SCHOOL OF ACCOUNTING SCIENCES

POSTGRADUATE DIPLOMA IN ACCOUNTING SCIENCES

TUTORIAL LETTER 305/2010
(DIPACA8)

TEST 3 AND THE SUGGESTED SOLUTIONS WRITTEN ON 19 JUNE 2010

Dear Student

This tutorial letter comprises of the third test that was written on 19 June 2010, as well as the suggested solutions and comments made by the markers.

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 the 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

SCHOOL OF ACCOUNTING SCIENCES
POSTGRADUATE DIPLOMA IN ACCOUNTING SCIENCES

TEST 3: 19 JUNE 2010

PAPER 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:	Mr. H.T. Meyer Ms. A. de Jongh Ms. N. Fotsios	Mrs. M.C. de Klerk Mr. B.J. Mothuloe
SECOND EXAMINER:	Prof. H.C. 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 (Advanced Financial Accounting) paper consists of 3 pages and is out of 40 marks.

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PAPER 1: DIPAC15 (ADVANCED FINANCIAL ACCOUNTING) **(40 MARKS)**

PART A **(6 marks)**

Nakamachi SA (Pty) Ltd is a leading car manufacturer in the world. This iconic brand, developed several decades ago by its founder J Choi, is renowned for its unrivalled safety and reliability in the car industry. The financial year-end of the company is on 30 June.

The company has recently been exposed to bad publicity worldwide owing to problems with the accelerator system of some of its cars. The company announced in a press release that eight million cars worldwide would be recalled to fix the defective accelerator system. One per cent of the cars with the defective accelerator system were sold in South Africa.

Car mats, which became loose and got stuck under the accelerator pedals, caused the problem in the accelerator system. Closer inspection of the defective system in cars sold overseas revealed that the accelerator pedal mechanism was hard to depress, returned slowly to idle position and even became stuck in a partially depressed position.

Nakamachi SA (Pty) Ltd released a further press statement on 15 June 2009 in which it undertook to recall all the cars affected and fix the faulty accelerator system. It is standard practice in the car industry for the manufacturer to fix latent defects in the manufacturer's products, and Nakamachi SA (Pty) Ltd subscribes to this practice. This procedure is followed to protect the company's public image and to give customers peace of mind.

A spokesperson for the beleaguered car manufacturer announced that the recalls would cost R1 500 per vehicle. It is estimated that 10% of the recalled vehicles will not have a defective accelerator system. The recalls will be at the expense of Nakamachi SA (Pty) Ltd and at no cost to the customer. The cars affected were at the low end of the market and were not covered by any maintenance plan. The total sales of Nakamachi SA (Pty) Ltd in South Africa for the year ended 30 June 2009 were 500 000 units.

REQUIRED

	Marks
Discuss, with reasons, the appropriate accounting treatment of the recall of cars by Nakamachi SA (Pty) Ltd in the financial statements for the year ended 30 June 2009, in accordance with International Financial Reporting Standards (IFRS). Where possible, your discussion must be accompanied by relevant amounts.	**6**

PART B **(34 marks)**

Lesedi Letwaba qualified as a chartered accountant (SA) two years ago. He was the first person to qualify as a CA (SA) in the Moruleng Village situated 20 km from Sun City. A new platinum mining company, Bakgatla Platinum Mines (Pty) Ltd, started its operations in Moruleng at the beginning of the year.

Lesedi and a consortium of local business people formed a BEE company, Marang (Pty) Ltd, which won a lucrative tender to provide specialised mining-related services to the Bakgatla Platinum Mines (Pty) Ltd.

On 1 April 2008, Marang (Pty) Ltd entered into a lease agreement with Phuthanang Ltd that specialises in mining equipment.

The lease agreement permits Marang (Pty) Ltd to lease an item of machinery for use in its operations.

PAPER 1: DIPAC15 (ADVANCED FINANCIAL ACCOUNTING) continued

The details of the lease agreement are as follows:

Lease term	:	4 years
Useful life and economic life	:	5 years
Guaranteed residual value	:	R10 000
Interest rate	:	20% per annum
Fair value of machinery	:	R100 000

Ownership of the machinery will remain with Phuthanang Ltd at the end of the lease term. The terms of the lease agreement comply with a resolution of Marang (Pty) Ltd's board of directors, in terms of which all leased equipment have to be returned to the lessor at the end of the lease term. This allows the board of Marang (Pty) Ltd, as a newly founded company, time to focus on strategic management instead of being burdened with issues relating to the ownership of property, plant and equipment. Marang (Pty) Ltd will be responsible for the maintenance and repair of the machine.

The lease instalments are paid monthly in arrears.

Take note of the following:

- Ignore VAT.
- The financial year-end is on 30 June.
- The tax rate is 28%.

REQUIRED

		Marks
1.	Discuss whether the lease agreement will be classified as a finance leases or an operating lease for accounting purposes in the books of Marang (Pty) Ltd.	**4**
2.	Provide the journal entries to account for the machinery leased from Phuthanang Ltd in the books of Marang (Pty) Ltd for the 2008 and 2009 financial years assuming the lease agreement will be classified as a financial lease.	**30**
	Journal narrations are not required.	

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

SCHOOL OF ACCOUNTING SCIENCES
POSTGRADUATE DIPLOMA IN ACCOUNTING SCIENCES

TEST 3: 19 JUNE 2010

PAPER 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. F.J.C. Benade	Mr. L. Crafford
	Ms. A. Combrink	Mr. A. De Graaf
	Ms. J. Foot	Mr. S. Ndlovu
	Ms. A. Ravat	Ms. F. Tayob
	Ms. F. Venter	
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 (Advanced Management Accounting) paper consists of 5 pages and is out of 40 marks.

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PAPER 2: DIPAC26 (ADVANCED MANAGEMENT ACCOUNTING) **(40 MARKS)**

THIS PAPER CONSISTS OF TWO INDEPENDENT PARTS

PART A **25 marks**

Box Limited is a manufacturer of packaging materials.

The following is an extract from the Statement of Financial Position of Box Limited as at 31 March 2010:

	R'000
Issued share capital	250 000
Reserves	120 000
250 000 preference shares	100 000
12% irredeemable debentures	200 000

The current risk-free rate on RSA Treasury bonds is 9%. The expected market return is currently 19%. Box Limited has a Beta of 1,2.

The preference shares are not redeemable, have no conversion rights and pay a dividend of R36 per share annually. Plastic Limited, a competitor of Box Limited, has recently issued preference shares with a par value of R500 each that pay a dividend of R55 per share annually, which is currently considered a fair market return.

Debentures similar to those of Box Limited are currently trading at 15%.

The directors of Box Limited have indicated that the company is targeting a ratio of 70% equity, 10% preference shares and 20% debentures.

The company is considering a new project with a five year life. The marketing manager has prepared the following cash flow for the project:

Year	1 R'000	2 R'000	3 R'000	4 R'000	5 R'000
Sales	4 500,0	5 535,0	6 697,4	7 702,0	8 703,2
Less:	(4 612,5)	(4 955,6)	(5 284,5)	(5 484,2)	(5 744,6)
Materials	(945,0)	(1 217,7)	(1 406,4)	(1 540,4)	(1 740,6)
Employee expenses	(450,0)	(553,5)	(669,7)	(770,2)	(870,3)
Overheads	(467,5)	(524,4)	(588,4)	(643,6)	(698,7)
Research and development costs	(50,0)	-	-	-	-
Other expenses	(100,0)	(110,0)	(120,0)	(130,0)	(135,0)
Wear and tear	(2 000,0)	(2 000,0)	(2 000,0)	(2 000,0)	(2 000,0)
Interest	(600,0)	(550,0)	(500,0)	(400,0)	(300,0)
Cash flow before taxation	(112,5)	579,4	1 412,8	2 217,8	2 958,6
Tax	33,8	(173,8)	(423,8)	(665,3)	(887,6)
Cash flow after taxation	(78,8)	405,6	989,0	1 552,4	2 071,0

<u>PAPER 2: DIPAC26 (ADVANCED MANAGEMENT ACCOUNTING)</u> continued

Overheads include rental of R200 000 per year (no escalation). The project will be undertaken in the existing factory and therefore a portion of the rental will be allocated to the new project.

Overheads also include overheads allocated to recover Head Office costs e.g. financial and management reporting, tax and legal compliance. The policy is to allocate an amount equal to 10% of the project overheads (including allocated rental).

Investment in plant and equipment of R10 million will be made at the start of the project. The plant and equipment will be sold for R1 million at the end of the project.

Total working capital required for the project will as follows in each year:

Year 0	R180 000
Year 1	R220 000
Year 2	R260 000
Year 3	R300 000
Year 4	R340 000
Year 5	R250 000

The current company tax rate is 30%. Ignore capital gains tax. There is a tax allowance on new plant of 20% per annum on cost on a straight-line method. This is in line with the depreciation method. The company is making positive cash flows from other projects. There is a one year tax time lag for tax purposes.

You are to assume that all cash flows, other than the plant acquisition, take place at the end of the year.

REQUIRED		**Marks**
(a)	Calculate the target weighted average cost of capital (WACC) for Box Limited.	(7)
(b)	Calculate the net present value of the new project and conclude whether it should be accepted or not. Assume that the target WACC is 17%. Start your calculation by using the cash flow before taxation as calculated by the marketing manager and then make the necessary adjustments and additions. Show all your workings. Clearly indicate any assumptions made.	(18)

PAPER 2: DIPAC26 (ADVANCED MANAGEMENT ACCOUNTING) continued

PART B — 15 marks

FurnPro (Pty) Ltd is a manufacturer of good quality furniture in Gauteng for the residential and business market. The company was started 18 years ago by Mr Wood who is a 60% shareholder and the Chief Executive Officer. The remainder of the shares are held equally by Mr Wood's two sons, both of whom work in the medical field. Mr Wood is considering retirement and has approached you for advice regarding the valuation of his shares.

You have been given the following extracts from the Statements of Comprehensive Income for the years ended 31 December:

	2007 R	2008 R	2009 R
Turnover	40 000 000	44 000 000	53 000 000
Cost of sales	(15 000 000)	(16 500 000)	(19 900 000)
Gross profit	25 000 000	27 500 000	33 100 000
Depreciation	(1 000 000)	(1 050 000)	(1 300 000)
Other income	800 000	840 000	1 070 000
Other expenses	(20 000 000)	(22 200 000)	(25 100 000)
Earnings before tax	4 800 000	5 090 000	7 770 000

You obtain the following additional information:

1. FurnPro has a contract to supply school desks to the Department of Education. The contract will be coming to an end on 31 March 2010 and Mr Wood believes it is unlikely that it will be renewed due to expenditure cutting by the Department. The contract contributed R500 000, R540 000 and R550 000 to gross profit in the 2007, 2008 and 2009 years respectively.

2. In the 2009 year FurnPro supplied a large number of beds to a hotel chain who were busy upgrading their rooms in preparation for the expected tourist inflow due to an international sporting tournament that would be taking place in South Africa during 2010. The gross profit due to the sale was R2 000 000.

3. Included in Other expenses in 2007 are advertising expenses of R100 000. In the 5 year budget prepared by Mr Wood he had anticipated that they would increase by 7% per year from 2008 onwards. The actual increase was 14% for 2008 and 13% for 2009.

4. At the start of the 2008 year the admin department moved to new premises owned by one of Mr Wood's sons. The rental of R150 000 per year increases by 10% per year and is 20% higher than that of similar premises in the area.

5. During 2009 FurnPro bought several new machines. This resulted in an increase in Depreciation of R250 000.

PAPER 2: DIPAC26 (ADVANCED MANAGEMENT ACCOUNTING) continued

6. Sleepy Beds, a competitor of FurnPro, went out of business during 2009. FurnPro managed to secure one of Sleepy Beds' former customers, a furniture retailer, as a customer. Bed sales to the new customer resulted in additional gross profit of R1 000 000 in 2009.

7. FurnPro had sold some old machinery during 2009 resulting in a profit of R200 000 (included in Other income). Sleepy Beds was one of the buyers. They still owed R80 000 at the time of their liquidation. FurnPro was not hopeful of recouping any of the outstanding money but had not yet made provision for writing-off the amount.

The current company tax rate is 28%.

REQUIRED		**Marks**
(a)	List the areas / documents that you will analyse as part of your going concern evaluation.	(5)
(b)	Calculate maintainable earnings for the 2007, 2008 and 2009 years to enable a valuation of FurnPro.	(15)

SCHOOL OF ACCOUNTING SCIENCES
POSTGRADUATE DIPLOMA IN ACCOUNTING SCIENCES

TEST 3: 19 JUNE 2010

PAPER 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 EXAMINERS:	Prof. A.C. Engelbrecht Ms. M.M. Pretorius Ms. M. Ungerer
SECOND EXAMINER:	Prof. M.J. Nieuwoudt

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 (Advanced Taxation) paper consists of 5 pages and is out of 40 marks.

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PAPER 3: DIPAC38 (ADVANCED TAXATION) **(40 MARKS)**

This paper consists of three unrelated parts. **You may ignore value-added tax.**

PART A **10 marks**

Julius Jacobs saw an opportunity to "cash in" during the Soccer World Cup and incorporated a new company, Soccer Mania (Pty) Ltd with three of his friends. The company will trade in various products, including soccer balls, vuvuzela's, official soccer T-shirts and Zakumi mascots. Soccer Mania (Pty) Ltd commenced trading on 1 June 2009. Soccer Mania (Pty) Ltd has a 31 December year end.

Being very optimistic, the company purchased trading stock at a cost of R1 450 000 in its first month of trading. The trading stock had a market value of R2 175 000. Sales did not meet expectations and in reaching its first year-end, Soccer Mania (Pty) Ltd only had sales to the value of R300 000. The cost of trading stock items sold, was R200 000.

The shareholders of Soccer Mania (Pty) Ltd was not discouraged by this and remained convinced that the demand for Soccer Mania (Pty) Ltd's products would increase as the World Cup approached. They subsequently decided to import a new range of soccer balls from the USA in order to expand their product range.

An order for 1 000 soccer balls was placed on 11 January 2010, to the value of $150 000. The soccer balls were shipped free-on-board (FOB) on 3 February 2010 and arrived at Soccer Mania's premises on 5 March 2010. Soccer Mania (Pty) Ltd agreed to settle the purchase price in full by 30 June 2010. No forward exchange contract was entered into as a hedge against currency fluctuations.

Being unhappy with the quality of the soccer balls received, Soccer Mania (Pty) Ltd decided to withhold their payment until the dispute with the USA supplier could be resolved. At 31 December 2010, the full amount was still outstanding.

During the World Cup tournament, Soccer Mania (Pty) Ltd decided to distribute vuvuzela's (trading stock) as a dividend-*in-specie* to its shareholders. These vuvuzela's had a cost of R80 000 and a market value of R130 000.

During the 2010 financial year, trading stock with a cost of R800 000 was sold for R1 200 000.

Relevant exchange rates are as follows:

Date	Spot Rate
11 January 2010	\$1 = R7.50
3 February 2010 (transaction date)	\$1 = R7.45
5 March 2010	\$1 = R7.60
30 June 2010	\$1 = R7.20
31 December 2010	\$1 = R7.90

PAPER 3: DIPAC38 (ADVANCED TAXATION) continued

REQUIRED	MARKS
Indicate and calculate the normal tax implications that will result from the above transactions for Soccer Mania (Pty) Ltd in respect of the 2009 and 2010 years of assessment. You may assume that current legislation had also been in force during the 2009 year of assessment.	10

PART B **23 marks**

Vitality (Pty) Ltd, a retailer and resident of the Republic, entered into the following transactions during its financial year ended 28 February 2010:

	R
Taxable income from operations, calculated correctly, before taking the following items into account:	2 065 000
Prepaid expenses (note 1)	144 000
Donation to public benefit organisation (PBO)	30 000
Legal expenses (note 2)	55 000
Restraint-of-trade payment (note 3)	160 000
Leave pay (note 4)	90 000
Bad debts (note 5)	17 000
Repairs (note 6)	15 000

Notes:

(1) **Prepaid expenses**
Insurance for the period 1 January 2010 – 30 September 2010 was paid on 28 February 2010.

(2) **Legal expenses**
The following legal expenses were incurred during the year of assessment:

Drawing up of restraint-of-trade agreement (note 3)	12 000
Debt collection	6 000
Dispute with one of its customers for supplying a defective product Judgement was given in favour of the customer, with all legal costs to be borne by Vitality (Pty) Ltd. Damages paid were R25 000 and legal costs paid were R12 000 (own legal costs of R5 000 and the customer's legal costs of R7 000).	37 000
	55 000

(3) **Restraint-of-trade**
A restraint-of-trade payment was paid to a former employee. The restraint prohibited the former employee to work for a competitor of the company within a radius of 15km from its business premises, for a period of four years.

PAPER 3: DIPAC38 (ADVANCED TAXATION) continued

(4) **Leave pay**
Included in the amount for leave pay is a general R50 000 leave pay provision. The balance of R40 000 was paid to an employee on 31 January 2010 when he left the employment of Vitality (Pty) Ltd.

(5) **Bad debts**

	R
Included in bad debts are the following amounts:	
Trade debtors from trading in the 2010 year of assessment	10 000
A loan to an employee who has died before the loan was paid back (no amount could be recovered from the estate)	2 000
A provision for doubtful debts	5 000
(The total list of doubtful debts for the 2010 year of assessment amounts to R8 000)	
	17 000

The Commissioner allows 25% of the qualifying debts on the doubtful debt list as a deduction in terms of section 11(*j*) and the full list relates to trade debtors.

The doubtful debts allowance, allowed by the Commissioner in the 2009 year of assessment, amounted to R3 500.

(6) **Repairs**
During the year of assessment, Vitality (Pty) Ltd replaced the windows of their boardroom with sliding doors. This was done in order to create an easy access to the outdoor “braai” area when entertaining clients. The building does not qualify for any tax allowance.

REQUIRED	**MARKS**
Calculate the taxable income of Vitality (Pty) Ltd for the 2010 year of assessment. Support your calculations with relevant explanations and motivate the deductibility of the compensation for damage paid to the customer (refer note 2).	23

<u>PAPER 3: DIPAC38 (ADVANCED TAXATION)</u> continued

<u>PART C</u> 7 marks

Custodian (Pty) Ltd, a South African resident, decided to expand its operations and bought new capital items for the purposes of its business. Custodian (Pty) Ltd has a 31 December year end. The following was bought during the 2010 year of assessment:

	R
Standby power generator (note 1)	80 000
Tractor (note 2)	600 000

Notes:

1. The cost of the foundation for the standby generator amounts to R10 000 and is not included in the cost of R80 000. The foundation is regarded as being integrated with the generator and its useful life is limited to that of the generator. The generator was purchased on 1 March 2010 and brought into use on 1 April 2010 once the foundation had been laid.

2. The tractor was purchased from a connected person on 1 January 2010. It was brought into use on the same day. The connected person originally paid R500 000 for the tractor and have claimed allowances of R250 000 in total on the tractor until the date of its disposal. The sales transaction resulted in a recoupment (under section 8(4)(a)) of R250 000 and a taxable capital gain of R50 000 (50% x R100 000) for the connected person.

The write-off periods for the abovementioned assets as per Interpretation Note No. 47 are as follows:

	Years
Standby power generator	15
Tractor	4

REQUIRED	**MARKS**
Calculate the wear and tear allowances,(if any), that Custodian (Pty) Ltd will be entitled to with regard to these two capital items, for the 2010 year of assessment. Show your workings.	7

SCHOOL OF ACCOUNTING SCIENCES
POSTGRADUATE DIPLOMA IN ACCOUNTING SCIENCES

TEST 3: 19 JUNE 2010

PAPER 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. S. Hassim	Mr. V.M. Motholo
	Mr. M.M. Mudau	Ms. C. Roets
	Ms. E.A.J. Terblanche	Ms. N.V. Thoothe
	Ms. R. Van Beek	Ms. J. de Wet
SECOND EXAMINER:	Ms. 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 (Advanced Auditing) paper consists of 3 pages and is out of 40 marks.

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PAPER 4: DIPAC49 (ADVANCED AUDITING) **(40 Marks)**

Your firm has recently been appointed as the auditors of Waratahs Ltd (Waratahs). You are the audit manager responsible for the audit. The company's previous auditors resigned and this is the first year that your firm is performing the audit. Waratahs is a wholesaler and distributor of sports equipment and their year-end is 28 February 2010.

1. Creditors reconciliation

To familiarise yourself with the business, you discussed the creditors with Mr Reds, Waratahs' financial director. According to Mr Reds, there were 236 suppliers on the creditor's master file at year-end. Most of the suppliers are local, but there are a few international suppliers too. Amounts owing to local and international creditors range from R420 to R54 061, the latter being owed to Stormers Ltd, a local manufacturer of rugby balls.

The inexperienced trainee accountant responsible for auditing the creditors decided to include only those creditors with high values in his sample. He submitted the following creditor's reconciliation to you:

Creditor: STORMERS LTD

Creditor's reconciliation between the creditor's monthly statement of Stormers Ltd and the creditors balance in the creditor's ledger of Waratahs as at 28 February 2010.

	R
Balance owing according to Stormers Ltd's monthly statement	110 310
Minus:	
– Payment made that is not yet reflected on the monthly statement	(40 509)
– Goods appearing on the monthly statement that haven't been received	(2 709)
– Goods returned to the supplier, for which no deduction has been made from the outstanding amount (30 rugby balls @ R434 each)	(13 020)
Balance according to creditors ledger	**54 072**

2. Provisions

During your final revision of the working papers, you discovered the following note made by one of the trainee accountants:

	2009	**2008**
Provision for damages	80 000	-

This amount is related to a claim against the company by a former client, Brumbies Ltd (Brumbies). Brumbies instituted a claim for damages against Waratahs because Brumbies lost a rugby game against the Lions rugby team. Brumbies alleged that this was the result of defective rugby balls supplied by Waratahs. The court found Waratahs guilty. The final court order containing the amount for damages is still outstanding from Brumbies' attorneys. Waratahs' management estimated the total amount due at R80 000.

PAPER 4: DIPAC49 (ADVANCED AUDITING) continued

Audit procedures performed

A management representation letter was obtained regarding the reasonability of the provision for legal costs at year-end.

REQUIRED

		Marks
(a)	I.r.o. the audit of opening balances contained in the financial statements of Waratahs: (i) Describe the auditor's objective in this regard. (ii) List the procedures that the auditor must perform in respect of the opening balances.	 2 4
(b)	Discuss the criteria that must be used for the selection of creditors for audit purposes and also indicate if you agree with the trainee accountant. Motivate your answer in detail.	7
(c)	Describe the audit procedures that the trainee accountant must perform on the creditors reconciliation of Stormers Ltd.	20
(d)	Explain the following to the trainee accountant: (i) whether you agree with the accounting recognition and measurement of the provision for damages; (ii) the appropriateness of the management representation letter as audit evidence; (iii) what additional audit procedures, if any, should be performed by the trainee accountant.	 2 2 3

SUGGESTED SOLUTIONS AND COMMENTARY ON TEST 3

<u>SUGGESTED SOLUTIONS TO PAPER 1: DIPAC15</u>

<u>ADVANCED FINANCIAL ACCOUNTING</u> **(40 MARKS)**

PART A

The following criteria are a prerequisite for the recognition of a provision:

- There must be an obligating past event that creates a legal or a constructive obligation that the company has no other realistic option but to settle:
  - → The press release issued by Nakamachi SA (Pty) Ltd on 15 June 2009 gives rise to an obligating event. (1)
  - → A constructive obligation arises on 15 June 2009 because it raises a valid expectation that Nakamachi SA (Pty) Ltd will fix all the cars affected by the recall. (1)
- The outflow of future economic benefits must be probable:
  - → The cost to repair the defective accelerator system in all the affected cars. (1)
- The amount of the provision must be estimated reliably:
  - → 1% x R8m x 90% x R1 500 = R108 000 000. (2)

Therefore, Nakamachi SA (Pty) Ltd must raise a provision for R108 million in the financial statement for the year ended 30 June 2009. (1)

Logical argument – Part A	<u>(1)</u>
	<u>7</u>
MAXIMUM	**<u>6</u>**

PART B

1. Although ownership of the asset does not pass to the lessee at the end of the lease, the following aspects can be indicators that the risk and rewards vest in the lessee:

   - IAS17.10 (c). The lease term is for the major part of the economic life of the asset. The lease term is 4 years and the useful life is 5 years. (1)

   - IAS17.10 (d). At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset. (1)

   - Marang (Pty) Ltd also carries the risk regarding the asset since the company responsible for all repairs and maintenance. (1)

   Based on the above, the lease agreement is treated as a finance lease for accounting purposes in terms of IAS 17.(7-11). <u>(1)</u>

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<u>SUGGESTED SOLUTIONS TO PAPER 1: DIPAC15</u> continued

2.

HP 10bII	**Sharp EL-733A**	**Sharp EL-738**
1. 2^{nd}F C (Clear all)	1. 2^{nd}F C.CE (Clear all)	1. 2^{nd}F MODE (Clear all)
2. 1 2^{nd}F PMT (P/YR)	2. 100 000 PV (½)	2. 100 000 PV (½)
3. 100 000 PV (½)	3. -10 000 FV (½)	3. -10 000 FV (½)
4. -10 000 FV (½)	4. (20/12) i (½)	4. 48 N (½) *(12 x 4 = 48)*
5. (20/12) I/YR (½)	5. 48 n (½) *(12 x 4 = 48)*	5. (20/12) I/Y (½)
6. 48 N (½) *(12 x 4 = 48)*	6. COMP PMT ⇒ R2 905,40	6. COMP PMT ⇒ R2 905,40
7. PMT ⇒ R2 905,40	7. 1 P_1/P_2 3 P_1/P_2 ACC *Prin*; ACC *Int*; ACC *Bal*	7. AMORT 1 ENT ▼ AMORT 2 ENT ▼*Bal*;▼*Prin*;▼*Interest*
8. 1 INPUT 3 2^{nd}F AMORT = *Prin*; =*Int*; =*Bal*		
Balance	**Finance cost**	**Capital**
96 222[e]	4 938[a]	3 778[b]
9. 4 INPUT 15 2^{nd}F AMORT = *Prin*; =*Int*; =*Bal*	8. 4 P_1/P_2 15 P_1/P_2 ACC *Prin*; ACC *Int*; ACC *Bal*	8. ▼ AMORT 1 ENT ▼ AMORT 15 ENT ▼*Bal*;▼*Prin*;▼*Interest*
Balance	**Finance cost**	**Capital**
79 087[f]	17 730[c]	17 135[d]

∴ Instalment = R2 905,40
Present value minimum lease payments = R100 000 *(1)*

∴ Capitalise at the **lower** of fair value and present value of minimum lease payments which is both R100 000 *(1)*

∴ R100 000

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SUGGESTED SOLUTIONS TO PAPER 1: DIPAC15 continued

PART B

Journal entries

	Dr R	Cr R	Dis-clo-sure	Calc
Equipment (SFP)	100 000		(½)	(1)/*(3)*
Lease liability (SFP)		100 000	(½)	
Being the lease liability on 1 April 2009				
Finance cost	4 938[a]		(½)	(1)
Lease liability	3 778[b]		(½)	(1)
Bank (2 905,40 x 3)		8 716	(½)	(1)
Being the lease instalments for April, May and June				
Depreciation	6 250		(½)	(1½)*
Accumulated depreciation: Equipment		6 250	(½)	
Being the accumulated depreciation for three months (100 000(½)* x 3/12(½)* x ¼(½)*)				
Deferred tax (SFP) **[C1]**	692		(½)	(4)
Deferred tax (SCI)		692	(½)	
Being the deferred tax on equipment held under a finance lease				
Finance cost	17 730[c]		(½)	(1)
Lease liability	17 135[d]		(½)	(1)
Bank (2 905,40 x 12)		34 865	(½)	(1)
Being the payment of lease rental				
Depreciation	25 000		(½)	(1)#
Accumulated depreciation		25 000	(½)	
Being the accumulated depreciation on equipment (100 000(½)#/4(½)#)				
Deferred tax (SFP) **[C2]**	2 202		(½)	(4½)
Deferred tax (SCI)		2 202	(½)	
Being the deferred tax on equipment held under a finance lease				
			8	18
				26

SUGGESTED SOLUTIONS TO PAPER 1: DIPAC15 continued

CALCULATIONS

		CA		TB	TD			DT	
C1.									
1^{st} yr	Equipment (100 000 – 6 250)	93 750	(1)	- (½)	93 750				
	Finance lease liability	(96 222)[e]	(1)	- (½)	(96 222)				
					2 472	(½)	x 28%(½) =	692 Asset	
C2.									
2^{nd} yr	Equipment (93 750 – 25 000)	68 750	(1)	- (½)	68 750				
	Finance lease liability	(79 087)[f]	(1)	- (½)	(79 087)				
					10 337	(½)	x 28%(½) =	2 894 Asset	
								2 202	(½)

MARKERS COMMENTARY OF PAPER 1: DIPAC15 (ADVANCED FINANCIAL ACCOUNTING)

PART A:

- 500 000 units instead of 8 000 000 units was used when calculating the amount of the provision.

- 10% instead of 90% (100% less 10%) was used when calculating the amount of the provision.

PART B:

Part 1 (Discussion)

- The majority of students incorrectly identified the lease as an operating lease based only on the fact that ownership of the asset did not pass to the lessee at the end of the lease. Students need to consider all indicators in order to determine whether the risks and rewards vest with the lessee.

Part 2 (Journal Entries)

- The payment calculation was incorrectly calculated using years instead of months and as such both the n and i were incorrect.

- Depreciation calculation: The cost was incorrectly divided by 5 years instead of 4 years.

- Deferred tax was not specified in the journals - i.e.: to the Statement of Financial Position (SFP) or Statement of Comprehensive Income (SCI).

- The journal entry which accounted for the movement in deferred tax was often left out by students.

MARKERS COMMENTARY OF PAPER 1: DIPAC15 continued

GENERAL COMMENTS:

- Calculations not shown
- Calculations not cross-referenced

The question and solution to Test 3 can be found under 'Additional Resources' on myunisa. As exam preparation, it is advised that you work through the question & solution and take note of the mistakes you made.

SUGGESTED SOLUTIONS TO PAPER 2: DIPAC 26

ADVANCED MANAGEMENT ACCOUNTING **(40 MARKS)**

THE QUESTION CONSISTS OF TWO UNRELATED PARTS

General Note: Marks should not be deducted for sensible rounding

PART A **25 marks**

(a) Weighted average cost of capital (WACC)

Cost of equity (Ke)
Ke = Rf + β (Rm - Rf)
= 0,09 + 1,2 (0,19 - 0,09)
= 21,0% (2)

Note: Half mark allocated per veriable :Rf + β (Rm – Rf)

Cost of preference shares (Kd)
= R55 / R500
= 11,0% (1)

Irredeemable debentures
Kd = Market interest rate after tax
= 0,15 x 0,7
= 10,5% (1)

WACC	**% Weight**	**Cost**	**Weighted**	
Equity	0,70	0,210	0,147	
Preference shares	0,10	0,110	0,011	
Debentures	0,20	0,105	0,021	
			0,179	(3)

Target WACC = 17,9%

Note: 1 Mark allocated for using the target weight and one mark allocated for weighing per the "Weighted" column and one mark allocated for the correct WACC of 17,9%

SUGGESTED SOLUTIONS TO PAPER 2: DIPAC 26 continued

(b) Net present value (NPV)

Alternative 1:

Year	0 R'000	1 R'000	2 R'000	3 R'000	4 R'000	5 R'000	6 R'000	
Cash flow before taxation - given	-	(112,5)	579,4	1 412,8	2 217,8	2 958,6	-	(1)
Adjustments:	-	2 842,5	2 797,7	2 753,5	2 658,5	2 563,5	-	
Overheads – Rental (N1)		200,0	200,0	200,0	200,0	200,0	-	(1)
Overheads - Head Office costs (N2)		42,5	47,7	53,5	58,5	63,5	-	(2)
Wear and tear (N3)		2 000,0	2 000,0	2 000,0	2 000,0	2 000,0	-	(1)
Interest (N4)		600,0	550,0	500,0	400,0	300,0	-	(1)
Adjusted Cash flow before tax	**-**	**2 730,0**	**3 377,1**	**4 166,3**	**4 876,3**	**5 522,1**	**-**	(2)#

Alternative 2:

	1 ***R'000***	***2*** ***R'000***	***3*** ***R'000***	***4*** ***R'000***	***5*** ***R'000***	
Sales	*4 500,0*	*5 535,0*	*6 697,4*	*7 702,0*	*8 703,2*	
Less:	*(1 770,0)*	*(2 157,5)*	*(2 531,0)*	*(2 825,7)*	*(3 181,1)*	
Materials	*(945,0)*	*(1 217,7)*	*(1 406,4)*	*(1 540,4)*	*(1 740,6)*	
Employee expenses	*(450,0)*	*(553,5)*	*(669,7)*	*(770,2)*	*(870,3)*	
Overheads adjusted	***(225)***	***(276.3)***	***(334.9)***	***(385.1)***	***(435.2)***	
➢ *Overhead cost was*	*(467,5)*	*(524,4)*	*(588,4)*	*(643,6)*	*(698,7)*	
➢ *Rental adjustment*	*200*	*200*	*200*	*200*	*200*	*(1)*
➢ *Head office cost adjustment*	*42.5*	*47.7*	*53.5*	*58.5*	*63.5*	*(2)*
Research and development costs	*(50,0)*	*0,0*	*0,0*	*0,0*	*0,0*	
Other expenses	*(100,0)*	*(110,0)*	*(120,0)*	*(130,0)*	*(135,0)*	
Wear and tear	*0*	*0*	*0*	*0*	*0*	*(1)*
Interest	*0*	*0*	*0*	*0*	*0*	*(1)*
Adjusted Cash flow before tax	***2 730,0***	***3 377,1***	***4 166,4***	***4 876,3***	***5 522,1***	*(2)#*

Note#: 1 Mark allocated for the correct amounts and 1 Mark allocated if the Cash flow before tax was calculated

Year	0 R'000	1 R'000	2 R'000	3 R'000	4 R'000	5 R'000	6 R'000	
Tax on cash flows above (N5)			(819,0)	(1 013,1)	(1 249,9)	(1 462,9)	(1 656,6)	(2)

<u>SUGGESTED SOLUTIONS TO PAPER 2: DIPAC 26</u> continued

Note: 1 Mark allocated for calculating the tax and one mark allocated for the correct period

Purchase plant and equipment	(10 000,0)							(1)
Wear and tear - tax impact (N3)			600,0	600,0	600,0	600,0	600,0	(2)
Sale of plant and equipment						1 000,0		(1)
Recoupment (N6)							(300,0)	(1)
Working capital (N7)	(180,0)	(40,0)	(40,0)	(40,0)	(40,0)	90,0		(1)
Working capital released (N8)						250,0		(1)
	(10 180,0)	2 690,0	3 118,1	3 713,2	4 186,4	5 999,2	(1 356,6)	
Discount rate =	17,00%							(1)
Discount factor @ 17%	1,00	0,85	0,73	0,62	0,53	0,46	0,39	
Discounted cash flows	(10 180,0)	2 299,1	2 277,8	2 318,4	2 234,1	2 736,3	(528,9)	

Net present value **<u>1 156,8 or 1 306,11</u>** (1)

Conclusion: The NPV is positive and therefore the project should be accepted. (1)

Note: Mark allocated for the correct conclusion based on the students NPV

Notes:

1. Overheads – Rental

The rental of the existing factory is a sunk cost (not relevant). The costs are therefore added back.

2. Overheads - Head Office costs

Year 1 = 467,5 x 10 / 110 = 42,5
Year 2 = 524,4 x 10 / 110 = 47,7
Year 3 = 588,4 x 10 / 110 = 53,5
Year 4 = 643,6 x 10 / 110 = 58,5
Year 5 = 698,7 x 10 / 110 = 63,5
Head office costs allocated to the project are not relevant and are not cash costs. The costs are therefore added back

3. Wear and tear / Depreciation

Wear and tear or depreciation is not a cash cost. The wear and tear / depreciation is therefore added back.
The tax impact of the wear and tear allowance is however a cash flow:
= R10 million x 20% x 30% = R600 000 per year
There is a one year tax time lag, therefore the cash flows take place from year 2 to year 6.

<u>SUGGESTED SOLUTIONS TO PAPER 2: DIPAC 26</u> continued

4. Interest	Interest cost is not relevant for the investment decision since it has already been taken into account in the cost of capital. The costs are therefore added back.
5. Taxation	Tax is calculated at 30%. There is a one year tax time lag, therefore the cash flows take place from year 2 to year 6.
6. Recoupment	= R1 million x 30% = R300 000 There is a one year tax time lag, therefore the cash flow takes place in year 6.
7. Working capital	Year 0 = R180 000 (given) Year 1 = R220 000 - R180 000 = R40 000 increase (cash outflow) Year 2 = R260 000 - R220 000 = R40 000 increase (cash outflow) Year 3 = R300 000 - R260 000 = R40 000 increase (cash outflow) Year 4 = R340 000 - R300 000 = R40 000 increase (cash outflow) Year 5 = R250 000 - R340 000 = R90 000 decrease (cash inflow)
8. Working capital released	The total working capital employed in the project is released at the end of the project, therefore cash inflow.

PART B **15 marks**

(a) Evaluation of going concern:

Analyse and document the following:

1. strengths and weaknesses of the company, as well as the opportunities and threats it faces. (1)
2. state of the operating assets. Determine whether they are in good working order and have been maintained / replaced regularly. Look at cost, net book value and annual depreciation to establish an opinion on the life and state of the assets.*(Document –Fixed asset register or an asset valuation report)* (1)
3. status of cash flows. Is the company converting its turnover into cash? What about the liquidity of current assets?*(Document –Cash flow statement)* (1)
4. debt vulnerability. Does the company have too much debt? Is it able to service its interest and capital commitments? (1)

<u>SUGGESTED SOLUTIONS TO PAPER 2: DIPAC 26</u> continued

5. market environment. What does the future hold for the industry? (1)

6. *Document –Income statement to determine if a profit was made.* (1)

7. *Document- Lawyers letter to determine if there are litigation claims against the company that could affect their going concern.* (1)

8. *Document- Any long term contracts (lease, suppliers, customers) that could affect the company's going concern*

9. any other valid comments.

Max 5

(b) Maintainable earnings

<u>Alternative 1:</u>	**Note**	**2007** **R**	**2008** **R**	**2009** **R**	
Earnings before tax		4 800 000	5 090 000	7 770 000	
Adjustments:					
Dept of Education	1	(500 000)	(540 000)	(550 000)	(2)
Hotel chain	2			(2 000 000)	(1)
Advertising expenses	3				
Rental	4		25 000	27 500	(2)
Depreciation	5				
Sleepy Beds former customer	6				
Sale of machinery	7			(200 000)	(1)
Sleepy Beds debt	8				
Adjusted earnings before tax		**4 300 000**	**4 575 000**	**5 047 500**	

SUGGESTED SOLUTIONS TO PAPER 2: DIPAC 26 **continued**

Alternative 2:		***2007 R***	***2008 R***	***2009 R***	
Turnover		*40 000 000*	*44 000 000*	*53 000 000*	
Cost of sales		*(15 000 000)*	*(16 500 000)*	*(19 900 000)*	
Gross profit before adjustment		*25 000 000*	*27 500 000*	*33 100 000*	
➢ *Dept. of Education adjustment*		*(500 000)*	*(540 000)*	*(550 000)*	*(2)*
➢ *Hotel chain adjustment*				*(2 000 000)*	*(1)*
Gross profit after adjustment		***24 500 000***	***26 960 000***	***30 550 000***	**
Depreciation		*(1 000 000)*	*(1 050 000)*	*(1 300 000)*	
Other income before adjustment		*800 000*	*840 000*	*1 070 000*	
➢ *Sale of machinery adjustment*				*(200 000)*	*(1)*
Other income after adjustment		***800 000***	***840 000***	***870 000***	**
Other expenses before adjustment		*(20 000 000)*	*(22 200 000)*	*(25 100 000)*	
➢ *Rental adjustment*			*25 000*	*27 500*	*(2)*
Other expenses after adjustment		***(20 000 000)***	***(22 175 000)***	***(25 072 500)***	**
Adjusted earnings before tax		*4 300 000*	*4 575 000*	*5 047 500*	

Note **:Marks are allocated if the adjusted gross profit/ other income/ other expenses is correct

Continue....

Tax	9	(1 204 000)	(1 281 000)	(1 413 300)	(1)
Maintainable earnings		3 096 000	3 294 000	3 634 200	
Year on year % change			6,4%	10,3%	(1)

Conclusion: The maintainable earnings to use for the valuation is R3 634 200. (1)

Note: Mark allocated for the correct conclusion was made based on the maintainable earnings calculated

<u>SUGGESTED SOLUTIONS TO PAPER 2: DIPAC 26</u> continued

Notes:

1.	Dept of Education	The income stream will not continue in the future and must therefore be excluded.	(1)
2.	Hotel chain	The income was once-off and must therefore be excluded.	
3.	Advertising expenses	The higher than budgeted expenses will continue in the future and must therefore be included (no adjustment required).	(1)
4.	Rental	2008 = R150 000 x 20/120 = R25 000 2009 = R150 000 x 1,1 x 20/120 = R27 500	
5.	Depreciation	The higher depreciation will continue in the future and must therefore be included (no adjustment required).	(1)
6.	Sleepy Beds former customer	The higher income will continue in the future and must therefore be included (no adjustment required).	(1)
7.	Sale of machinery	The income was once-off and must therefore be excluded.	(1)
8.	Sleepy Beds debt	The profit on the sale of the machinery has already been excluded and therefore no adjustment is required for the related bad debt.	(1)
9.	Tax	Tax is calculated as 28% of Adjusted earnings before tax.	

Max <u>15</u>

MARKERS COMMENTARY OF PAPER 2: DIPAC26 (ADVANCED MANAGEMENT ACCOUNTING)

The following is a common list of mistakes made by students:

General:

- Students didn't pace themselves to ensure that they had sufficient time available to attempt all sections.
- Students didn't conclude based on their calculations.
- Students didn't show their detail calculations.
- The layout and structure of some students' answers caused them to lose marks.
- Students didn't write the words out and made their own abbreviations (sms style).

Part A

a):

- Students do not know the formula of Cost of equity: Ke = Rf + β (Rm - Rf).
- Students didn't use percentages or 0.09 or 0.19 when calculating the Cost of equity.
- Students didn't calculate debentures based on the market related rates and/ or they do not take taxation into account.
- Students didn't use the target ratio

b):

- They didn't start the question with the cash flow before taxation as required.
- Students inaccurately added and subtracted the adjustment, thus indicating that they do not understand the reasoning behind the adjustments.
- Students neglected to make some of the adjustments.
- Students didn't calculate the overhead adjustment by using 10/110 in their calculations.
- Students used the incorrect tax periods (period 2 to 6).
- Wear and tear and recoupment was not adjusted for, or was adjusted in the incorrect period.
- Working capital movements were not used, the totals were incorrectly used instead.
- The working capital released was not only that of year 5, instead students incorrectly added all the years' totals together.
- Students do not know how the actual NPV calculation is done and thus make incorrect conclusions.

Part B

a):

- Students do not write full and well structured sentences.
- Students write in general and do not answer the question relating to going concern.

b):

- Students inaccurately added and subtracted the adjustment, thus indicating that they do not understand the reasoning behind the adjustments.
- Students didn't draw a conclusion.

SUGGESTED SOLUTIONS TO PAPER 3: DIPAC 38

ADVANCED TAXATION **(40 MARKS)**

PART A

2009 year of assessment:

	R	
Sales	300 000	(1)
Add: Closing stock (R1 450 000 – R200 000)		
(Calculated at the lower of cost or market value i.t.o s 22(1)(a))	1 250 000	(1)
Less: Purchases (section 11(a))	(1 450 000)	(1)
Taxable income	100 000	

2010 year of assessment:

Sales	1 200 000	(1)
Add: Closing stock (note 1)		
(Calculated at the lower of cost or market value i.t.o s 22(1)(a))	1 487 500	
Less: Opening stock (section 22(2)(a)) – closing stock for 2009	(1 250 000)	(1)
Less: Acquisition of trading stock from a supplier in the USA		
($150 000 x R7.45)	(1 117 500)	(1)
Less: Exchange difference (loss) on outstanding debt at year end.		
(translation date)		(1)
($150 000 x (R7.90 – R7.45))	(67 500)	
Add: Trading stock distributed as a dividend-*in-specie*.		
Recoupment included in taxable income (s22(8)(B)), at market value	130 000	(1)
Taxable income	382 500	

Note 1:

Opening stock	1 250 000	(½)
Add: Purchases (USA supplier)	1 117 500	(½)
Less: Sales	(800 000)	(½)
Less: Dividend-*in-specie*	(80 000)	(½)
Closing stock	1 487 500	

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SUGGESTED SOLUTIONS TO PAPER 3: DIPAC 38 continued

PART B

		R	
Taxable income from operations		2 065 000	
Prepaid expenses			
Insurance			
The full benefit of the insurance will not be enjoyed within six months after year-end. Section 23H, proviso (aa) will not apply and the s23H limitation may be applicable. Therefore, test for proviso (bb).			(1)
Insurance: R144 000 x 7/9 (prepayment for March – September (7 months))	112 000		
	112 000		
The R112 000 exceeds the R80 000 threshold and therefore s23H will apply. The prepaid portion of expenditure will be disallowed notwithstanding the fact that it had actually been incurred.			(1)
Insurance: R144 000 x 2/9		(32 000)	(1)
Legal fees			
Restraint-of-trade agreement – of a capital nature		-	(1)
Debt collection – deductible i.t.o s11(*c*)		(6 000)	(1)
Dispute with customer			
Damages paid – the compensation relates to a risk which is inherent to the business. It is a necessary concomitant of its trading operations and will be considered to have been incurred in the production of income. (***Bonus mark***: Joffe & Co (Pty) Ltd). (***Bonus mark***: Port Elizabeth Electric Tramway Company Ltd). The amount is not of a capital nature as it does not give rise to an enduring benefit. Because of the close connection to the trading operations and the earning of income, the expense will be deductible i.t.o the general deduction formula in section 11(a) as it is also non-capital in nature.		(25 000)	(4)
Legal fees with regards to the dispute – as the compensation is deductible, the legal expenses incurred in connection with the claim will also be deductible i.t.o section 11(*c*). It will also be considered not to be of a capital nature.		(12 000)	(2)
Restraint-of-trade payment (R160 000/4)		(40 000)	(2)
Capital in nature but special deduction under section 11(*cA*) and paid to a natural person who has to include it in his income.			
Lower of - R160 000/3; or - R160 000/4			
(Restraint of trade payment must be deducted over the period to which it relates, but the minimum period for writing it off is three years.)			

SUGGESTED SOLUTIONS TO PAPER 3: DIPAC 38 continued

Leave pay	(40 000)	(1)
The general leave pay provision of R50 000 is not deductible i.t.o s23E as this section deals exclusively with leave pay and leave pay outstanding at year end. The employer is deemed not to have incurred expenditure on the leave pay until it is actually paid or it becomes due and payable by him.		(1)
Bad debts	R	
Trade debtors (deductible) – section 11(*i*)	(10 000)	(1)
Loan to employee, not deductible – section 11(*i*)	-	
The debt did not arise from an amount that was included in its income. (It is not deductible under section 11(*a*) as the company is not a money-lender.)		(1)
Add: Doubtful debt allowance (2009) – added back to income	3 500	(1)
Less: Doubtful debt allowance (2010) (R8 000 x 25%)	(2 000)	(1)
Repairs	-	
The work done to their boardroom will be an improvement (not deductible – capital in nature) and not a repair (s11(*d*) – only allows a deduction for repairs). The original structure was not damaged or deteriorated and the aim was not to restore it to its original condition. (***Bonus mark*** – African Products Manufacturing Co Ltd)		(2)
Taxable income before s18A deduction	1 901 500	
Donation to PBO – s18A deduction R30 000 actually paid, limited to R1 901 500 x 10% (cannot deduct more than amount donated)	(30 000)	(2)
Taxable income	1 871 500	
Total:		**23**

SUGGESTED SOLUTIONS TO PAPER 3: DIPAC 38 **continued**

PART C

	R	
Generator		
Cost	80 000	
Add: Cost of foundation (deemed to be part of generator)	10 000	(1)
	90 000	
Wear-and-tear allowance:		
R90 000/15 x 9/12 (s11(*e*))		(1)
Apportion for part of the year (April – December)	4 500	
Tractor		
Purchase price	600 000	
Cost on which allowances can be claimed, limited to the following per section 23J (acquired from connected person):		
R500 000 (cost to connected person) – R250 000 (allowances claimed by connected person)	250 000	(2)
Plus: Recoupment under s 8(4)(a) for connected person on sale	250 000	(1)
Plus: Taxable capital gain for connected person on sale	50 000	(1)
Cost on which section 11(*e*) allowances can be claimed	550 000	
Wear-and-tear allowance:		
R550 000/4 (s 11(*e*))	137 500	(1)
		7

Total marks: **40**

MARKERS COMMENTARY OF PAPER 3: DIPAC 38 (ADVANCED TAXATION)

The following broad assessment criteria were applied, namely:

- You had to demonstrate that you are able to value trading stock for taxation purposes, including dealing correctly with opening stock and closing stock in an income tax calculation as well as trading stock distributed as a dividend.
- You had to demonstrate that you are able to calculate foreign exchange differences which should be included in or deducted from income.
- You had to demonstrate that you are able to establish which expenses are deductible for tax purposes.
- You had to demonstrate that you are able to calculate wear and tear allowances as well as apply rules in determining the cost of depreciable assets acquired from a connected person.

The test focused on your technical and communication skills and the following summary will assist you in evaluating your learning strategies as well as where you can improve your technical skills. The question consisted of three parts.

Part	Topic	Reference to legislation	Reference to examples or questions in TL or in Silke
A	Trading stock and foreign exchange	Sections 22 and 24I	Example 13.6 in the Tax Workbook Example 21.6 in Silke Example 22.2 in Silke Question 13 in Section C of TL105 Question 16 (case 3) in Section C of TL105
B	General deductions and special deductions	Sections 11(*a*), 23H, 11(*cA*), 23E, 11(*c*), 11(*d*), 11(*i*), 11(*j*) and 18A	Example 5.3 in the Tax Workbook Example 5.4 in the Tax Workbook Question 5.3 in the Tax Workbook Question 6.2 in the Tax Workbook Examples 7.6 and 7.7 in Silke Example 8.1 in Silke Example 8.7 in Silke Example 8.26 in Silke Question 13 in Section C of TL105 Question 16 in Section C of TL105
C	Capital allowances and recoupments	Sections 11(e) and 23J	Example 9.1 in Silke Question 7.1 in the Tax Workbook Example 7.8 in the Tax Workbook

It is important to note that if you had followed the suggested working method in TL 105 and worked through the examples and questions in TL 105 you would have easily obtained a high mark. Please remember that we test the application of knowledge and that you must make time to work through the questions and examples in both the TL and the textbook

<u>SUGGESTED SOLUTIONS TO PAPER 4: DIPAC 49</u>

<u>ADVANCED AUDITING</u> **(40 MARKS)**

PART A

(i) Responsibility (in terms of ISA 510)

The auditor must obtain sufficient and appropriate audit evidence that:

- the opening balance does not contain material misstatements that would affect the financial statements of the current year. (1)

- the accounting policy is applied consistently, and that changes thereto are appropriately accounted for and disclosed. (1)

(ii) Conduct of auditor (in terms of ISA 510)

- Inspect the most recent financial statements and the predecessor auditor's audit report for any information relevant to the opening balances, including any disclosures. (1)

- Confirm that the prior period's closing balances have been correctly brought forward as the opening balance of the current year or, where appropriate, have been corrected and disclosed. (1)

- Review the previous auditor's working papers to obtain evidence regarding the opening balances. (1)

- Confirm that audit procedures performed during the current year provide evidence relevant to the opening balances, or perform specific audit procedures to obtain evidence regarding the opening balances. (1)

- If the auditor obtains audit evidence that the opening balances contain material misstatements that could affect the financial statements of the current year substantially, he must perform additional audit procedures to determine the effect on the current period's financial statements. (1)

- If the auditor concludes that misstatements exist in the current year's financial statements due to misstatements in the opening balances, the auditor must communicate these misstatements with management and those changes with governance. (1)

Total 8

Maximum 6

SUGGESTED SOLUTIONS TO PAPER 4: DIPAC 49 continued

PART B

- No, I do not agree with the trainee accountant's statement that only creditors with high outstanding balances are selected for testing. (1)
- For a sample to be reliable, it needs to represent the population to be tested. (1)
- Waratahs have 236 suppliers and by selecting only high-value creditors, the population is not represented well. (1)
- The primary risk relating to creditors is understatement, in other words, that not all creditor balances are included in the balance as at year end (completeness). (2)
- The learner accountant must test a selection of creditors, from the creditor invoices (source documents) to the general ledger accounts, to ensure that all creditors have been included in the year-end creditor balances. (2)
- International creditors should also be included in the sample because these reconciliations may contain material errors with regard to rates of conversion used, etc. (1)
- The following creditors should also be included in the sample:
  - long outstanding creditors;
  - creditors whose balance has decreased substantially during the current year;
  - creditors with a nil balance;
  - creditors with a debit balance;
  - creditors who are paid fixed monthly payments;
  - creditors with whom the company is in dispute. Maximum (3)

Total 11
Maximum 7

PART C

General audit procedures with regard to creditor reconciliations

- Compare the reconciling items of this month to those of the previous and future months to ensure that reconciling items are not of a recurring nature. (1)
- Inspect the monthly statement of Stormers Ltd and confirm that:
  (i) The balance of the monthly statement is R110 310. (1)
  (ii) The date of the monthly statement is 28 February 2010 (cut-off). (1)
- Agree the creditor's balance of R54 061 as per creditor’s ledger on the reconciliation to the balance in the creditor’s ledger. (1)
- Review the account of Stormers Ltd in the creditor’s ledger for any unusual or abnormal transactions and follow up with the creditor’s personnel if necessary. (1)

<u>SUGGESTED SOLUTIONS TO PAPER 4: DIPAC 49</u> continued

- Reperform the additions and computations of the reconciliation (accuracy). (1)
- Obtain, with the client's permission, external confirmation from Stormers Ltd of the out-standing balance to confirm the accuracy of the balance. (1)

Audit procedures with regard to payment made to creditor that does not appear on the creditor's statement

- Inspect the creditor's monthly statement and confirm that receipts of R40 509 from Waratahs do not appear on the statement. (1)
- Inspect the creditor's ledger account and the cash book, and ensure that the payment of R40 509 does appear on this account. (1)
- Inspect the paid cheque that was returned from the bank and ensure that:
  - payment agrees with the credit entry in the cash book; (1)
  - payment agrees with the amount paid as on the bank statement; (1)
  - payment has been made to Stormers Ltd; (1)
  - the cheque has been authorised; (1)
  - the cheque has been stamped by the bank as paid. (1)
- Inspect the bank statement to confirm that the payment has been made before year end (cut-off). (1)
- Inspect the ensuing monthly statement from Stormers Ltd and confirm the deduction/acknowledgement of receipt of payment. (1)

Audit procedures with regard to goods that have never been received

- Inspect the creditor's monthly statement and confirm that the invoice of the goods concerned has been included in the monthly statement. (1)
- Inspect the creditors ledger and ensure that this invoice amount has not been included (ensure that it is a reconciling item). (1)
- Confirm that the entry has been corrected on the following monthly statement by inspection of the creditor's statement. (1)
- Request the creditor (with the client's permission) to provide you with a copy of his goods received note (GRN). (1)
- Inspect the goods received notes and confirm that a GRN has not been issued for the goods concerned. (1)

SUGGESTED SOLUTIONS TO PAPER 4: DIPAC 49 continued

Audit procedures with regard to goods returned for which no credit appears on the monthly statement

- Confirm by inspecting the statements that the item does not appear on the statement. (1)

- Inspect the creditor's ledger account and ensure that the item does appear in that account. (1)

- Agree the credit with:
  - the extension of credit on the following monthly statement and the credit note; (1)
  - the journal entry posted in the general ledger as a credit to the inventory control account; (1)
  - the debit note issued when inventory was returned; (1)
  - the signed goods returned note obtained from Stormers Ltd. (1)

- Confirm by inspection of the goods returned notes that the date is before year end (cut-off). (1)

- Confirm that the inventory was removed physically from the storeroom before the stock count had taken place by inspection of the date on the dispatch note and the inventory records. (1)

- Confirm that the units as they appear on the signed goods returned documentation agree with the number of units used in the calculation of the amount on the debit note. (1)

- Agree the unit price used for the calculation of the goods returned amount with the unit price as per the original invoice supplied to Waratahs Ltd. (1)

- Recalculate the computation (30 x 434.37) to ensure that it does equal to R13 030 (accu-racy). (1)

32

Maximum 20

PART D

1. Accounting recognition and measurement:

   - The provision needs to be recognised because a current legal obligation exists to pay the amount at year end (the court found Waratahs Ltd guilty). (1)

   - Payment of the amount will lead to an outflow of economic benefits. (1)

   - The amount can be estimated reliably since the Brumbies have already incurred the cost regarding the court case. (1)

2. Appropriateness of the management representation:

   - A management representation letter cannot substitute for other audit evidence that can be reasonably expected to be available. (2)

<u>SUGGESTED SOLUTIONS TO PAPER 4: DIPAC 49</u> continued

3. Additional audit procedures:

- Inspect minutes after year end for any decisions concerning payment of the claim. (1)
- Review the bank statements after year end regarding payment of legal costs. (1)
- Obtain permission from the client to contact the Brumbies's lawyer in order to discuss the estimates of R80 000 and to establish whether the amount is fair. (1)
- Establish whether the lawyer has the necessary competence, skills and objectivity. (1)
- Read the court's findings to confirm that Waratahs Ltd have indeed been found guilty.(1)
- Review the journal entry for the provision and confirm that the journal has been authorised by the financial manager. (1)

Total 11
Maximum 7

MARKERS COMMENTARY OF PAPER 4: DIPAC49 (ADVANCED AUDITING)

Part (a)

- Students performed badly in this part of the question and were unable to identify that they must apply ISA 510. “Initial audit engagements-opening balances”.

Part (b)

- Most students identified that the sample did not represent the population to be tested, but they did not discuss the criteria that must be used for the selection of creditors.

Part (c)

- Most candidates did not read the required for part c properly and their answers were irrelevant. For instance they wrote audit procedures for the audit of **creditors** instead of audit procedures for **a creditor’s reconciliation**. Students who worked through question 8 in tutorial letter 104 did well in this part of the question.

- The students didn’t use headings for procedures for the different line items on the reconciliation. This made it difficult to mark. Improve your exam technique by using headings where possible.

- Many students still do not know how to properly formulate an audit procedure and which verbs to use to start procedures with. (Refer to tutorial letter 104, pages 14 to 16.)

- Most students did not list enough procedures for the amount of marks allocated to the question.

Part (d)

- Students did not apply the measurement and recognition criteria of IAS 37 to the scenario.

- Students formulated additional audit procedures relating to creditors, instead of audit procedures relating to the provision.

- Remember to work hard for Test 4 and to keep doing enough practice questions!

Good luck for Test 4.