards for Reportable Irregularities
(b) Whistleblowing regulations
(c) NOCLAR
(d) FICA

QUESTION 4:
The financial manager is not happy with the decision of the CFO in appointing the firm of accountants to perform a Review based on the public interest score of the company. The financial manager further recommended that an audit is more appropriate for the company, as this was done before by Ahmed Essop and was also employed by the CE of the company. Is it acceptable for the company to continue to have its financial statements Reviewed on the following basis?
(a) costs less than an audit
(b) PI score is within the scope of a Review
(c) audit will make the financial statements more credible
(d) PI score recommends a Review and the MOI does not require an audit

QUESTION 5:

The objective of a Review of the financial statements are to:

(a) express an opinion on the financial statement
(b) provide assurance that the financial statements comply with IFRS for SME's
(c) provide assurance that there are no material misstatements in the financial statements
(d) provide assurance that the financial statements are reliable and accurate

QUESTION 6:

When the financial statements are Reviewed the following report(s) issued by the Professional Accountants must be attached to the financial statements:

(a) Independent Review report
(b) Accounting Officer's report
(c) Compilation report
(d) (a) and (c)

QUESTION 7:

When the Professional Accountant firm accepts the engagement to assist with the preparation of the financial statements, the least of its considerations should be:

(a) violation of independence
(b) ethical dilemma and behaviour
(c) the addition income that can be generated
(d) Code of Professional Conduct

The information provided under the Marketing Expenses should be used to answer Question 8 to 11.

QUESTION 8:
The input tax that can be claimed on the expenses incurred in New York (excluding the flight costs) amounts to:
(a) R 11 925,00
(b) R 13 713,75
(c) R 11 227,63
(d) zero

QUESTION 9:
The working papers and schedules are the property of the Professional Accountants firm because:
(a) printed on the letterheads of the firm
(b) evidence to support the work completed for the engagement
(c) proof of work to be charged
(d) requirement in terms of the standards and regulations

QUESTION 10:
The amount that can be deducted for income tax purposes in respect of the expenses including the flight costs amounts to:
(a) R 107 425,00
(b) R 105 460,09
(c) R 94 232,46
(d) None of the above

QUESTION 11:
If the chief buyer travelled to Cape Town to meet suppliers, the input tax claimed in respect of the accommodation and meals will:
(a) not be allowed because the expenses are defined as entertainment
(b) allowed because the buyer is away from home doing work for the company
(c) allowed because the buyer is away from home and work for at least one night for business purpose
(d) Allowed because the company paid the expenses as per the invoice

The information provided under the Risk Management should be used to answer Question 12 to 14.

QUESTION 12:

Risk management in an organisation should be the responsibility of:

(a) the risk management department
(b) the board of directors
(c) senior management
(d) all the employees of the organisation

QUESTION 13:

The risk management strategy of the organisation should be focused on the operations of and the environment in which the organisation operates. The fundamental pillars of the risk management strategy should include:

(a) compliance to policies and procedures
(b) compliance to regulations and legislation
(c) corporate governance
(d) continuous evaluation of potential risks (financial and non-financial) to the organisation

QUESTION 14:

The component of appraisal in ISQC1 refers to the evaluation of:

(a) performance of the staff
(b) quality of work performed
(c) preparation of financial statements in compliance with the appropriate accounting framework
(d) not applicable to the accounting departments in commerce and industry

The information provided under the Accounting Officer's Report should be used to answer Question 15 to 20.

QUESTION 15:

Which of the following statements is part of the duties of the duly appointed accounting officer of the CC:

(a) to file the annual income tax return and pay the taxes due
(b) to file the annual returns required by CIPC
(c) to do the books of the close corporation
(d) none of the above

QUESTION 16:

The engagement standard applicable to the compilation referred to in the above report is:

(a) ISRS 4410
(b) ISA 910
(c) ISRE 2400
(d) Regulation 910

QUESTION 17:

The report above is styled, Accounting Officers Report. Which of the following statement is correct?

(a) the Companies Act 2008 revoked all Accounting Officer's Reports for close corporations
(b) despite the impact of the Companies Act 2008 on Close Corporations ACT, every CC must still have an Accounting Officer's Report
(c) both (a) and (b)
(d) neither (a) nor (b)

QUESTION 18:

The Accounting Officer of a Close Corporation is terms of the regulations of the Close Corporations Act may be:

(a) a member of a Recognised Control Body
(b) a member of a member body of the International Federation of Accountants
(c) another Close Corporation of which all members of that Close Corporation is able to accept the office of the Accounting Officer in their personal capacities
(d) all of the above

QUESTION 19:

The statement reported by the Accounting Officer about the fair value of the assets and liabilities represents:

(a) an opinion expressed on the financial statements
(b) a finding that may render the financial statements unreliable
(c) a statement about the liquidity and solvency of the business
(d) a statement on the going concern of the business

QUESTION 20:

The accounting policies adopted by the business serve as a basis for the preparation of the financial statements. The following statement represents the duty and responsibility of the accounting officer with respect to the accounting policies:

(a) ensure that the policies comply with the provisions and allowances of the Income Tax Act
(b) develop and implement the accounting policies for the business
(c) ensure that the policies complies with IFRS for SME's
(d) ensure that the policies are appropriate for the business

Question 21 to 25 are general question questions and does not relate directly to the case study.

QUESTION 21:

Which of the following are not recommended in the engagement letter for an Agreed upon Engagement?

(a) having no acceptance by the engaging entity
(b) the responsibilities of the engaging parties
(c) the basis of calculating fees of the service providers
(d) restrictions on the resultant report

QUESTION 22:

Which of the following statements are true. Turnover Tax regime may only be elected by:

(a) professional service providers, such as doctors engineers, accountants, etc.
(b) by sole traders irrespective of the turnover value
(c) any business entity with a turnover below R1 million per annum and provided the owner manager has no other business or interest in a business that would ordinarily be regarded as a taxpayer in its own right
(d) any business entity with a gross income below R1 million per annum and provided the owner manager has no other business or interest in a business that would ordinarily be regarded as a taxpayer in its own right

QUESTION 23:

With effect from 01 January 2014 SARS has implemented the ETI scheme. Identify the false statements:

(a) the ETI is an incentive aimed at encouraging the employment of young work seekers
(b) the ETI cannot be used if an otherwise eligible person has signed entered into a learnership agreement
(c) the ETI is available to employers who are registered for or must be eligible to register for PAYE
(d) all of the above

QUESTION 24:

Section 29 of the Companies Act (2008) requires the preparer of financial statements to be named on a prominent place on the first page of that financial statements. The person referred to must be:

(a) an independent accounting professional
(b) a person registered with IRBA
(c) an person who has done the work
(d) none of the above

QUESTION 25:

A person who has completed the learnership and has attended CPD session prior to being admitted as full member of SAIPA may:

(a) can claim the CPD hours as part of the membership requirement
(b) submit it as CPD hours for the principal who paid the CPD fees
(c) recognise it as part of the competencies requirement of the logbook
(d) none of the above

[GRAND TOTAL: 50]

CASE STUDY QUESTIONS

PART A:

[36 MINUTES]
[30 MARKS]

Market conditions were favourable as retailers eagerly dished out credit to consumers without performing detailed credit checks and/or any type of verification procedures. The domestic economy grew above 4% quarter-on-quarter with the Rand trading between R6.00 to R8.00 to the dollar. The relative strength of the Rand supported the business plans as Penny-Dreadful imports most of its merchandise. During this period the management under the leadership of Ahmed Essop advanced their diversification strategy as the company had sufficient cash reserves and also easy access to financing.

Then the global financial crisis hit markets worldwide, darkening Penny-Dreadful's fortunes, as cash-strapped consumers' preferences changed to lower priced goods. This placed significant strain on the cash flow of Penny-Dreadful as most of its capital and cash were invested in capital projects which have not yet reached majority. Many of the shareholders, including the major shareholder, were dissatisfied with the management and performance of the company because it deteriorated from a cash flush company to one that was surviving on debt financing. To ease the cash flow challenges a proposal was presented to the shareholders that equity funding was required to avoid the company from being declared commercially insolvent. In 2009 a consortium led by the Omarjee-Nolo brothers and venture capitalist firm Reddy's as well as other shareholders bought shares from the major shareholder.

The investors of Penny-Dreadful were concerned that the company was possibly in financial distress and might not pass the commercial insolvency test for the reporting period ended 28 February 2017. The stakeholders are contemplating whether the CIPC might place the company under business rescue in terms of chapter 6 of the Companies Act.

You are a Professional Accountant (SA) employed by Bank of Johannesburg and your team is working on an independent assessment of Penny-Dreadful (Pty) Ltd financial statements and results. The following information was presented to the team performing the assessment of the company:

Ratio	**2016**	**2015**	**2014**	**2016-Industry Average**
Long-term debt	0.45	0.40	0.35	0.35
Inventory Turnover	62.65	42.42	32.25	53.25
Depreciation/Total Assets	0.25	0.014	0.018	0.015
Days' sales in receivables	113	98	94	130.25
Debt to Equity	0.75	0.85	0.90	0.88
Profit Margin	0.082	0.07	0.06	0.075
Total Asset Turnover	0.54	0.65	0.70	0.40
Quick Ratio	1.028	1.03	1.029	1.031
Current Ratio	1.33	1.21	1.15	1.25
Times Interest Earned	0.9	4.375	4.45	4.65
Equity Multiplier	1.75	1.85	1.90	1.88

<u>You are required to answer the following questions:</u>

QUESTION 1:

What is meant by the term "financial distress"?

[2 marks]

QUESTION 2:

In the annual integrated report to the stakeholders, the CEO of Penny-Dreadful (Pty) Ltd remarked that: "2014 was a good year for the company with respect to our ability to meet our short-term obligations. We achieved a higher liquidity position largely due to an increase in highly liquid current assets (cash, account receivables and short-term marketable securities)." Analyse the liquidity, solvency and cash management ratios given and comment on the statement made by the CEO correct.

[6 marks]

QUESTION 3:

Analyse the information given and discuss the strategy of management to utilize its assets and resources to achieve the strategic goals of the company. Be as complete as possible given the above information.

[6 marks]

QUESTION 4:

You are asked to provide the investors with an assessment of the firm's solvency and leverage. Be as complete as possible given the above information, but do not use any irrelevant information.

[4 marks]

QUESTION 5

Suppose that the directors of Penny-Dreadful (Pty) Ltd were to apply for business rescue from the CIPC. Discuss what is the difference between a business rescue and liquidation?

[3 marks]

QUESTION 6:

Perform the substantive procedures to test the accounts receivable balances.

[9 marks]

PART B:

[30 MINUTES]
[25 MARKS]

After studying the solvency and liquidity assessment report from the Bank of Johannesburg, the newly appointed management team addressed the improvement of the cash position of the company as their number 1 priority. In order to improve its revenue performance and cash flow, management recommended that the following strategies be implemented with immediate effect:

(a) 70% of the receivable balances at the end of each month (30 days sales) should be factored. The debtors are factored at a rate of 85%, refund 10% when the customer settles the account and claim a 5% service fee. The terms and conditions of the factoring agreement states that if the debtor does not settle their accounts within the agreed credit terms, then the debtors' accounts would be returned to Penny-Dreadful. For the period ended 28 February 2017 trade receivables/debtors with a book value of R 1 350,000 were factored with the institution. On 26 May 2017, before the financial statements were finalised for the reporting period 28 February 2017, debtors with account balances of R 120,000 were returned to Penny-Dreadful as a result of the debtors not meeting their payment terms and conditions.

(b) The company entered into an agreement with one of the major banks that offer customer benefits (similar to e-bucks and u-count rewards), whereby the customers can utilise the benefits to pay for the sales transactions concluded. The sales value of the transactions concluded for the month of February 2017 amounted to R 661,200 (inclusive of VAT), of which an estimated value of 35% was settled by the customers using their benefits.

(c) The customers with credit balances of totalling R 228,000 consist of amounts of R 91,200 is respect of payments received more than four months ago and the remaining balance was less than four months. The accountant decided that the credit balances can be set off against the debit balance when reporting the debtors figure in the financial statements.

You are required to answer the following questions:

QUESTION 7:

Advise the accountant on how she should recognise the factoring debtors as per the terms and conditions of the debtors' factoring agreement in the financial statements in compliance with the accounting standards.

[4 marks]

QUESTION 8:

Discuss how the notification received from the factoring house on 26 May 2017 should be recognised and reported in the financial statements for the reporting period ended 28 February 2017 in compliance with the accounting standards.

[4 marks]

QUESTION 9:

Prepare the note relating to debtor factoring that should be disclosed in the financial statements for the reporting period ended 28 February 2017 in compliance with the accounting standards.

[4 marks]

QUESTION 10:

Record the journal entries to recognise the transactions concluded with the customer benefits being used to settle the sales amount due. Support you answer with calculations and reasons, including the transactions relating to VAT.

[7 marks]

QUESTION 11:

Discuss the income tax and VAT implication of the credit balances of the debtors' accounts in compliance with the provisions of the Tax Acts.

[4 marks]

QUESTION 12:

Discuss whether the recommendation by the accountant to set off the credit balances against trade receivables in the financial statements is acceptable in terms of the accounting standards.

[2 marks]

PART C:

[24 MINUTES]
[20 MARKS]

After the dismissal of the CEO, Ahmed Essop, the board of directors emphasised that in order for the business to survive, greater emphasis should be placed on Corporate Governance and Risk Management. Various statistics indicated that the tourism industry was gaining momentum and that South Africa was becoming one of the preferred tourism destinations in the world, as well as the shopping Mecca for African and indigenous products. The newly appointed Marketing Executive, Ms. Cathy Zondo-Bearly, stated that this provided a unique business opportunity to address the cash flow dilemmas of the company. Tourists often pay cash for their purchases and this would ease the cash strain resulting from credit sales transactions. She recommended that the company establish a rehabilitation working centre for abused women to improve the image of the company by marketing this as part of its Corporate Social Investment (CSI) project. She informed the board that this will be rolled out as part of the company's CSI strategy and will involve the production of hand crafted products that will be sold as part of its indigenous product line. The centre was established and operated successfully in achieving its objective as well as creating a demand which was rapidly exceeding the supply – this has become a very profitable venture.

At the reporting date, 28 February 2017, the following was extracted from the inventory records for the centre:

	Cost	Fair value
Raw materials	R 110,000	The cost of importing substitute materials results in the value of the raw materials declining significantly – estimated fair value was R 86,000
Work-in-progress	R 245,000	The demand for the products is steady increasing with order being received from foreigners.
Finished goods	R 672,000	The idea of the indigenous products has captured the market and more stores are selling similar products resulting in an increase in competition. The estimated selling price of the goods is R 630,000 with selling costs of R 3,000

The accountant stated that the inventory should be valued at the lower cost or net realisable value and thus recommended that an impairment loss of R 66,000 should be recognised at the reporting date.

The company received an order of 20,000 items from a customer in Germany at a selling price per unit of R 150.00. The following information was presented by the manager of the centre:

Direct materials cost per unit	56.70
Direct labour cost per unit	17.50
Total production overhead costs	560,000
Variable selling expenses	3.50
Other total fixed costs	340,000

The following information was extracted from the production records:

	August	September	October	November
Number of units produced	165,000	240,000	280,000	180,000
Total production overhead costs	547,500	660,000	720,000	570,000

Management expected to realise a profit of R 20.00 per unit for all goods sold to foreign customers.

<u>You are required to answer the following questions:</u>

QUESTION 13:

Discuss whether the statement made be the accountant relating to the valuation of the inventory and the recognition of the loss at the reporting date is acceptable in terms of the accounting standards.

[4 marks]

QUESTION 14:

Discuss whether the loss recognised on valuation at the reporting date (impairment loss) will be allowed as a deduction for the calculation of taxable income.

[3 marks]

QUESTION 15:

Record the journal entry to account for the loss recognised on the valuation of inventory at the reporting date in compliance with the accounting standards.

[3 marks]

QUESTION 16:

Calculate the variable production cost per unit, if the total production overhead costs are considered to be mixed costs.

[4 marks]

QUESTION 17:

Based on the expected profits management intends to realise on the sale of its products, advice management on whether the order received from the customer in Germany should be accepted.

[6 marks]

PART D:

[24 MINUTES]
[20 MARKS]

The executive management was well-taken care of under the management of Ahmed Essop, when cash was easily available. For example, their vehicles were replaced every three years through cash purchases and old vehicles were given to them as rewards for their contribution to the success of the company. To improve its cash flow position, the financial manager, Mr. Goodness, decided that the vehicles of the executives should be replaced with a finance lease agreement. The conditions of the lease agreement were as follows:

Commencement of lease	01 July 2016
Leased assets	4 motor vehicles
Lease period	4 years
Lease rental payments	R 65,000 payable half-yearly in advance
Cash value of vehicle	R 427,855
Effective interest rate	12%

Due to the economic downturn management approved the seeking of a loan to assist with the cash flow problems they were experiencing. They approached the shareholders for assistance by providing bridging finance and obtained a loan of R 20 000 000 at an interest rate of 12% per annum from one of its major shareholders on 01 September 2016. Penny paid R1 200 000 in interest (correctly calculated) to the shareholders on 28 February 2017.

You are required to answer the following questions:

QUESTION 18:

Record the journal entries recording the finance lease agreement for the reporting period ended 28 February 2017 in compliance with the accounting standards. Ignore the effects of deferred taxation.

[6 marks]

QUESTION 19:

Disclose the information relating to the finance lease creditors in the financial statements, including the note for the reporting period ended 28 February 2017 in compliance with the accounting standards.

[9 marks]

QUESTION 20:

Discuss whether the interest of R 1 200 000 paid is deductible by Penny for the year of assessment ended 28 February 2017.

[5 marks]

PART E:

[36 MINUTES]
[30 MARKS]

The major concern of management was that the statement of financial position reflected a poor state of affairs. This was with respect to the solvency and financial risks to debt providers and thus it was extremely difficult to obtain debt financing from financial institutions. On 28 February 2015 management revalued machinery and equipment with a carrying amount of R 720,000 (original cost of R 960,000) and a remaining useful life of six years to its gross replacement cost of R 1,200,000. The company depreciates machinery and equipment on a straight-line based over an estimated useful life of eight years. The reason for the revaluation was to reflect the "true" solvency and liquidity position of the company.

With changes in technology and the increase in the level of competition in the sector for which the machinery and equipment are used, Ms. Gugu Latshayi Professional Accountant (SA), advised management that the recoverable amount of the machinery and equipment at 28 February 2017 was estimated at R 450,000. The accountant accepted the recommendation of Ms. Latshayi and recorded the impairment loss of R 150,000 in compliance with the accounting standards.

The company occupied the building it owned as its warehouse, was correctly classified by the accountant as Property, Plant and Equipment. The building was recorded at its original cost of R 800,000 (carrying amount of R 400,000) and was depreciated at 5% per annum which was the same as the capital allowance granted in terms of the Income Tax Act. The accountant estimated that the land has an original cost of R 100,000. During the current reporting period management decided that the warehouse should be leased to tenants with the primary objective of securing a stable cash inflow with the company continuing to occupy 15% of the storage space. The date the lease for the warehouse commenced was at 01 June 2016 and the estimated market values for the land and building were R 120,000 and R 1,500,000 respectively. The accountant did not revalue the building as it is not the policy of the company to revalue properties and continued to reflect the building as part of Property, Plant and Equipment.

You are required to answer the following questions:

QUESTION 21:

Discuss whether the transaction recorded by the accountant, to recognise the impairment loss, complies with the accounting standards. Support your answer with reasons and appropriate calculations.

[8 marks]

QUESTION 22:

Discuss whether the impairment loss can be claimed as a deduction for income tax purposes in terms of the provisions of the Income Tax Act.

[3 marks]

QUESTION 23:

Discuss whether the accountant recognised the building correctly as part of Property, Plant & Equipment for the reporting period 28 February 2017 in compliance with the accounting standards

[8 marks]

QUESTION 24:

Record the journal entry to re-classify the building from Property, Plant & Equipment to Investment Property in compliance with the accounting standards.

[8 marks]

QUESTION 25:

Advise management on whether the capital allowance for the building including the land is correct in terms of the provisions of the Income Tax Act.

[3 marks]

PART F:

[30 MINUTES]
[25 MARKS]

Labour cost was major operating costs to the manufacturing divisions of the company. Management decided that the manufacturing process should be automated in order to improve the quality of the products manufactured, but also to improve the efficiency and cost effectiveness by reducing the level of wastage. The implementation plan involved the replacement of existing machinery and equipment with a carrying amount and tax value at 01 March 2016 of R 800,000 of R 400,000 respectively (original cost of R2,000,000). At 31 August 2016 the existing machinery and equipment was disposed of at a price of R 2,500,000 after incurring costs of R 150,000 to service and repair the machinery and equipment. On 01 September 2016 the machinery and equipment purchased from a registered vendor was installed at an aggregate cost of R 3,300,000. The machinery was brought into use immediately after it was installed. The company depreciated the machinery and equipment on a straight-line basis with residual values of R 200,000 and R 300,000 for the existing and new machinery and equipment respectively. The wear and tear allowance for the machinery and equipment is 20% per annum.

After the machinery and equipment was installed it was discovered that a back-up generator was required with specific specification in order to minimise the risk of electrical disruptions for causing damages to the machinery and equipment. On 01 January 2017 management purchased the back-up generator at a cost of R 360,000 and spare part at a cost of R 90,000. The spare part can be used for other machinery used in the production process.

You are required to answer the following questions:

QUESTION 26:

Advice management whether the "roll-over" option can be used for income tax purposes for the year of assessment ended 28 February 2017. Support your answer with reasons.

[3 marks]

QUESTION 27:

Discuss how the back-up generator and the spare part should be accounted for accounting and income tax purposes taking into consideration the provisions of the appropriate standards and legislation.

[12 marks]

QUESTION 28:

The accountant provided you with the following schedule:

	Accounting	Taxation	Difference	Deferred tax
Existing machinery – opening balance	800 000	400 000	?	?
Transactions for the current period:			?	?
Existing machinery – disposal	-	-	?	?
Deferred recoupment	-	(288 000)	?	?
Deferred capital gain	-	(50 400)	?	?
New machinery	3 050 000	2 640 000	?	?
Generator	330 000	324 000	?	?
Repairs	90 000	90 000	?	?
	3 470 000	2 715 600		

Use the above schedule to record the journal entries, if any, in respect of deferred taxation relating the reporting period ended 28 February 2017 in compliance with the accounting standards. Support your answers with relevant calculations.

[10 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%