SCHOOL OF ACCOUNTING SCIENCES

POSTGRADUATE DIPLOMA IN ACCOUNTING SCIENCES

TUTORIAL LETTER 303/2010
(DIPACA8)

Dear Student

This tutorial letter comprises of the first test that was written on 27 March 2010, as well as the suggested solutions and comments

Your marks are will be available on the internet **(www.unisa.ac.za)** under **"myUnisa"**. (Refer to section 8.2.2. [Demarcation of tests] in tutorial letter 301/2010.)

It is in your own interest to work through the material carefully as the system of self-evaluating assignments and tests requires more responsibility from you as an advanced student.

Best wishes

YOUR LECTURERS

Question 1: DIPAC15

ADVANCED FINANCIAL ACCOUNTING
(40 Marks)

Duration: 1 Hour (Time: 08:15 – 09:15). Students must be seated by 08:00. The test begins at 08:15.

FIRST EXAMINERS:	Ms. A. de Jongh Mr. B.J. Mothuloe	Mr. H.T. Meyer
SECOND EXAMINER:	Prof. HC. Wingard	

Please ensure that you have completed the cover of the answer book for this question in full i.e. name, address, student number, code of paper and test number.

This DIPAC15 (Financial Accounting) question consists of 4 pages and is out of 40 marks.

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QUESTION 1: DIPAC15 **(40 marks)**

This question consist of two separate parts that are not related.

PART A

The following information relating to TrueBlue Ltd is presented to you for the year ended 28 February 2010:

1. Inventories amounting to R95 000 were destroyed and written off due to a flood during the year. An amount of R60 000 was received from the insurance company as compensation.

2. The directors of the company decided to change the accounting policy in respect of the valuation of inventories, as the new policy will ensure a more reliable value of inventories. Previously inventories were valued according to the weighted average method, but now it should be valued according to the first-in-first-out method.

3. At the same time it was decided to increase the provision for obsolete inventories to 10% of the value of inventories, compared to the 5% used in the past.

4. The value of inventories at 28 February, based on the two methods of valuation, was as follows (before taking into account any provision for obsolete inventory):

	2010 **R**	**2009** **R**	**2008** **R**	**2007** **R**
First-in-first-out method	460 000	420 000	395 000	380 000
Weighted average method	420 000	395 000	382 000	375 000

5. The SARS will not re-open the previous years' assessments, but will accept the new policy in respect of the current year for tax purposes.

6. During the current year the bookkeeper established that a material error had been made in the published financial statements for the year ending 28 February 2009. Equipment amounting to R25 000 that was acquired on 1 September 2008 was incorrectly recorded as administration expenses. The company depreciates such equipment at 20% per annum according to the straight-line method. The accountant immediately informed SARS of the error, SARS agreed to re-open the 2009 assessment and made the necessary adjustment. SARS grants a wear and tear allowance of 20% per annum according to the straight-line method on equipment.

7. Assume a normal tax rate of 28% for all the years.

REQUIRED

Marks

Disclose the following notes to the financial statements of TrueBlue Ltd for the year ended 28 February 2010:

Profit before tax
Change in accounting policy
Prior period error **20**

Note: **Round** all amounts off to the nearest rand.

Your answer should **comply** with International Financial Reporting Standards (IFRS).

PART B

Root Ltd

The following information is in respect of Root Ltd for the year ending 31 December 20.9:

	20.9 **R**	**20.8** **R**
Profit/(Loss) before tax	650 000	(540 000)
Non-taxable income	60 000	50 000
Non-deductible expenses	20 000	15 000
Dividends paid at year-end	55 000	25 000
Dividends received	20 000	30 000
Cumulative taxable temporary differences (excluding any tax losses)		27 000
Normal tax rate (20.7 – 28%)	28%	28%
Secondary Tax on Companies	10%	10%

During 20.9 the taxable temporary differences (excluding any tax losses) increased by R65 000. At 31 December 20.7 the deferred tax balance amounted to R12 000 (Cr).

The company's directors decided that it is not probable that future taxable profit will be available against which the unused tax losses can be utilised. Dividends will however still be paid for some time from retained earnings.

REQUIRED

	Marks
Disclose the notes to the statement of comprehensive income regarding taxation for the year ended 31 December 20.9. Your answer should comply with International Financial Reporting Standards (IFRS) and South African Standards and Interpretations of Generally Accepted Accounting Practice (AC 501)	**20**

All amounts should be **rounded** to the nearest **rand**.

No comparative figures are required.

Question 2: DIPAC26

ADVANCED MANAGEMENT ACCOUNTING
(40 Marks)

Duration: 1 Hour (Time: 09:30–10:30). Students must be seated by 09:15. The test begins at 09:30.

FIRST EXAMINERS:	Mr. FJC. Benade Mrs. A. Combrink Ms. J. Foot Mrs. A. Ravat Mrs. F. Venter	Mr. L. Crafford Mr. A. De Graaf Mr. S. Ndlovu Mrs. F. Tayob
SECOND EXAMINER:	Prof. B. Van Heerden	

Please ensure that you have completed the cover of the answer book for this question in full i.e. name, address, student number, code of paper and test number.

This DIPAC26 (Management Accounting) question consists of 5 pages and is out of 40 marks.

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QUESTION 2: DIPAC26 **(40 Marks)**

PART A **20 Marks**

Antihistamines (Pty) Ltd manufactures medication for allergies which is then sold to doctors and pharmacies.

Antihistamines (Pty) Ltd only specialises in the production of one type of tablet which is sold per kg.

The management accountant has extracted a portion of the trial balance for the year ended 31 December 2009:

		Note	Dr R'000	Cr R'000
Sales		1		142 500,0
Delivery costs		2	500,0	
Depreciation	Factory and equipment		7 500,0	
	Administrative		250,0	
Interest paid		3	320,0	
Materials purchased		4/5	60 000,0	
Overhead costs	Fixed		4 794,2	
	Variable		2 380,4	
Salaries	Administrative	5	4 090,5	
	Sales		2 166,0	
Packaging costs			500,0	
Travelling			7 000,0	
Wages manufacturing		6	15 995,0	
Inventory – 1 January 2009				

1. Sales for the year took place at an average net price of R9,50 per kilogram.

2. Delivery costs vary with sales.

3. Interest paid relates to interest on a long term loan.

4. Materials were purchased at an average net cost of R4,00 per kilogram.
   On 31 December 2009 there was 250 000 kilograms of raw materials in inventory i.e. closing inventory.

5. Antihistamines (Pty) Ltd determined the cost of 1 kg of tablets (1 January 2009 to 31 December 2009) to be:

	R
Material (1,25kg input @ R4/kg)	5,00
Depreciation-manufacturing	0,40
Overheads- fixed	0,40
Overheads- variable	0,20
Packaging	0,15
Wages	0,50
Value of finished goods	6,65

The cost per kilogram is based on production of 12 000 000 kilograms of tablets.

6. Administrative salaries are fixed. Sales salaries are variable i.e. they vary according to sales.

7. Manufacturing wages are considered to be of a fixed nature.

8. Inventory 1 January 2009: Finished goods valued at R6,50 per kg
There was no raw materials opening inventory on this date.

REQUIRED	**Marks**
Calculate Antihistamines (Pty) Ltd's profit for the year ended 31 December 2009 using an absorption costing basis. **Note: Do not calculate the under/over recovery of fixed overheads** Closing inventory is valued at standard cost. Ignore taxation for this section	20

PART B **12 Marks**

Select the correct answer for each question below. Show **ALL** calculations clearly.

Cycle Addicts (Pty) Ltd manufactures mountain bikes for health fanatics. The company is now busy with its budget for the Super mountain bike line for 2011 and has the following information available:

Total cost if 5 000 units are produced	35 000 000
Total cost if 7 000 units are produced	45 000 000

The company expects to produce and sell 6 000 units of Super mountain bike in 2011.
The selling price is R10 000 per mountain bike.
The company can not produce more than 7 000 units per annum.

1. Calculate the break-even point for the Super mountain bike. The following quantity should be sold for the company to achieve its break-even point:

   (a) 7 000 units
   (b) 8 000 units
   (c) 2 000 units
   (d) 6 000 units
   (e) none of the above (3)

2. What profit will the company realise at its expected sales level of 6 000 units?

   (a) R10 000 000
   (b) R20 000 000
   (c) R30 000 000
   (d) R60 000 000
   (e) none of the above (3)

3. What units must the company sell in order to earn a profit of R30 000 000?

   (a) 6 000 units
   (b) 2 000 units
   (c) 8 000 units
   (d) 7 000 units
   (e) It is not currently possible for the company to earn a profit of R30 000 000 (3)

4. What is the company's margin of safety?

   (a) 66,67%
   (b) 40%
   (c) 200%
   (d) 0%
   (e) none of the above (3)

PART C **8 Marks**

Select the correct answer for each question below. Show ALL calculations clearly**.**

ABC (Pty) Ltd, manufactures two products, A and B. The production of these products gives rise to a fixed manufacturing overhead cost of R 2 000 000 per annum, which has traditionally been allocated to the products based on labour hours required in the production process. The financial director wants to change the accounting system to an ABC system, and has asked for your assistance.

The following information has been provided:

	Number of units	**Labour hours**	**Machine hours**	**Number inspections**
A	20 000	1 600 000	20 000	800
B	60 000	6 400 000	80 000	1 200
	80 000	8 000 000	100 000	2 000

Overhead costs

Maintenance of machinery	480 000
Quality control	920 000
Set-up costs	600 000
Total	2 000 000

5. The **total** overhead cost that would be allocated to Product B on a traditional costing system using labour hours as an allocation would be:

   (a) R1 600 000
   (b) R26,67
   (c) R1 500 000
   (d) R25,00
   (e) None of the above (4)

6. The overhead cost per unit allocated to Product B, based on activity based costing system should be:

   (a) R26,67
   (b) 25,00
   (c) R33,33
   (d) R21,60
   (e) None of the above (4)

Question 3: DIPAC38

ADVANCED TAXATION
(40 Marks)

Duration: 1 Hour (Time: 10:45-11:45). Students must be seated by 10:30. The test begins at 10:45.

FIRST EXAMINER: Prof. A.C. Engelbrecht

SECOND EXAMINERS: Mrs. M. Ungerer Mrs. M.M. Pretorius

Please ensure that you have completed the cover of the answer book for this question in full i.e. name, address, student number, code of paper and test number.

This DIPAC38 (Taxation) question consists of 4 pages and is out of 40 marks.

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QUESTION 3: DIPAC38 **(40 Marks)**

PART A **33 Marks**

Mr Molefe and Mr Ebrahim commenced a computer software maintenance business (Netsoft) in a 50:50 partnership on 1 November 2009. Netsoft concluded annual computer software maintenance contracts to maintain the computer software and networks of a number of large corporations. The total value of these annual contracts on 30 November 2009 amounted to R798 000 (including VAT). During January 2010 Netsoft concluded more contracts and the partners anticipated that by 28 February 2010 the total value of their annual contracts would amount to R1 105 800 (including VAT).

During the period 1 November 2009 until 28 February 2010 Netsoft entered into the following transactions (**all amounts include VAT** unless stated otherwise):

1. A residential property was purchased during November 2009 from a non-vendor for R1 800 000 (excluding VAT). Transfer duty amounted to R114 000 and was paid during February 2010.

   The property consisted of a house together with a double garage. The double garage will be converted into a garden flat and will be let as residential accommodation to a person not related to Netsoft. The total estimated rent receivable for the 12 month period from 1 February 2010 should amount to R48 000 (excluding VAT). The house will be converted into offices for use by Netsoft. Both of the conversions to the buildings were done during January 2010. The cost of converting the double garage into a garden flat amounted to R125 400 and the cost of converting the house into offices amounted to R319 200. Both amounts were paid in February 2010 after an invoice was issued on 1 February 2010 by the contractor. The garden flat comprises 4% of the total floor space of the buildings on the property. You may assume that this ratio will be accepted by SARS as the method for any apportionment, if applicable.

2. A single cab Yotota LDV ("bakkie") with a cash value of R239 400 was purchased in February 2010 and financed by way of a financial lease agreement. This agreement meets the requirements of the definition of an instalment credit agreement in the Value-Added Tax Act (VAT Act). This vehicle will be used exclusively for the computer software maintenance part of the business. The monthly lease payment amounted to R5 447. The February 2010 payment consisted of R2 593 (excluding VAT) of finance charges and R2 854 capital.

The following payments were made during February 2010 regarding the bakkie:	R
Fuel	2 870
Purchase and installation of a canopy...	9 348

3. A number of computers were needed in the business and were consequently obtained at a cash cost of R160 000 (excluding VAT) and financed by way of a 3-year operating lease during February 2010. The operating lease meets the requirements of the definition of a rental agreement in the VAT Act. The monthly rental amount for February 2010 amounted to R6 146, of which R1 976 (excluding VAT) is for finance charges and R4 170 for capital.

   A local area network (LAN) as well as a wireless internet connection was set-up and the computers were linked to these networks. Netsoft had to bear the cost of this installation which amounted to R32 376. An invoice was issued on 15 February 2010, but the amount was only paid by Netsoft on 3 March 2010.

4. On 18 February 2010 lightning caused severe damage to the LAN (network) due to the fact that the surge and lightning protection unit failed. The cost of repairing the network amounted to R9 804 and this amount was paid by Netsoft during February 2010. Netsoft claimed from their short term insurer to be indemnified for this loss. On 24 February 2010 the insurer paid R8 664 into Netsoft's bank account to indemnify them for the loss suffered in repairing the network. On 25 February 2010 the insurer replaced the faulty surge and lightning protection unit at a cost of R13 680.

5. The invoices issued (on 28 February 2010) to clients for computer software and network maintenance done by Netsoft during February 2010 amounted to R136 800. However, one client had also paid for the March 2010 services of R11 400 during February 2010, before an invoice was issued by Netsoft.

REQUIRED	**Marks**
(a) Indicate whether Netsoft is liable to register as a vendor for VAT purposes in terms of sections 23 and 51 of the VAT Act. Motivate your answer and support your answer with calculations. Ignore voluntary registration requirements. Remember to consider all types of income. In this regard also refer to transaction 1.	4
(b) On the assumption that Netsoft has in fact registered as a category B VAT vendor on the invoice basis as from 1 February 2010, calculate the output tax and input tax relating to transactions 1 to 5 mentioned above. Indicate the following (where applicable) for each transaction separately: • whether the transaction deals with output tax or input tax; • the amount of the VAT; • the period in which the VAT must be accounted for, as well as • any apportionment. Give reasons where necessary.	29

PART B **7 Marks**

Mr Zeelie made the following donations during the year of assessment ended 28 February 2010:

1. His parents really struggle financially and he consequently decided to contribute a monthly amount of R3 000 towards their maintenance. These payments were made monthly from 1 March 2009 to 28 February 2010. You may assume that SARS will regard these contributions as reasonable.

2. He also contributes R2 000 per month to his local church congregation (a registered Public Benefit Organisation). He contributed for the period 1 March 2009 to 28 February 2010.

3. Mr Zeelie maintains his son (22 years), his only child, who is studying full-time at university. The study fees, books and hostel fees amounted to R40 000 and was paid on 1 March 2009. He purchased a brand new sports car of R320 000 and gave it to his son on his 22nd birthday on 25 March 2009.

REQUIRED	**Marks**
Calculate and discuss the donation's tax implications of these donations. Give reasons for your answers.	7

Question 4: DIPAC49

ADVANCED AUDITING
(40 Marks)

Duration: 1 Hour (Time: 12:00-13:00). Students must be seated by 11:45. The test begins at 12:00.

FIRST EXAMINERS:	Ms. C. Boswel Mr. V.M. Motholo Ms. E.A.J. Terblanche Ms. R. Van Beek	Ms. S. Hassim Mr. M.M. Mudau Ms. N.V. Thoothe
SECOND EXAMINER:	Mrs. L. Du Plessis	

Please ensure that you have completed the cover of the answer book for this question in full i.e. name, address, student number, code of paper and test number.

This DIPAC49 (Auditing) question consists of 3 pages and is out of 40 marks.

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QUESTION 4: DIPAC49 **(40 Marks)**

Background information

Your firm was recently appointed as auditors of Shosholoza (Pty) Ltd (Shosholoza), a large construction company which is involved in the construction of medium to large projects. You are the manager on the audit and your uncle, Mr Max Motholo, is the CEO and major shareholder of Shosholoza. Your inclusion in the audit team was one of the conditions of awarding the audit to your firm. The previous auditors resigned from this audit, as the audit fee for the previous year was still outstanding.

Shosholoza has a good track record and was awarded a contract to be involved in the construction of the Gau-Metro. This contract was very important for Shosholoza as there has been a decline in the demand for their services due to the weak economy. At the end of the contract, the bulk of the building accessories and any excessive materials will be sold to the public. Shosholoza gave your firm the first option to promote the above to all your firm's clients in the building industry. A contract will be put in place and Mr Singh, the partner in charge of the audit, will also receive 10% of Shosholoza's shares as part of the remuneration for this service.

Due to the extent of the project, Shosholoza plans to buy a 100% stake in a BEE company. Mr Motholo requested your firm to perform a due diligence investigation on this BEE company. He also wants Mr Singh to form part of the panel which will make the final decision as to whether the company should be bought or not. If this deal is concluded, Mr Motholo also wants your firm to do the accounting work of this BEE company. The financial department of Shosholoza is already under a lot of strain with their current workload, since a lot of the personnel have been retrenched when the company started experiencing financial difficulty.

Matters relevant to the audit

In February the audit team held a meeting with Mr Motholo, in preparation for the audit for the financial year ending 31 March 2010. He informed you that the audited annual financial statements must be available by no later than 7 May 2010. The audited financial statements will be used to apply for an extension of the company's overdraft facility. Shosholoza is currently making a very small loss, but they are not too concerned as the Gau-Metro contract is going to create huge profits in the future. You learned at the meeting that the directors receive a bonus based on the company's profit for the year. Mr Motholo also indicated that, due to the contract being awarded to them, the bonus amounts were expected to be substantial.

Bearing in mind the tight deadline, the audit should have commenced on 12 April 2010. However, on this day the employees were on strike and cordoned off the Head Office where the audit was supposed to be performed. The workers claimed that their salaries for March 2010 have not been paid. They were also unhappy with the salary increases that were communicated to them and are planning to take legal action. As a result, the audit only commenced a week later, on 19 April 2010, while the negotiations were still underway. The financial director indicated that the dispute was under control and that the salary payments would be made during the course of the week.

Consulting fees

While performing fieldwork on the audit, one of the junior audit clerks performed analytical tests on expenses. There was a huge variance in the consulting fees and you instructed her to perform more detail tests. This additional work revealed that payments to the amount of R3 million were made to Sebeli Consultants CC. After discussions with the financial director and further investigations, you realised that Sebeli Consultants CC were co-owned by the chairman of the tender board, who was involved in the awarding of the Gau-Metro contract and the financial director of Shosholoza. According to the minutes of the directors' meetings, all of these payments have been approved. Other than the minutes, there is no other supporting documentation available. On enquiry, it was stated that these might be misplaced and they undertook to look for it. To date no proof has been provided by the client. When he heard about this, the financial director threatened you to not make a big deal out of the situation. He made it clear that your firm would otherwise be dismissed as auditors and service providers to Shosholoza.

REQUIRED

		Marks
(a)	Identify and describe the different types of threats to independence pertaining to the audit in this scenario, as well as the possible safeguards to reduce these threats. ***(Present your answer in table format.)***	10
(b)	Briefly discuss the issues that we as auditors would have to consider before accepting the appointment as auditors of Shosholoza.	8
(c)	Identify the risk indicators in the scenario and briefly explain the risk factors at the overall financial statement level pertaining to Shosholoza. ***(Present your answer in table format.)***	12
(d)	Discuss fully the implications of the consulting fees (including any further actions that might be required of you) in terms of the Auditing Profession Act 26 of 2005 (APA). ***Hint: Refer to sections 44 and 45 of the APA.***	10

SUGGESTED SOLUTIONS AND COMMENTARY ON TEST 1

SUGGESTED SOLUTIONS TO QUESTION 1
DIPAC15
ADVANCED FINANCIAL ACCOUNTING

PART A

TRUEBLUE LTD

NOTES FOR THE YEAR ENDED 28 FEBRUARY 2010

1. Profit before tax

Profit before tax is stated after the following items have been taken into account:

	2010 R	2009 R	
Income:			
Compensation received from insurance company	60 000	-	(1)
Expenses:			
Write-off of inventories as a result of flood	95 000	-	(1)
Depreciation [C2]	5 000	2 500	(2)

Included in cost of sales is a change in estimate regarding the provision for obsolete inventory. The provision is now based on 10% of the value of inventory compared to 5% as in the past. The effect of the change in estimate is a decrease in profit of R23 000 (460 000 x 5%). Since future inventory values are not known, it is not possible to calculate the amounts of the effect in future periods. (2)

2. Change in accounting policy

During the year the company changed its accounting policy in respect of the valuation of inventories from the weighted average method to the first-in-first-out method. This change has been effected to ensure a more reliable valuation of inventories. The change in accounting policy was accounted for retrospectively and comparative amounts have been restated. The effect of this change in accounting policy is as follows: (2)

	2010 R	2009 R	2008 R	
Decrease in cost of sales [C1]	12 250	11 400	7 600	(3)
Increase in tax expense [C1]	(3 430)	(3 192)	(2 128)	(2)
Increase in profit	8 820	8 208	5 472	
Increase in inventory [C1]	36 000	23 750	12 350	(3)
Increase in current tax due [C1]	(10 080)	-	-	(½)
Increase in deferred tax liability [C1]	-	(6 650)	(3 458)	(1)
Increase in equity	25 920	17 100	8 892	
Increase in retained earnings			8 892	(½)

3. Prior period error

This represents a correction in respect of equipment that was recorded as administrative expenses in the 2009 financial year. The effect of the correction of the error on the 2009 results is as follows: (1)

	2009 R	
Decrease in other expenses (25 000 – 2 500 [C2])	22 500	(1)
Increase in tax expense (22 500 x 28%)	(6 300)	(½)
Increase in profit for the year	16 200	
Increase in property, plant and equipment (25 000 – 2 500)	22 500	(1)
Increase in current tax owing	(6 300)	(½)
Increase in equity	16 200	
		22
	Maximum	20

CALCULATIONS

C1. Change in accounting policy

	2007	I/S	2008	I/S	2009	I/S	2010
FIFO	361 000[a]		375 250[c]		399 000[e]		414 000[g]
WA	356 250[b]		(362 900)[d]		(375 250)[f]		(378 000)[h]
	4 750	7 600	12 350	11 400	23 750	12 250	36 000
Tax (28%)	(1 330)	(2 128)	(3 458)	(3 192)	(6 650)	(3 430)	(10 080)
	3 420	5 472	8 892	8 208	17 100	8 820	25 920

[a] 380 000 x 95% = 361 000
[b] 375 000 x 95% = 356 250
[c] 395 000 x 95% = 375 250
[d] 382 000 x 95% = 362 900
[e] 420 000 x 95% = 399 000
[f] 395 000 x 95% = 375 250
[g] 460 000 x 90% = 414 000
[h] 420 000 x 90% = 378 000

C2. 25 000 x 20% x 6/12 = 2 500
25 000 x 20% = 5 000

PART B

ROOT LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.9

2. Income tax expense

	20.9	
	R	
SA normal taxation	21 800	
Current [C1]	-	(6)
Deferred [C2]	21 800	(3)
Secondary tax on companies	3 500	
Current [C3]	3 000	(2)
Deferred [C2]	500	(2)
Tax expense	25 300	

	20.9	
Tax rate reconciliation	**R**	
Accounting profit	650 000	(½)
Tax rate	28%	(½)
Tax at standard rate	182 000	(½)
Tax effect of		
- Non-taxable income (60 000 x 28%)	(16 800)	(½)
- Non-deductible differences (20 000 x 28%)	5 600	(½)
- Utilisation of unprovided tax loss (532 143 [C2] x 28%)	(149 000)	(1)
Secondary tax on companies	3 500	(½)
Tax expense	25 300	
		(17)

Secondary taxation on companies is payable on dividend distributions at a rate of 10%

3. Tax benefit from a previously unrecognised tax loss

	20.9	
Balance brought forward (532 143 [C2] x 28%)	149 000	(2)
Utilised to reduce current tax	(149 000)	(1)
	-	
		(3)

CALCULATIONS

C1. Current tax - 2009

	20.9 R	
Profit before tax	650 000	(½)
Non-taxable income	(60 000)	(½)
Non-deductible expenses	20 000	(½)
Deductible/(taxable) temporary differences	(65 000)	(1)
Taxable income before loss	545 000	
Assessed loss [C4]	(559 143)	(3)
Tax loss	(14 143)	(½)
		(6)

* Taxable temporary differences 31/12/20.9 (given)
Movement for the year (deductible)

C2. Deferred taxation

	Temporary differences R	Deferred tax R		
20.8				
Cumulative taxable temporary differences	27 000	7 560		
Unutilised tax loss R559 143 [C4] – limited to R27 000*	(27 000)	(7 560)		
Deferred tax liability	-	-		
STC credit – deferred tax asset (25 000 – 30 000)	(5 000)	(500)		
• Movement in statement of comprehensive income				
Normal tax:				
Deferred tax liability at 31/12/20.7 (given)		12 000		
Movement		(12 000)	Cr	
Deferred tax liability 31/12/20.8		-		
• STC				
Balance at 31/12/20.7		-		
Movement		500	Cr	
Deferred tax asset 31/12/20.8		(500)		

* The tax loss for which no deferred tax asset has been raised amounts to R532 143 (559 143 [C4] – 27 000)

	Temporary differences R	Deferred tax R		
20.9				
Cumulative taxable temporary differences (27 000 + 65 000)	92 000	25 760		(1)
Unutilised tax loss [C1]	(14 143)	(3 960)		(1)
Deferred tax liability	77 857	21 800		
• Movement in statement of comprehensive income				
Normal tax:				
Deferred tax liability at 31/12/20.8		-		(½)
Movement		21 800	Dr	(½)
Deferred tax liability 31/12/20.9		21 800		
				(3)
• STC				
Deferred tax asset 31/12/20.8 (25 000 – 30 000 x 28%)		500	Cr	(1)
Movement		500	Dr	(1)
Deferred tax asset 31/12/20.9		-		
				(2)

C3. Secondary tax on companies

	20.9 R	
Dividends paid	55 000	(½)
Dividends received	(20 000)	(½)
STC credit carried over	(5 000)	(½)
	30 000	
STC – current (30 000 x 10%)	3 000	(½)
		(2)

C4. Assessed loss - 2008

	20.8 R	
Loss before tax	(540 000)	(½)
Non-taxable income	(50 000)	(½)
Non-deductible expenses	15 000	(½)
Deductible/(taxable) temporary differences	15 857*	
Taxable income before loss	(559 143)	
Assessed loss	-	
Tax loss	(559 143)	
* Taxable temporary differences 31/12/20.7 (12 000 / 28%)	42 857	(1)
Taxable temporary differences 31/12/20.8 (given)	(27 000)	(½)
Movement for the year (Reduce tax loss)	15 857	
		(3)

COMMENTARY ON QUESTION 1

1. The question consists of two separate parts

Part 1
- Disclosure of the following notes to the financial statements are required:
  a. Changes in accounting policy
  b. Prior period errors
  c. Changes in estimates
- You had to demonstrate that you are competent in the application of IAS 8 – Accounting policies, changes in estimates and errors.
- Refer to Descriptive Accounting, chapter 6 or GAAP Handbook 2010, chapter 5.

Part 2
- Disclosure of the notes to the statement of comprehensive income regarding taxation are required.
- You had to demonstrate that you are able to ensure that the appropriate amount of tax is disclosed in the financial statements of the entity.
- Refer to Descriptive Accounting, chapter 9 or GAAP Handbook 2010, chapter 6.

2. It is important to note that you must follow the suggested working method in Tutorial letter 102
   - Study the prescribed text book.
   - Work through the examples and questions in Tutorial letter 102.
   - Study the relevant International Financial Reporting Standard in the SAICA Handbook 2009/2010.

SUGGESTED SOLUTIONS TO QUESTION 2
DIPAC26
ADVANCED MANAGEMENT ACCOUNTING

PART A

Raw materials	**Units**		
Opening stock	-	Given	(½)
Purchased	15 000 000	60 000 000 / 4	(1)
Closing stock	250 000	Given	(½)
Production	14 750 000		

Finished goods

Opening stock	0	0	(1)
Put in production	11 800 000	14 750 000 / 1,25	(1)
Sold	15 000 000	142 500 000 / 9,50	(1)
Closing stock - short	0		

Please note that it is possible to record sales without stock being available. This is referred to as deferred sales in practice.

Value of closing stock

Raw materials = 250 000 x R4	1 000 000	(2)
Finished goods	0	(1)
	1 000 00	

Income statement of Antihistamines (Pty) Ltd for the year ended 31 December 2009

		R'000	
Sales		142 500,00	(1)
Less: Cost of sales			
Opening inventory		0	(1)
Materials		60 000,00	(1)
Depreciation – Manufacturing		7 500,00	(1)
Overheads – Fixed		4 794,20	(1)
Overheads – Variable		2 380,40	(1)
Packaging		500,00	(1)
Wages		15 995,00	(1)
Closing inventory		(1 000,00)	
Cost of sales		90 169,60	
Gross profit		52 330,40	
Delivery costs		500,00	(1)
Depreciation	– Administrative	250,00	(1)
Interest paid		320,00	(1)
Salaries	– Administrative	4 090,50	(1)
	– Sales	2 166,00	(1)
Travelling		7 000,00	(1)
		38 003,90	

Max 20

Part B

1.	(c)	(3)
2.	(b)	(3)
3.	(e)	(3)
4.	(a)	(3)
5.	(a)	(4)
6.	(e)	(4)

1 (c) **In order to calculate the breakeven point we need to determine the fixed and variable costs:**
Using the Hi low method the variable cost is determined as follows:

(45 000 000 - 35 000 000)/(7 000 - 5 000)

= 10 000 000/2 000

= 5000 per unit (1)

The fixed cost is then :
(35 000 000 - 5 000(5 000))
= 35 000 000 - 25 000 000
= 10 000 000 (1)

The break even point is then calculated as follows:

Profit = Sales - variable costs -fixed costs
0 = 10 000x - (5 000x + 10 000 000)
0 = 10 000x - 5000x - 10 000 000
10 000 000 = 5 000x
x = 2000 units (1)

(a) This is merely the maximum capacity available. AT this point the company will make a profit of [(10 000 - 5 000) x 7 000 - 10 000 000] =R 25 000 000.

This is much higher than the break even point where profit = 0.

(b) This number is higher than the expected sales and the maximum capacity available and is therefore not feasible.

(d) This is the expected sales for the next year, not the point at which the company would not make any profits or suffer losses (i.e. Breakeven point).

(e) Not applicable as a correct answer is available.

2 (b) **The profit based on the expected sales of 6 000 units, may be calculated as follows:**

Contribution ([10 000 - 5 000] x 6 000 units)	**30,000,000.00**	(1)
Less: Total fixed cost	**10,000,000.00**	(1)
Profit	**20,000,000.00**	(1)

(a) The amount represents the fixed cost, not a profit, and as the calculation above shows, a profit is made, not a loss.

(c) This is the total contribution for the product, but the fixed cost is incorrectly ignored. To calculate profit, fixed cost should be deducted from the contribution obtained.

(d) This answer merely represents the total sales amount if 6 000 units are sold.

(e) Not applicable as a correct answer is available.

3(e) **To calculate the required number of units to sell in order to generate a profit of,**

we use the formula: **Number of units = (Fixed cost + required profit) / Contribution per unit**

$$= \frac{(10\ 000\ 000 + 30\ 000\ 000)}{5\ 000} \quad (2)$$

$$= 8\ 000 \text{ units}$$

However the maximum capacity is currently 7 000 units, and therefore it is not currently possible for the company to earn a profit of R 30 000 000. (1)

(a) This is the expected sales for the next year, and as calculate above would lead to a profit of R20 000 000

(b) 2 000 bicycles must be sold in order to break even. No profit or loss would be incurred at this level, and it cannot possibly be the correct number of units to generate a high profit of R30 000 000.

(c) This is the correct number of units to produce in order to achieve a profit of R30 000 000.
However, the company can not manufacture this number of units as its maximum capacity is currently 7 000 units per annum.

(d) This is merely the maximum capacity available. At this point the company will make a profit of (10 000 - 5 000) x 7 000 - 10 000 000 = R25 000 000. This does not achieve the profit of R30 000 000.

4(a) The calculation of margin of safety is:

(Expected sales - Break even sales) / Expected sales x 100
= (6 000 - 2 000)/ 6 000 x 100 (2)
= 66,67% (1)

(b) This is merely the difference between the maximum quantity that may be produced (7 000 units) and the lowest quantity given for the cost calculation (5 000 units), divided by the 7 000 units maximum capacity. The answer doesn't make any sense and it's a complete misapplication of the formula.

(c) The answer is incorrect as the formula is applied incorrectly. Instead of dividing by the expected sales, the break even sales level is used, i.e (6 000 units - 2 000 units)/ 2 000 units.

(d) This answer is incorrect as the margin of safety may be calculated as 66,67%, which means that the sales may drop from current levels with 66,67% before a loss will be suffered.

(e) Not applicable as a correct answer is available.

5(a) **The total overhead cost of product B based on labour hours is calculated as follows:**

$$\frac{\mathbf{6\ 400\ 000}}{\mathbf{8\ 000\ 000}} \mathbf{\times 2\ 000\ 000}$$ (1)

= R1 600 000 (2)

(b) This is the overhead cost PER UNIT of product B (i.e. 1 600 000/60 000 units). This is incorrect as the question asks for TOTAL overhead cost.

(c) This would be the cost if the number of units were incorrectly used to allocate the total overhead costs to the two products. It is wrong as the question clearly asked that the labour hours be used as an allocation basis.

(d) This is the cost incorrectly calculated (R 2 000 000 / 80 000 units)- the allocation should have been done over the number of labour hours, not the units produced.

(e) Not applicable as a correct answer is available. (1)

6(e) Machine related cost: R480 000 x 80 000 machine hrs/ 100 000 machine hrs (1)

= 384 000

Quality control: 920 000 x 1 200/ 2 000

= 552 000 (1)

Set up costs: $\mathbf{600\ 000 \times \frac{6\ 400\ 000}{8\ 000\ 000}}$

= 480 000 (1)

(Set-up costs are calculated according to the traditional method using labour hours because there is no cost driver applicable to set-up costs in the question)

Total = 384 000 + 552 000 + 480 000
= 1 416 000

Per unit = 1 416 000 / 60 000
= 23,60

The question asks for the overhead cost PER UNIT.

This cost per unit does not match any of the choices from a to d therefore the answer is (e) none of the above.

(a) This is the cost per unit according to the traditional costing system, using labour hours as the allocation base.

(b) This is the cost per unit according to the traditional costing system, using the number of units produced as the allocation base.

(c) The total cost of R2 000 000 is divided by the 60 000 units of Product B produced. This is incorrect as no cost would then be allocated to Product A, which is clearly wrong clearly wrong as Product A also causes the incurrence of overhead costs.

(d) Not applicable. (1)

COMMENTARY ON QUESTION 2:

Many students performed well in test 1. The following mistakes were noted:
Section a
Students did not use the correct lay out for the income statement. Production costs should be grouped together before gross profit and non production costs below before the net profit is calculated.
Section b and c
This was used to test if students understood the basic principles of cost volume profit and activity based costing. Most students would have done well in this section if they studied it.

SUGGESTED SOLUTIONS TO QUESTION 3
DIPAC38
ADVANCED TAXATION

PART A

(a) Registration of Netsoft as a vendor for VAT purposes

Software and network maintenance – services rendered – not exempt - taxable supplies.
Residential letting – exempt supplies.

A partnership (an unincorporated body of persons) is included as a **person** for purposes of the VAT Act (s 51). ✓

Value of annual software maintenance contracts for the **preceding 12 month period < R1 000 000** (s23(1)(*a*)).

Value of annual software maintenance contracts for the **following 12 month period** ✓ =
R1 105 800 x 100/114 = R970 000 < R1 000 000. (s 23(1)(*b*)) ✓

Annual value of residential letting (R48 000) – **ignore** as it is **exempt supplies** and not taxable supplies. ✓

As the value of Netsoft's taxable supplies for the preceding and following 12 month period is < than R1 000 000, Netsoft is under **no obligation** to register as a VAT vendor.

[4]

(b) Output and input tax implications of transactions

TRANSACTION 1:

Fixed property purchased from non-vendor
Input tax - **deemed (notional) input tax on second-hand goods** ✓ – claimable as the property will be used to **make taxable / mixed supplies** ✓.
Denied? – not denied.
Amount **– lesser of consideration or open market value = R1 800 000 x 14/114 = R221 053** ✓, but limited to **transfer duty paid (R114 000)** ✓.
Apportionment - this expense relates to both the software and network maintenance (taxable supplies) part of the business as well as to the residential letting (exempt supplies) and therefore **expended only partly to to make taxable supplies**, BUT the ***de minimus*-rule (at least 95%)** ✓ is applicable as the garden flat comprises only 4% (< 5%) of the total floor space of the buildings on the property – **no apportionment** ✓.
Time – second-hand fixed property purchased from a non-vendor - can only claim input tax in the period in which the **transfer duty has been paid** ✓ - claimable in February 2010. max. (6)

Conversion of double garage into garden flat
Input tax - but it is **not claimable** ✓ as the garden flat will be used to make **exempt supplies**. ✓ (2)

<u>Conversion of house into offices</u>
Input tax – claimable as a deduction as the house will be used to **make taxable /mixed supplies**.
Denied? – not denied.
Amount – general rule - **R319 200 x 14/114 = R39 200.** ✓
Apportionment – this expense probably relates to both the software maintenance (taxable supplies) part of the business as well as to the (administration of) the residential letting (exempt supplies) and therefore **expended only partly to to make taxable supplies**, BUT the *de minimus*-rule (at least 95%) is applicable as the garden flat comprises only 4% (< 5%) of the total floor space of the property – **no apportionment**. ✓
Time - general rule – invoice basis – **earlier of date that invoice is issued or payment made** - claimable in February 2010. max. (2)

TRANSACTION 2:

<u>Purchase of single cab Yotota LDV</u>
Input tax – claimable due to the fact that the vehicle will be used to **make only taxable supplies**.
Denied? – not a denied input as a single cab LDV is **not a motor vehicle as defined**. ✓
Amount – **cash value** = **R239 400 x 14/114 = R29 400**. ✓
Apportionment – the question specifically stated that this expense only relates to the computer software maintenance part of the business and is therefore expended fully in the course of making taxable supplies - **no apportionment**. ✓
Time – as a **financial lease agreement is regarded as an instalment credit agreement** by the VAT Act, the timing rule is the **earlier of delivery or any payment**. The VAT on the full purchase price is therefore claimable in February 2010. ✓ max. (3)

<u>Fuel</u>
Input tax – no VAT paid as fuel is **zero rated** ✓ – **no VAT claimable**. ✓ (2)

<u>Purchase and installation of canopy</u>
Input tax – claimable due to the fact that the vehicle will be used to **make only taxable supplies**.
Denied? – not denied.
Amount – general rule - **R9 348 x 14/114 = R1 148**. ✓
Apportionment – the question stated that this expense only relates to the computer software maintenance part of the business and is therefore expended fully in the course of making taxable supplies - **no apportionment**. ✓
Time – general rule – invoice basis – **earlier of date that invoice is issued or payment made** - claimable in February 2010. ✓ max. (2)

TRANSACTION 3:

<u>Computers</u>
Input tax - claimable due to the fact that the computers will be used to **make taxable / mixed supplies**.
Denied? – not denied.
Amount

- **capital portion of instalment** - general rule - **R4 170 x 14/114 = R512**. ✓
- **finance charges** – financial service – **exempt**. ✓

Apportionment – although the facts were silent on this aspect, you may assume that this expense relates to both the software maintenance (taxable supplies) part of the business as well as to the residential letting (exempt supplies) and therefore **expended only partly to to make taxable supplies**, BUT the ***de minimus*-rule (at least 95%)** ✓ is applicable as the garden flat comprises only 4% (< 5%) of the total floor space of the property – **no apportionment**. ✓
Time – a **rental agreement is not regarded as an instalment credit agreement** by the VAT Act, the payments are **deemed as successive supplies**. Each successive supply is deemed to take place at the **earlier of whenever any payment is due or received (paid)**. The input tax on the capital portion of the monthly rental payment is therefore claimable in February 2010. ✓ max. (3)

<u>Installation of local area network (LAN)</u>
Input tax - claimable due to the fact that the network will be used to **make taxable / mixed supplies**.
Denied? – not denied.
Amount – general rule – **R32 376 x 14/114 = R3 976**. ✓
Apportionment – same as for computers - ***de minimus*-rule** applicable - **no apportionment**. ✓
Time – general rule – invoice basis – **earlier of date that invoice is issued or payment made** – claimable in February 2010. (2)

TRANSACTION 4:

<u>Cost of repair to the network</u>
Input tax - claimable due to the fact that the network is used to **make taxable / mixed supplies**.
Denied? – not denied.
Amount – general rule – **R9 804 x 14/114 = R1 204**. ✓
Apportionment – same as for computers - ***de minimus*-rule** applicable - **no apportionment**. ✓
Time – general rule – invoice basis – **earlier of date that invoice is issued or payment made** – claimable in February 2010. ✓ max. (2)

<u>Indemnity payment received from insurer</u>
Output tax – **deemed supply**. ✓
Time – **date of receipt of payment** – output tax must be accounted for in February 2010. ✓
Amount – consideration received - **R8 664 x 14/114 = R1 064**. ✓
Apportionment – no apportionment of deemed proceeds. max. (2)

<u>Replacement of unit by insurer</u>
Replacement of an asset by an insurer is **not a deemed supply** – no need to account for output tax on the replacement. ✓ (1)
No input tax claim as the asset was not paid for by Netsoft.

TRANSACTION 5:

<u>Invoices issued for software and network maintenance and prepayment received</u>
Output tax – taxable supplies – must account for output tax.
Time – **Earlier of date invoice issued OR date any payment received** ✓– output tax will be accounted for during February 2010 for all amounts received and invoiced (whichever takes place first) - **R136 800 + R11 400 = R148 200**.
Amount – general rule – **R148 200 x 14/114 = R18 200**. ✓ (2)
[29]

PART B

Donation's tax implications for Mr Zeelie

1. The monthly contribution towards his parents' maintenance is ***bona fide*** and is regarded as **reasonable** ✓ and is **exempt** ✓ in terms of s 56(2)(*c*). (2)

2. The monthly contribution to his local church congregation is **exempt** ✓ in terms of s 56(1)(*h*). (1)

3. The study fees, book and hostel fees paid on behalf of his son while studying full-time at a University should also be **exempt** ✓ in terms of s 56(2)(*c*) as it could be argued that it is a ***bona fide*** and **reasonable** ✓ contribution towards the maintenance of another person. max. (1)

The sports car given to the son as a gift will **probably not be regarded as a *bona fide* contribution towards his maintenance** and it is **doubtful** whether this will be seen to be **reasonable**. Donation's tax will therefore have to be paid on this donation. ✓

R320 000 **– R100 000** (exemption in terms of s 56(2)(*b*)) = R220 000 x **20%** = R44 000. ✓✓ (3)

[7]

SUGGESTED SOLUTIONS TO QUESTION 4
DIPAC49
ADVANCED AUDITING

Presentation mark – If both (a) and (c) were presented in table format – 2 marks (1 mark per table)

(a) Threats

Threat	**Safeguards**
Familiarity threat. The audit manager is the CEO's nephew. (1)	• Consider the significance of the relationship. (1) • If significant, consider not to accept the engagement./Have discussions with the CEO to possibly remove the nephew from the audit. (1) • The nephew should be closely monitored and his work should be reviewed frequently, otherwise they will lose the client. If it is not possible or if independence is an issue, consider not to accept the client. (1)
Intimidation threat. The financial director threatens to take steps to get the firm dismissed if the auditors make a big deal of the consultation fees. (1) CEO might intimidate the nephew and the audit team. (1) Prerequisite for our appointment is that the nephew of the CEO should form part of the engagement team. (1)	• Report the irregularity to IRBA, even if it jeopardises our appointment as auditors. (1) • Consider resigning as auditors after reporting the reportable irregularity. (1) • Continue with the audit under the revised conditions. (1)
Self-interest threat. The partner will obtain 10% shares in Shosholoza (Pty) Ltd. (1) Partner is part of the panel who decides if BEE company should be bought or not. (1)	• Dispose of the financial interest at the earliest date; or (1) • The current partner should be removed from the engagement team and a new partner should be appointed; or (1) • Involve an additional professional accountant to review the work done. (1) • Refuse to form part of the panel or resign as auditor. The auditor is not allowed to make any management decisions. (1)
Self-review threat. Perform the accounting work of the BEE company. The firm will be responsible for doing the audit if Shosholoza decides to buy into the BEE company. (1)	• Different engagement teams should be responsible for the different functions. One team should do the audit and the other should be responsible for the accounting work of the BEE company. (1) • Do not make any management decisions. (1) • Do not accept to do the accounting work. (1)
Advocacy threat. Additional work that will flow to the audit firm due to the promoting of a bulk of the building accessories and any excessive materials. (1) Total 8 Maximum 5	• Auditors should not be involved in the selling of the building accessories and any excessive material. It should be sold directly to the public. (1) Total 14 Maximum 5

(b) Issues your firm would have considered prior to accepting the appointment as auditors of Shosholoza (Pty) Ltd

1.1 Client investigation

Consider the following issues pertaining to Shosholoza (Pty) Ltd:

(a) Integrity of management (1)

- The CEO, Mr Max Motholo, is a majority shareholder. In view of his position, he has an incentive to be involved in fraudulent financial reporting owing to the bonuses that they will receive. The CEO could also influence the nephew. (1)

(b) Independence (1)

Consider the auditor's independence as discussed in (a). (Many issues concerning independence have been identified.) If any threat/independence issue is mentioned – student can still get 1 mark.

(c) The ability to pay the audit fee (1)

- Shosholoza (Pty) Ltd suffered a loss during the year under review. This does not imply that Shosholoza (Pty) Ltd will not be able to pay the audit fee. (1)
- Note that they were unable to pay the previous auditors. (1)

(d) Consider the quality of the overall audit in terms of ISQC1 – *Quality control for firms that perform audits and reviews of historical financial information, and other assurance and related services engagement*. (1)

(e) Conflict of interest (1)

- In future there might be a possible conflict of interest if the safeguards are not put in place, as the partner in charge will be receiving 10% of Shosholoza's shares as part of his remuneration for services that still has to be rendered. (1)

(f) Client's industry and operating environment (1)

- We need to familiarise ourselves with the client's industry and the manner in which Shosholoza operates, as it is a new client. They are currently making a loss and as the result of the weak economy there has been a decline in the demand for their services. (1)

(g) Relationship with previous auditors (1)

- There is no mention of the relationship with previous auditors in the question, but as part of our consideration before accepting the new client, we should contact the previous auditors to determine whether there is any reason/s not to accept the client. The non-payment of the previous audit fees is not reason enough not to accept the client. (1)

1.2 Skill and competence

- Consider the adequacy of our skills, knowledge and resources to properly service Shosholoza (Pty) Ltd. (1)
- Limited time frame to complete the audit (due to the strike) could impact on properly performing the audit in time. (1)

1.3 Terms of the engagement

Establish the terms of the engagement in the engagement letter and highlight the following:

- The responsibilities of the directors and the responsibilities of the auditors (1)
- The duty to report any reportable irregularity to the IRBA (1)

Total 17
Maximum 8

(c) Risk indicators and risk factors

Note: Even if the indicator is not properly worded, but the factor were properly described you can give marks for the risk factor.

Risk indicator	Risk factor
1. New client. (1)	• Opening balances might be wrong or misstated. (1) • Unfamiliar with business, unable to recognise misstatements. (1) • Accounting policies might not be consistently applied. (1)
2. Litigations, legal issues. (1)	• Going concern may be threatened. (1) • Provisions might be understated – the workers are on strike because their March 2010 salaries have not been paid and they are unhappy with the promised salary increases, etc. They are planning to take legal action. (1)
3. Losses suffered, financial position, salaries not paid to employees. (2)	• Risk that the financial statements are not prepared on the correct basis (liquidation basis – if going concern). (1) • Management might be engaged in fraudulent financial reporting. (1)
4. Bonuses to directors. (1)	• Income might be overstated as bonuses are based on profit, or • Expenses or liabilities are not accounted for. (1)
5. Reliance on the audited financial statements by the bank to increase the overdraft facility.(1)	• Legal liability of the auditors regarding negligence. (1)
6. Time limitation for the completion of the audit. (1)	• Non-detection of events after the balance sheet date. (1) • Incomplete financial statements or misstatements. (1)
7. BEE transaction (1)	• Complex accounting treatment • Structure • Intercompany transactions Maximum 2
	Total 21 Maximum 12

(d) Statutory implications of the consultation fees – Auditing Profession Act 2005

1. The situation regarding the payment of consultation fees could indicate payment of bribes, which is a reportable irregularity. (1)

1.1 An ***unlawful act*** has been committed, namely the payment of consultation fees to obtain a contract. This could be a possible bribe. (1)

1.2 The unlawful act has been committed by a person responsible for the ***management*** of the company. This unlawful act is carried out by the financial director, who is also a co-owner of Sebeli Consultants CC. According to the minutes the payments were also approved by the directors. (1)

1.3 The unlawful act has or is likely to ***cause financial loss***. Where fraud has been committed, a financial loss is not a prerequisite for a reportable irregularity. However, it is likely that there will be financial loss. (1)

- To the company itself – Payment of bribes to obtain a contract. (1)
  – Penalties imposed by the court. (1)
- To creditors – Banks and other suppliers of credit may advance funds on the strength of the fictitious profits. (1)

The penalties may have a huge impact on the cash flow, and the possible cancellation of the contract may have an impact on the future of the company. Consider whether the company is a going concern. (1)

1.4 Alternatively consider whether fraud has been committed. Could it be proved that a bribe was offered? (1)

1.5 Alternatively the unlawful act represents a material breach of the director's fiduciary duty. This has occurred as it is a serious breach of shareholders' trust on the part of the directors. (They have a fiduciary duty to shareholders.) (1)

Possible non-disclosure of their interest in the contract?

1.6 Before reporting, I must be satisfied or have reason to believe that the unlawful act did take place. (1)

- We need to use the minutes as part of our corroborative evidence, because no other information is available. (1)
- We need to discuss the matter with the other directors, excluding the financial director. (1)
- We need to obtain a management representation letter, because the supporting documentation is not available. We need to follow up on the documentation, because a management representation letter cannot replace the actual evidence. (1)

(Maximum 2)

2. My duty in terms of section 45 of the AP Act 2005:

2.1	I should have reported (should report) the matter to the IRBA "without delay" once I was satisfied that the reportable irregularity was taking place (first report). (1)
2.2	Within three days of sending the first report I should have notified the company of the report and provided them with a copy of the report. (1)
2.3	As soon as reasonably possible but within 30 days I should discuss the report with the directors to enable me to make a second report to the IRBA. (1)
2.4	I should be in a position to state the following in the second report: • No reportable irregularity has or is taking place (unlikely in this case); ***or*** (1) • The suspected reportable irregularity is no longer taking place and adequate steps have been taken for the prevention or recovery of any loss (possible in this case); ***or*** (1) • The reportable irregularity is continuing. (1) (Maximum 2)

3. The second implication of the consultation fees is that I will be obliged to issue a qualified audit report in terms of section 44 of the AP Act for the following reasons:

3.1	I have not carried out my audit free of restriction in compliance with the ISAs. • The financial director has restricted the procedures I am able to perform. Only the minutes are available to prove that these payments have been approved. (1)
3.2	Proper accounting records of transactions have not been kept. • The payments are reflected in the financial statements, but there is no corroborative evidence to support the payments. (1)
3.3	I have been unable to obtain "all information, vouchers and other documents necessary for the proper performance" of my duties. • Only the minutes are available as supporting documentation – it is claimed that the documentation has been misplaced. (1)
3.4	I have been unable to comply with all the requirements of the law relating to this audit. • Certain duties required in terms of section 300 of the old Companies Act (section 90 of the 2008 Companies Act) cannot be carried out. (1)
3.5	I am not satisfied that the financial statements are fair in respect of the consultation fees. (1)
3.6	I am not in a position to report to the IRBA that no reportable irregularity has taken place. (1) (Maximum 3)

Total 17
Maximum 10

COMMENTARY ON QUESTION 4:

General

Remember that this is the first of four tests of the year and it is just one the stepping stones toward passing this module. If your marks did not meet your expectations, stay positive and work harder!

- Students demonstrated poor time management, as they did not answer all parts of the question.
- Many students did not read the question carefully and therefore did not present the solution for parts (a) and (c) in a table format. For those who did, two presentation marks were awarded.

Part (a)

- This was an easy question in which students should have scored marks.
- Many students did not describe the threat at all or they linked it to the incorrect description. By doing this the incorrect examples were also linked to the incorrect threat. This further implicated that no marks could be awarded to that specific safeguards.
- Remember to use the correct term when identifying a threat to independence!

Part (b)

- This section was very easy and if students studied tutorial letter 102 and did questions they could have done very well here. For those who failed this section, you need to go back to your study material and make sure that you are well acquainted with pre-engagement activities.
- Students tend to forget to apply the information in the question to their solutions and thereby lose a lot of valuable marks.

Part (c)

- Many students mentioned risks and procedures, but procedures were not required.
- Students are confused with the difference between a risk indicator and a risk factor. If you studied tutorial letter tutorial letter 102, this section was very easy. Refer to pages 11 to 14 of the tutorial letter to help you with this.

Part (d)

- There were a lot of students who did not attempt this section or only attempted it partially.
- Some students are not applying the information to the question and then no marks can be awarded.
- If you used the hint in the required part, you should have picked up that you should have discussed a reportable irregularity. Unfortunately a lot of students did not identify it!