SCHOOL OF ACCOUNTING SCIENCES

POSTGRADUATE DIPLOMA IN ACCOUNTING SCIENCES

TUTORIAL LETTER 306/2010
(DIPACA8)

TEST 4 AND THE SUGGESTED SOLUTIONS WITH COMMENTS WRITTEN ON 31 JULY 2010

Dear Student

This tutorial letter comprises of the fourth test that was written on 31 July 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

TEST 4: 31 JULY 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	Ms. 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 4 pages and is out of 40 marks.

THE USE OF A NON-PROGRAMMABLE POCKET CALCULATOR IS PERMISSIBLE.

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NB:

a) This question paper is written continuously for one hour, i.e. there will be no breaks till 09:15.

b) No student will be allowed to enter the venue after 08:15 once the test has commenced and no student will be allowed to leave the venue during the duration (08:15 – 09:15) of the test.

c) The test is a limited open-book test: Students are allowed to take in **ONE COPY** of the 2009/2010 version of the SAICA Legislation Handbook (two volumes) and the SAICA Handbook (five volumes: Volumes 1A, 1B, 1C, 2 and 3) into the venue.

d) The text books **MUST** be the latest version: **2009/2010.**

e) **No writing** is allowed in these text books.

f) Students are **allowed to highlight, underline, sideline and flag** in the above mentioned permitted texts.

g) Flags **may** be referenced.

PAPER 1: DIPAC15 (ADVANCED FINANCIAL ACCOUNTING) **(40 Marks, 60 minutes)**

PART A **(20 marks)**

The following is an extract of Soccer Ltd's financial statements for the year ended 31 December 2009. The company specializes in the manufacturing of soccer balls.

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2009

	2009 R	2008 R
ASSETS		
Non-current assets	109 759	106 475
Property, plant and equipment	34 749	43 475
Machinery at cost	51 750	51 750
Machinery: Accumulated depreciation	(22 000)	(11 875)
Furniture at cost	18 800	17 000
Furniture: Accumulated depreciation	(13 801)	(13 400)
Intangible assets	23 000	24 000
Investments - held for trading	52 000	39 000
Current assets	456 551	479 315
Inventories	229 351	266 316
Trade and other debtors	180 000	210 000
Taxation refund	43 000	2 999
Cash and cash equivalents	4 200	-
Total assets	566 300	585 790
EQUITY AND LIABILITIES		
Total equity	546 100	513 100
Share capital	150 000	160 000
Retained earnings	365 200	322 100
Asset replacement reserve	21 000	31 000
Capital redemption reserve fund	9 900	-
Non-current liabilities		
Deferred tax	1 000	-
Current liabilities	19 200	72 690
Trade and other creditors	19 200	61 390
Bank overdraft	-	11 300
Total equity and liabilities	566 300	585 790

PAPER 1: DIPAC15 (ADVANCED FINANCIAL ACCOUNTING) continued

Information obtained from the statement of comprehensive income and the statement of changes in equity for the year ended 31 December 2009:

	2009 Dt/(Cr) R	2008 Dt/(Cr) R
Dividends received	(10 500)	(9 500)
Dividends paid	22 000	22 000
Finance costs	6 000	5 000
Amortisation of intangible asset	1 000	-
Taxation		
Current	15 400	112 000
Deferred	1 000	-
Fair value adjustment – held for trading investment	(3 100)	-
Revenue	(292 545)	
Cost of sales	218 225	
Other expense	89 000	

Additional information

1. Share capital consists of 150 000 ordinary shares and 10 000 12% redeemable preference shares.

   10 000 preference shares were redeemed on 1 September 2009 at an amount of R10 000 cash.

   The redemption was done from cash funds which the company had at its disposal. The effective interest rate on the redeemable preference shares is 12%.

2. Soccer Ltd decided to update the furniture in the head office and sold the current furniture, which were originally purchased for R3 500, at a price of R8 300.

   This furniture was replaced with furniture bought at a discounted price of R6 000.

   The discount was received because the company opened an account at the local furniture shop and purchased over R5 000 worth of furniture. The outstanding balance on this account amounted to R3 000 at the end of December 2009, which is included in trade and other creditors.

   The director also made the generous offer of giving the two coffee table chairs to the cleaning lady since they only had a book value of R1 (Cost: R700). This offer was gladly accepted.

3. Machinery is used solely for the production of soccer balls.

   There were no purchases or sales regarding machinery during the year ended 31 December 2009.

4. Included in trade and other debtors is investment income of R1 800 (2008: R1 300).

5. There are no other non-cash items other than those evident from the information given above.

PAPER 1: DIPAC15 (ADVANCED FINANCIAL ACCOUNTING) continued

REQUIRED

	Marks
Prepare the statement of cash flows of Soccer Ltd for the year ended 31 December 2009, using the direct method.	20

Please note:

- Comparative figures are **not** required.
- Your answer should **comply** with International Financial Reporting Standards (IFRS).

PART B **(20 marks)**

Paper Ltd is a South African company with a 31 December year end. On 1 December 2009 the company ordered new printing equipment from a company in the USA. The order was not a firm commitment.
The equipment, which has a 5 year useful life, was shipped free on board on 15 December 2009 and was available for use when it arrived at Paper Ltd's premises on 31 December 2009.
Paper Ltd was invoiced $200 000, which was payable on 28 February 2010. In anticipation of the payment, Paper Ltd entered into a three month forward exchange contract for the full amount of $200 000 on 1 December 2009. The company accounts for a hedge of a forecast transaction as a cash flow hedge. Basis adjustment is applied when necessary.
The following exchange rates are applicable:

Date	**Spot rates**	**FEC rates for contracts expiring 28 February**
1 December 2009	$1 = R7,00	$1 = R7,50
15 December 2009	$1 = R7,80	$1 = R8,00
31 December 2009	$1 = R8,50	$1 = R8,80
31 January 2010	$1 = R8,70	$1 = R8,90
28 February 2010	$1 = R9,20	N/A

REQUIRED

	Marks
Show all the journal entries for the above transaction in the books of Paper Ltd for both the years ended 31 December 2009 and 31 December 2010.	20

Please note:

- Your answer should **comply** with International Financial Reporting Standards (IFRS).
- Journal narrations are **not** required.
- **Round** to the nearest rand.

SUGGESTED SOLUTIONS TO PAPER 1: DIPAC15

PART A

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2009

	(Discl)	R	(Calc)
Cash flow from operating activities	(1)	30 100	
Cash receipts from customers [C1]		323 045	(2½)
Cash paid to suppliers and employees [C2]		(219 544)	(4½)
Cash generated from operations		103 501	
Dividends received [C3]	(½)	10 000	(1½)
Dividends paid	(½)	(22 000)	(½)
Finance cost	(½)	(6 000)	(½)
Income tax [C4]	(½)	(55 401)	(1½)
Cash flow from investing activities	(1)	(4 600)	
Purchase of property, plant and equipment [C5]		(3 000)	(1)
Proceeds from sale of property, plant and equipment		8 300	(½)
Purchase of held-for trading investment [C6]		(9 900)	(1½)
Cash flow from financing activities	(1)		
Redemption of preference shares		(10 000)	(½)
Net increase in cash and cash equivalents		15 500	
Cash and cash equivalents at beginning of period		(11 300)	(½)
Cash and cash equivalents at end of period		4 200	
	5		15
			20

CALCULATIONS

C1. Cash receipts from customers

	R	
Revenue	292 545	(½)
Decrease in trade debtors (210 000 – 1 300) – (180 000 – 1 800)	30 500	(2)
	323 045	

C2. Cash paid to suppliers and employees

	R	
Cost of sales	218 225	(½)
Excluding non-cash items		
Depreciation on machinery	(10 125)	(½)
Other expenses	89 000	(½)
Excluding non-cash items		
Depreciation on furniture	(401)	(½)
Amortisation of intangible asset	(1 000)	(½)
Decrease in inventories (229 351 – 266 316)	(36 965)	(1)
Decrease in trade and other creditors (19 200 – 61 390 + 3 000)	(39 190)	(1)
	219 544	

SUGGESTED SOLUTIONS TO PAPER 1: DIPAC15 continued

C3. Dividends received

	R	
Other debtors (opening balance)	1 300	(½)
Dividends received – 2009	10 500	(½)
Other debtors (closing balance)	(1 800)	(½)
	10 000	

C4. Taxation

	R	
Opening balance	2 999	(½)
Tax recognised in 2009	(15 400)	(½)
Closing balance	(43 000)	(½)
	(55 401)	

C5. Property, plant and equipment

	R	
Purchase of furniture	6 000	(½)
Purchase price	(3 000)	(½)
Accounted for in trade and payables	3 000	

C6. Held-for-trading investment

	R	
Opening balance	39 000	(½)
Fair value adjustment	3 100	(½)
Closing balance	(52 000)	(½)
Increase in investment	9 900	

PART B

JOURNALS

	Dt R	Cr R	(Discl)	(Calc)
1 December 2009 (date FEC entered into)				
No journal entry				
15 December 2009 (transaction date)				
Plant: cost *(200 000 x 7.80)*	1 560 000		(½)	(1)
Foreign creditor		1 560 000	(½)	
Purchase of plant from a foreign creditor				
FEC asset (*200 000 x (8.00 – 7.50)*)	100 000		(½)	(1½)
Plant: cost		100 000	(½)	
Recognition of FEC on transaction date (CFH – basis adjustment)				

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

	Dt R	Cr R	(Discl)	(Calc)
31 December 2009 (year-end)				
Foreign exchange loss *(200 000 x (8.50 – 7.80))*	140 000		(½)	(1½)
Foreign creditor		140 000	(½)	
Re-measurement of foreign creditor at year-end				
FEC asset *200 000 x (8.80 – 8.00)*	160 000		(½)	(1½)
Forex gain: FEC (P/L)		160 000	(½)	
Re-measurement of FEC at year-end				
28 February 2010 (payment date)				
Foreign exchange loss *(200 000 x (9.20 – 8.50))*	140 000		(½)	(1½)
Foreign creditor		140 000	(½)	
Re-measurement of foreign creditor on payment date				
FEC asset *(200 000 x (9.20 – 8.80)*	80 000		(½)	(1½)
Forex gain: FEC (P/L)		80 000	(½)	
Re-measurement of FEC on payment date				

	Dt R	**Cr R**	**(Discl)**	**(Calc)**
Foreign creditor *(200 000 x 9.20)*	1 840 000		(½)	(1)
FEC asset *(100 000 + 160 000 + 80 000)*		340 000	(½)	(1½)
Bank (*200 000 x 7.50)*		1 500 000	(½)	(1)
Settlement of creditor				
31 December 2010 (year-end)				
Depreciation – plant *(1 560 000 – 100 000) / 5*	292 000		(½)	(1)
Plant: accumulated depreciation		292 000	(½)	
Provision for depreciation on year end				
			8½	13
		Maximum		11½
				20

MARKERS COMMENTS ON PAPER 1: DIPAC15

PART A: Statement of Cash Flows

- Students were unable to distinguish between the direct and indirect methods for cash flow statements.
- Students were confused as to whether amounts were inflows or outflows ie: whether they should add/deduct changes in working capital as well as cash and non-cash items. (Brackets were incorrectly used, if used at all.)
- Students confused investing activities with financing activities and visa versa.
- Cash on hand at the beginning of the year was often left out which resulted in the loss of an easy mark.

PART B: Journals

- Students did not use the appropriate rates when calculating the exchange differences. Students must be able to differentiate between the FEC rate and the rate used to calculate exchange difference on creditors.
- Students could not distinguish when an FEC is a cash flow hedge or fair value hedge, thus resulting in FEC differences being incorrectly taken to OCI or P&L.
- Students did not subtract the R 100 000 FEC asset from the cost price when the depreciation was calculated.
- Students confused the bank payment of R 1 500 000 (according to the FEC contract) with the creditor payment of R 1 840 000 at year end.
- *Students should get into the habit of drawing a timeline to track critical transaction dates when dealing with FEC transactions in order to improve exam technique and their mark scoring abilities.*

GENERAL COMMENTS:

- The questions were not read carefully and as such easy marks were lost
- Calculations not shown
- Calculations not cross-referenced

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

THE USE OF A NON-PROGRAMMABLE POCKET CALCULATOR IS PERMISSIBLE.

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

Superfind Limited is a manufacturing entity in a small town in South Africa and trades in specialised navigation equipment.

During the last few months Superfind's sales have shot through the roof due to the sudden high demand for their latest product "Destination find", a more affordable product, that will not only be used commercially.

The entity are starting to show signs of overtrading and Mr. Kent the financial manager, is concerned about Superfind's liquidity.

It is one month away from year end and Mr. Kent would like you to assist him with the proposed decision relating to a possible change in policies.

Statement of Comprehensive Income

	Note	**2011 Forecast R'000**	**2010 Actual R'000**
Income			
Revenue		6 200	4 200
Less:			
Cost of sales	1	(4 320)	(2 520)
Gross profit		1 880	1 680
Operating expenses		(520)	(500)
Operating profit		1 360	1 180
Interest paid		(60)	(48)
Profit before tax		1 300	1 132
Tax payable (@ 28%)		(364)	(317)
Profit after tax		936	815
Dividends declared		387	339
Current assets and liabilities as at the end of the year			
Inventory / work in progress		620	420
Receivable		750	520
Cash		0	2
Trade payables		(464)	(320)
Other payables (tax and dividends		(777)	(679)
Overdraft		(190)	0
Net current assets / (liabilities)		(61)	(57)

Note:

Cost of sales include depreciation of	230	190

Mr . Kent proposed the following policy changes to improve the cash position.

PAPER 2: DIPAC26 (ADVANCED MANAGEMENT ACCOUNTING) continued

1. *Receivables*

   Offer a 2,5% discount to customers who pay within 10 days of dispatch of invoice.
   It is estimated that 70% of the customers will take advantage of the new discount and that the remaining 30% will continue to take the current average credit period of 44 days .

2. *Trade payables and Inventory*

   Reduce the number of suppliers currently being used and negotiate better terms with those that remain by introducing a "just-in-time" policy.

   The aim will be to reduce the end of year cost of sales (excluding depreciation) with 10% and inventory/ WIP levels by 15%.

   The number of days credit taken by the entity must however be reduced to 30 days to help persuade suppliers to improve their prices.

Other important information

- All sales are on credit. Official terms of sale at present require payment within 30 days. No interest is charged on late payments.
- All purchases are made on credit.
- Operating expenses will be R 520 000 irrespective of the old or new policies and are paid in cash.
- Interest payments will be R 32 000 under the new policy.
- Capital Expenditure of R 780 000 is planned for 2011.
- There are 365 days in a year.
- Tax is paid one year in arrears.
- Ignore the impact of VAT and deferred tax

REQUIRED		**Marks**
(a)	Provide a cash-flow forecast for the **2011** year, assuming:	
	(i) The entity doesn't change its policies;	(7)
	(ii) The entity's proposal for managing receivables, payables and inventories are implemented. (Ignore the effects of the Machinery purchased from Nightfind) *(CIMA adapted)*	(8)

PAPER 2: DIPAC26 (ADVANCED MANAGEMENT ACCOUNTING) continued

(b)	Assist Mr. Kent by writing a short report to assist him in evaluating the **old** and **new** proposed credit policy. (Ignore the effects of the Machinery purchased from Nightfind) Your report should include calculations and comments on **any three** of the following ratios for **2011**: • Growth in gross profit • Operating margin • Interest cover • Current ratio • Quick ratio Assume that the closing cash balance under the new policy will be R477 000. **[Calculations count 6 marks and comments count 4 marks]**	(10)
(c)	Evaluate the **2011** financial performance by comparing the **2011 unchanged forecast figures** to the **2010 actual figures** and calculate the following ratios: • Growth in turnover (indicate whether there was growth or a decline) • Dividend yield (only 2011) • Solvency ratio (only 2011) • Earnings per share (only 2011) Assume that there are 50 000 shares in issue and that these shares are expected to trade at 910 cents per share at the end of 2011	(8)

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Superfind purchased a new machine from Nightfind in the USA that will allow them to reduce their labour and operating expenses.
Under the agreement, payment is to be made one year after installation, at the exchange rates on that date.

Machinery purchased from Nightfind

The following information is available on the purchase date:
The purchase price of the new machinery is $128 000

• Spot rates

Bid $1 = R 7,60
Ask $1 = R 7,75

• The forward R/$ rate is trading at a Rand discount of 14,5% pa.

• Interest rates

USA 9%pa
RSA 17%pa

(Ignore any possible effects of interest received)

(i) Calculate and draw a conclusion whether Superfind should use a forward hedge or a money market hedge.

(ii) Based on your decision in i) above;
Determine what would the impact be on Superfind if the spot rate one year later when payment is made is $1 = R 7,90
(Vigario adjusted)
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(2)</td>
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SUGGESTED SOLUTIONS TO PAPER 2: DIPAC26

Part (a)

	R'000	**Marks**	**R'000**	**Calc**	**Marks**
	2011 No change in policy – (i)		2011 Changes implemented- (ii)		
Profit from operations	1 360	(1)	1660,5	1.	
Add depreciation (*non cash)*	230	(½)	230,0		(½)
+/- Change in receivables	(230) (increase)	(1)	177,0 (decrease)	2.	
+/- Change in payables	144 (increase)	(1)	(17,5) (decrease)	3.	
Inventory	(200) (increase)	(1)	(107,0) (increase)	4.	
Interest paid	(60)	(½)	(32,0)		(½)
Tax paid *(prior year)*	(317)	(½)	(317,0)		(½)
Dividends paid *(declared 2010 and paid in 2011)*	(339)	(½)	(339,0)		(½)
Cash flow from operations	*588*		*1 255,0*		
Investing activities					
Non- current assets *(Capital expenditure)*	(780)	(½)	(780,0)		(½)
Net cash flow	*(192)*	(½)	*475,0*		(½)
Opening balance	2	(½)	2,0		(½)
Closing balance	*(190)*	(1)	*477,0*		(½)
				Max	7

Changes implemented:

1.	Profit from operations:		
	Revenue	6 200,0	
	Less discounts (6 200*70%*2,5%)	(108,5)	(1)
	COS ((4 320-230) *90%) + 230	(3 911,0)	(1)
	Operating expenses (unchanged)	(520,0)	(½)
		1 660,5	
2.	Decrease in receivables: 6 200 *30% = 1 860 1 860 *44/365 = 224,22 6 200 *70% = 4 340 4 340 *10/365 = 118,90 New debtors = **343,12**		
	R520 - ((4 340/365*10) + (1 860/365*44))	177,0	(1)
3.	Decrease in trade payables: New trade payables = **302,50**		
	R 320 - ((4320-230)*90%/365*30)	17,5	(1)
4.	Inventory: New inventory = **527**		
	420 - (620*85%)	107,0	(1)
		Max	8

SUGGESTED SOLUTIONS TO PAPER 2: DIPAC26 continued

Part (b)

Report structure and format (1)

Note 1:

Comments should be marked through based on students' calculation and its reasonability.

Note 2:

Marks should not be deducted for sensible rounding.

Calculations and comment on the following ratios for 2011:

	No changes		New policy	
• **Growth in gross profit:**	$= \frac{1\,880' - 1\,680'}{1\,680'}$		$= \frac{2\,180{,}5'^{\,1} - 1\,680{,}0'}{1\,680'}$	
[1] (6 200,0' -108,5' – 3 911,0')				
	= 11,91%	(1)	= 29,79%	(1)
The growth in gross profit will improve if the new policy is implemented. The main reason for the growth in gross profit is due to the 10% decrease in Cost of sales. Note however that the 2,5% discount on 70% of sales causes a slight decrease in the gross profit.				(2)
• **Operating margin:**	$= \frac{1\,360'}{6\,200'}$		$\frac{1\,660{,}5'}{6\,200'}$ (Calc 1)	
	= 21,94%	(1)	= 26,78%	(1)
The operating margin will improve if the new policy is implemented. The main reason for the increase in operating profit is due to the 10% decrease in Cost of sales. Note however that the 2,5% discount on 70% of sales causes a slight decrease in the operating profit.				(2)
• **Interest cover**	$= \frac{1\,360'}{60'}$		$\frac{1\,660{,}5'}{32'}$	
	= 22,67 times	(1)	= 52,89 times	(1)

<u>SUGGESTED SOLUTIONS TO PAPER 2: DIPAC26</u> continued

The interest cover will improve even more with the new policy.

Superfind's profit is able to cover the interest charge 53 times with the new policy.

This is due to the increase in profit before interest and tax and the decrease in interest charge under the new policy. (2)

• **Current ratio:**	$= \frac{620'+750'+0}{464'+777'}$		$\frac{527'+343{,}12'+477'}{302{,}5'+777'}$	
	= 110,39%	(1)	= 124,79%	(1)
Or	1,10:1		1,25:1	
Or if overdraft is taken into consideration	$= \frac{620'+750'+0}{464'+777'+190'}$			
	= 95,74%			

The liquidity has improved with the new policy, mainly due to the increase in the closing cash balance of R 477. (2)

• **Quick ratio:**	$= \frac{750'}{464'+777'}$		$= \frac{343{,}12'+477'}{302{,}5'+777'}$	
	= 60,44%		= 75,97%	
Or	0,60:1	(1)	0,76:1	(1)
Or if overdraft is taken into consideration	$\frac{750'}{464'+777'+190'}$			
	= 52,41%			

The quick ratio has improved partly due to the decrease in trade payables and increased cash balance. (2)

3 ratios*2 marks	= Total ratios 6
	Max 6 (ratios)
3 comments*2 marks	= Total comment 6
	Max 4 (comments)

<u>SUGGESTED SOLUTIONS TO PAPER 2: DIPAC26</u> continued

Part (c)

• Growth in turnover:	$= \dfrac{6\,200' - 4\,200'}{4\,200'}$	
	= 47,62%	(1)
	(growth)	(1)
• Dividend yield (2011):	= 387'/50'	
	= 7,74	(1)
	(dividend per share)	
	$= \dfrac{7{,}74 * 100\%}{9{,}10}$	
	= 85,05%	(1)
• Solvency (2011)	$= \dfrac{464' + 777' + 190'}{620' + 750'}$	
	= 104,45% or	(2)
	= 90,58%	
	(without the overdraft of 190')	
• Earnings per share (2011):	$\dfrac{936'}{50'}$	
	= R18,72	(2)
	Total	<u>8</u>

Part (d)

(i) *Money market hedge*

In 1 years time:

FV = 128 000 (Payment required in 1 Year)
N = 1 (1)
I = 9% (1)
PV = $117 431,19

Required transfer from RSA: (1)

$117 431,19*7,75 = R 910 091,74

Cost to RSA buyer in 1 years time if he borrows R 910 091,74 today at 17%
R 910 091,74*1,17 = **R 1 064 807,34** (1)

SUGGESTED SOLUTIONS TO PAPER 2: DIPAC26 continued

Forward Hedge

Forward rate
R7,75*(1,145) = R 8,87 (1)

Forward hedge
Payment in 1 years time $ 128 000*R 8,87 = **R 1 135 360** (1)

Conclusion: (Mark through)

The cost of the forward hedge is R 1 135 360 which is higher compared to the money-market hedge cost of **R 1 064 807,34.** Thus Superfind should take out a money market hedge as it has the lowest cost. (1)

Total 7
Max 5

(ii) If the spot rate one year later is R 7,90 it would have been better not to hedge the risk of the foreign currency transaction as it would cost only (R7,90 * $128 000) R 1 011 200 for the machinery. (1)
Superfind made an opportunity loss of R 54 607,34. (1)

Total 2

MARKERS COMMENTS ON PAPER 2: DIPAC26

Part (a)
Many students did not present their answer in the correct cash flow statement format, i.e. including dividends paid, capital expenditure, movement in working capital and opening and closing cash balances. The new receivables, trade payables and inventory balances were also either not calculated or calculated incorrectly.

Part (b)
Most students did not present their answer in a report format.
The question required a comparison of the ratios for 2011 based on the old and new proposed credit policy. Many students instead calculated the ratios for 2010 and 2011 (both based on the old credit policy). Other students only calculated one set of ratios for 2011 (old credit policy).
Several students did their calculations based on cash flow adjusted gross profit and operating profit figures instead of using the accounting figures.

Part (c)
Many students used incorrect formulae.

Part (d)
Most students were not able to calculate the cost of the machine if a money market hedge is used.
Many students calculated the forward rate incorrectly by reducing the spot rate with the Rand discount of 14,5% instead of increasing it.

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. Ungerer, Ms. M.M. Pretorius

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 4 pages and is out of 40 marks.

THE USE OF A NON-PROGRAMMABLE POCKET CALCULATOR IS PERMISSIBLE.

This test paper remains the property of the University of South Africa and may not be removed from the test venue.

NB:

a) This question paper is written continuously for one hour, i.e. there will be no breaks till 11:45.

b) No student will be allowed to enter the venue after 10:45, once the test has commenced and no student will be allowed to leave the venue during the duration (10:45 – 11:45) of the test.

c) The test is a limited open-book test: Students are allowed to take in **ONE COPY** of the 2009/2010 version of the SAICA Legislation Handbook (two volumes) and the SAICA Handbook (five volumes: Volumes 1A, 1B, 1C, 2 and 3) into the venue.

d) The text books **MUST** be the latest version: **2009/2010.**

e) **No writing** is allowed in these text books.

f) Students are **allowed to highlight, underline, sideline and flag** in the above mentioned permitted texts.

g) Flags **may** be referenced.

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

This question consists of two related parts.

PART A **(27 marks)**

Football Mania (Pty) Ltd ("Football Mania") is a South African resident company. Football Mania manufactures football gear, but deals in and invests in shares on the side as well. It uses separate accounting records and separate bank accounts to account for the manufacturing side of the business and the investment side thereof.

You have calculated the taxable income relating to the manufacturing side and it amounts to R18 500 000 for its year of assessment ended 31 March 2010.

- The following information was extracted from the "preliminary" statement of income relating to the share portfolios for its year of assessment ended 31 March 2010 with references to summaries and notes ***(remember: the following items were not taken into account in the calculation of the manufacturing taxable income of R18 500 000)***:

Income statement item	Company	Notes	R
Sales – shares	Flag Ltd	1	50 000
Sales – shares	Scarf Ltd	2	130 000
Opening stock		1 & 2	?
Purchases of shares	Sticker Ltd	3	(25 000)
Closing stock			?
Dividend received	Scarf Ltd	2	5 500
Distribution received	Fantastic (Pty) Ltd	4 & 6	15 000
Dividend received	Soccer Inc	5 & 7	28 000
Net income/loss			?

- The following summary relates to Football Mania's **local** share portfolio, which is treated as **trading stock**:

Notes	Company	Purchase Date	Quantity Purchased	Opening stock and purchases	Quantity Sold on 1/3/2010	Total selling price	Dividends received
1	Flag Ltd	5/4/ 2005	6 000	R30 000	6 000	R50 000	Nil
2	Scarf Ltd	9/1/2008	120 000	R240 000	60 000	R130 000	R5 500
3	Sticker Ltd	7/9/2009	2 000	R25 000			Nil

- The following summary relates to Football Mania's share portfolio, which is treated as **investments**:

Notes	Company	Acquisition Date	Quantity Acquired	Purchase price	% shares in company	Distributions and dividends received
4	Fantastic (Pty) Ltd - a resident company Capitalisation shares in Fantastic (Pty) Ltd	20/7/2006 1/3/2009	30 000 6 000	R48 000 Rnil	30%	R15 000 (refer to note 6 below)
5	Soccer Inc - a Controlled Foreign Company as defined	1/4/2007	10 000	R250 000	25%	R28 000 (refer to note7 below)

- **Additional notes**

6 Distribution of R15 000 received from Fantastic (Pty) Ltd

Football Mania acquired its 30% shareholding in Fantastic (Pty) Ltd on 20 July 2006 for R48 000. Fantastic (Pty) Ltd's issued share capital originally comprised of 100 000 ordinary shares of R1 each. On 1 March 2009, Fantastic (Pty) Ltd made its only capitalisation issue to shareholders and issued one capitalisation share for every five ordinary shares held. The capitalisation issue comprised ordinary shares of R1 each. In funding the capitalisation shares, Fantastic (Pty) Ltd applied R5 000 of its share premium and R15 000 of its profit.

On 15 February 2010, Fantastic (Pty) Ltd reduced the nominal value of its issued share capital by 20%. It paid its shareholders R50 000 in total for the reduction. The market value of the 30% shares held by Football Mania in Fantastic (Pty) Ltd immediately before this reduction was R70 000.

7 Dividend of R28 000 received from Controlled Foreign Company

Football Mania received a dividend of R28 000 from Soccer Inc (an investment company) on 15 January 2010. No withholding tax is applicable on dividends declared by Soccer Inc.

Soccer Inc's net income (as defined in section 9D) for its year ended 31 January 2010, amounted to R300 000 (converted into rands at the appropriate exchange rate). Foreign tax, the equivalent of R30 000, was paid by Soccer Inc on this income.

REQUIRED:	**Marks**
Calculate the normal tax liability of Football Mania for its year of assessment ended on 31 March 2010. Show all workings and clearly indicate amounts exempt from normal tax together with a reason therefore.	27

PAPER 3: DIPAC38 (ADVANCED TAXATION) continued

PART B **(13 marks)**

The directors of Football Mania want to distribute one of the machines that it uses in its manufacturing process as a dividend to Mr Bafanah on 15 May 2010. Mr Bafanah holds 10% of the issued share capital in Football Mania. Football Mania acquired the machine on 6 July 2008 for R9 000 (excluding VAT which could be claimed in full as an input tax credit). The machine was brand new at the date of acquisition. The market value of the machine on the distribution date will be R10 000. The machine will be used in the manufacturing process until 1 May 2010 after which it will be dismantled in order to distribute it to Mr Bafanah on 15 May 2010. The other shareholders will receive a cash distribution amounting to R90 000 on the same day.

REQUIRED:		**Marks**
1.	Briefly discuss (supported with calculations) the **normal tax effect** for Football Mania of the proposed distribution of the machine to Mr Bafanah.	7
2.	Calculate the amount of Secondary Tax on Companies (STC), if any, payable by Football Mania in respect of its dividend cycle ended 15 May 2010 if the directors go ahead with the planned distribution to the shareholders. Its previous dividend cycle ended on 14 June 2006. It has no STC credit brought forward from this dividend cycle. Apart from the information provided in Part A, no other dividends accrued to Football Mania during this dividend cycle.	6

SUGGESTED SOLUTIONS TO PAPER 3: DIPAC38

Part A

Part A tested your knowledge of the definition of a dividend (refer to the distribution received and note the CGT implications of the capital distribution); the normal tax implications for share dealers upon the acquisition and disposal of shares, taking into account the deeming capital provisions of section 9C of the Act.
Refer to TL 106 – Question 4 on page 47 dealing with share portfolios; Question 9 (notes 3 & 6) dealing with a distribution received; paragraph 9.3.3.2 regarding section 10 dividend exemptions and paragraph 9.5.2 regarding foreign companies and section 9D.

General reasons for students losing marks in this part of the test:

- Many students reflected the dividends received as exempt income in the tax calculation, without first including the receipts as gross income. Remember, one must first include the dividend received as gross income (par (*k*) of the definition) and then deduct it as exempt income (in terms of section 10(1)(*k*)).
- A number of students did not apply the provisions of section 9C on the disposal of the Flag Ltd shares, which deems the receipt upon the disposal of "qualifying shares" to be capital in nature.
- Some students still get the basics wrong – i.e. they deduct closing stock (as opposed to adding it back) and add back opening stock (as opposed to deducting it) in calculating taxable income.
- Most students struggled with the distribution received from Fantastic (Pty) Ltd. Please refer to the memorandum. Students who have, however, worked through the self-assessment section in Study Unit 9 of TL 106 could have recognised some similar principles being tested in the question. A few students did indeed score the maximum available marks for this question.

Normal tax liability of Football Mania for 2010 year of assessment

		R	
Taxable income before adjustments		18 500 000	(1)
Add:	Sale of Scarf Ltd shares (gross income)	130 000	(1)
	Recoupment - section 9C(5) (Flag Ltd) (Note 1)	**30 000**	(2)
	Closing stock: **R120 000** (Scarf Ltd: R240 000 x 60 000/120 000) + **R25 000** (Sticker Ltd) (section 22(1))	145 000	(2)
	Dividend received from Scarf Ltd (gross income – par (*k*))	5 500	(1)
	Dividend received on 15 February 2010 from Fantastic (Pty) Ltd (gross income – par (*k*)) (Note 2)	12 300	(1)
	Deemed income from CFC (section 9D): **R300 000** x **25%**	75 000	(2)
	Foreign dividend (gross income, par (*k*))	28 000	(1)
		18 925 800	
Less:	Purchase of Sticker Ltd shares (section 11(*a*))	(25 000)	(1)
	Opening stock: **R30 000** (Flag Ltd) + **R240 000** (Scarf Ltd) (section 22(2))	(270 000)	(2)
	Dividend from Scarf Ltd (exempt ito section 10(1)(*k*)(i))	(5 500)	(1)
	Dividend from Fantastic (Pty) Ltd (exempt ito section 10(1)(*k*)(i))	(12 300)	(1)
	Foreign dividend (exempt ito section 10(1)(*k*)(ii)(*dd*))	(28 000)	(1)
		18 585 000	

SUGGESTED SOLUTIONS TO PAPER 3: DIPAC38 continued

Add: **Taxable capital gain** (R20 000 (Note 1) + R849 (Note 2) × **50%** inclusion rate	10 425	(1)

Note 1: Deemed capital proceeds – longer than 3 years:		(1)
Taxable capital gain (Flag Ltd shares) (**section 9C** & section 26A):		
Proceeds:	R50 000	(1)
Less: Base cost:	(R30 000)	(1)
Capital gain:	R20 000	

Taxable income	18 595 425	
Normal tax liability (at 28%):	5 206 719	(1)
Less: Section 6*quat* rebate:	(7 500)	(1)
Normal tax liability:	5 199 219	

Note 2:

The distribution of normal profits by Fantastic (Pty) Ltd is calculated as follows:

	R	
Total distribution to Fantastic (Pty) Ltd's shareholders	50 000	(1)
The R50 000 distribution represents the following:		
Reduction of share capital (20% of R120 000) – not a dividend	(24 000)	(1)
Distribution of profits	26 000	

The dividend distributed to Fantastic (Pty) Ltd's shareholders is as follows:		
Reduction of profits (par (*c*) of the definition of a 'dividend')	26 000	(1)
Distribution of capitalised profits (to the extent that its share capital includes capitalised profits, the reduction of share capital is a dividend (first proviso to the definition of a 'dividend'))	15 000	(1)
Total dividend	41 000	

Football Mania has a 30% interest in Fantastic (Pty) Ltd. Football Mania's dividend is therefore R12 300 (30% of R41 000).

Par 76A of the Eighth Schedule: deemed part disposal of shares in Fantastic (Pty) Ltd:

	R	R	
Proceeds on capital distribution (**R15 000** (distribution, i.e. R50 000 x 30% = R15 000) **– R12 300** (dividend))	2 700		(2)
Less: Base cost (**R48 000** (cost price of shares) × **R2 700 / R70 000** (market value of Fantastic (Pty) Ltd's shares))	(1 851)		(2)
Capital gain		849	

	31
Max:	**27**

SUGGESTED SOLUTIONS TO PAPER 3: DIPAC38 continued

Part B:

Part B(1) tested the normal tax implications of a distribution of a dividend *in specie*.
Refer to Example 1 in TL 106 (pages 16 & 17).

General reasons for students losing marks in this part of the test:

- Students did manage to indicate the tax consequences, but for the wrong year of assessment. Note that the transaction occurred during the 2011 year of assessment (remember an individual's year of assessment ends on 28 February each year) and not during 2010. Where students showed the correct implications, but for the wrong year of assessment, they were penalised with 1 mark. The application of the 2010 year of assessment (as opposed to 2011) also had the implication that the recoupment amount was calculated incorrectly.
- Many students did not indicate that (under section 11(*a*)) the dividend *in specie* is not deductible.
- A number of students did not show the 28% inclusion rate – remember that the question required the normal tax implications – in other words, the normal tax liability had to be calculated.
- Many students calculated STC – note that STC does not form part of normal tax, but is a separate tax on dividends. The example in TL 106 reflects STC implications, due to the fact that the example required that **all** the tax implications be calculated (as opposed to Part B(1) of the test which required a mere discussion of the normal tax effect). It is thus extremely important to read carefully and ensure that you know what you are required to do.

1. Normal tax effect of proposed distribution of machine

The distribution of the machine will constitute a dividend *in specie*, which gives rise to a **recoupment** in terms of section 8(4)(*a*), read with section 8(4)(*k*).	(1)
Recoupment = **difference between market value of R10 000** (deemed proceeds in terms of **section 8(4)(*k*)) and tax value of R1 800** (R9 000 less section 12C allowances: namely, 40%, i.e. R3 600 claimed in the 2009 tax year and 20%, i.e. R1 800 claimed in the 2010 and 2011 tax years respectively), but **limited to amounts previously allowed as a deduction, namely R7 200** (R9 000 – R1 800).	(1) (1)
In addition, the distribution of an asset is a **disposal for CGT purposes**.	(1)

Capital gain on distribution (paragraph 74 of Eighth Schedule):

	R	R	
Deemed proceeds (market value ito par 75 of Eighth Schedule)	**10 000**		
Less: Recoupment (included in gross income) (par 35(3) of 8th Schedule)	**(7 200)**	2 800	(1)
Cost incurred	**9 000**		
Less: Total tax allowances claimed (par 20(3) of 8th Schedule)	**(7 200)**	(1 800)	(1)
Capital gain		1 000	

<u>SUGGESTED SOLUTIONS TO PAPER 3: DIPAC38</u> continued

Football Mania will include 50% of the capital gain in its taxable income (no roll-over relief available).
It follows that the normal tax effect of the distribution of the machine (to Mr Bafanah) for Football Mania in respect of its 2011 year of assessment is:

	R	
Recoupment	7 200	
Section 12C allowance (20% of R9 000)	(1 800)	(1)
Dividend *in specie* – no deduction	-	(1)
Taxable capital gain (R1 000 x **50%**)	500	(1)
Taxable income	5 900	
Normal tax liability at **28%**	1 652	(1)
		10
Max:		**7**

Part B(2) required a basic STC calculation.
Refer to example in TL 106 – pages 25 & 26.

General reasons for students losing marks in this part of the test:

- STC is a tax on dividends declared and is payable on the "net amount" of a dividend declared. "Net amount" is calculated by deducting from the dividend declared, all (qualifying) dividends accrued during the dividend cycle. Some students incorrectly deducted the dividends declared from the dividends accrued.
- A number of students still use the previous 12,5% as opposed to the current 10% tax rate.
- Some students used the 10/110 fraction as opposed to 10% of the net amount. Refer to page 27 of TL 106 for the distinction, i.e. when to use 10% and when to use the fraction of 10/110.

2. STC liability

STC calculation for the dividend cycle 15 June 2006 to 15 May 2010:

	R	
Dividend declared (**R10 000** (machine distributed as dividend *in specie*) + **R90 000** (cash dividend))	100 000	(2)
<u>Less</u>: Dividends accrued		
• Dividend from Scarf Ltd	(5 500)	(1)
• Dividend from Fantastic (Pty) Ltd	(12 300)	(1)
• Foreign dividend from CFC (not deductible - section 64B(3A)(*d*))	-	(1)
Net amount	82 200	
STC at **10%** of net amount (payable before or on 30 June 2010)	8 220	(1)
		6

Total marks: **40**

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. M.M. Mudau Ms. E.A.J. Terblanche Ms. R. Van Beek	Mr. V.M. Motholo Ms. C. Roets Ms. N.V. Thoothe 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.

THE USE OF A NON-PROGRAMMABLE POCKET CALCULATOR IS PERMISSIBLE.

This test paper remains the property of the University of South Africa and may not be removed from the test venue.

NB:

a) This question paper is written continuously for one hour, i.e. there will be no breaks till 13:00.

b) No student will be allowed to enter the venue after 12:00, once the test has commenced and no student will be allowed to leave the venue during the duration (12:00-13:00) of the test.

c) The test is a limited open-book test: Students are allowed to take in **ONE COPY** of the 2009/2010 version of the SAICA Legislation Handbook (two volumes) and the SAICA Handbook (five volumes: Volumes 1A, 1B, 1C, 2 and 3) into the venue.

d) The text books **MUST** be the latest version: **2009/2010.**

e) **No writing** is allowed in these text books.

f) Students are **allowed to highlight, underline, sideline and flag** in the above mentionedpermitted texts.

g) Flags **may** be referenced.

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

PART A

You are the manager responsible for the audit of Fabulous Fashions Ltd (Fabulous Fashions). The company is up against strong competition in the fashion world as it is involved in the importing and wholesaling of fashion items worn by many local celebrities. The financial director, Mrs Wilemina, presented you with the following draft Balance Sheet as at 31 March 2010:

		R'000
Assets		
Non-current assets		3 676
Property, plant and equipment	3 134	
Interest in subsidiary (Designer Handbags Ltd)	542	
Current Assets		2 142
Inventory	750	
Trade and other receivables	1 392	
		5 818
Equity and Liabilities		
Ordinary shareholders fund		2 154
Ordinary share capital	2 444	
Accumulated loss	(290)	
Non-current liability		1 200
Secured debentures	1 200	
Current liabilities		2 464
Trade and other payables	1 122	
Current portion of non-current liability	400	
Bank overdraft	942	
		5 818

During the course of your review of the audit file and discussions with the financial manager, you became aware of the following:

(a) Due to the strong competition in the market as well as the current economic downturn, the company has been incurring losses for the past 2 years.

(b) The non-current liability comprises 800 000 11.65% secured debentures of R2 each issued at par. Commencing in September 2010, the company is required to redeem one quarter of the debentures each year until 2013.The debentures are secured by a mortgage over the company's land and buildings.(Refer c.)

(c) Property, plant and equipment primarily consist of an office and warehouse complex purchased in 2009 for R2 830 000.

(d) Designer Handbags Ltd is a wholly owned subsidiary of Fabulous Fashions and is involved in the importing and distribution of designer handbags. Although initially profitable, Designer Handbags Ltd has reported an operating loss during the current financial year.

PAPER 4: DIPAC49 (ADVANCED AUDITING) continued

(e) The overdraft facility of R1000 000 is secured by a cession of book debts and a notarial bond over inventory.

(f) Management is currently revising their internal audit department, to make provision for the changes brought about by King III and have indicated their uncertainty regarding risk based internal audit.

REQUIRED

	Marks
(a) Discuss the factors that you would consider to determine whether Fabulous Fashion will be able to trade in the foreseeable future.	14
(b) Describe the audit procedures that you would perform to satisfy yourself that the company will be able to trade in the foreseeable future.	8
(c) Explain the term risk-based internal audit and recommend to management areas which they should include in their planning to comply with the provisions of King III.	6

PART B

The following information is relevant to the audit report of Fabulous Fashions:

- The ability of the company to continue its operations as a going concern is dependent upon the public's response to a proposed offer of shares in May 2010. Details of the proposed share offer are disclosed in the Directors' Report. The directors are confident that the response would be positive.

- You were required to audit various supplementary schedules required for tax purposes. These schedules are to be bound in the same cover as the annual financial statements. You have satisfactorily concluded the necessary work and are satisfied that the schedules have been prepared in accordance with the provisions of the Income Tax Act.

- No other matters have come to light during the course of the audit that would cause you to issue a qualified audit report.

REQUIRED

	Marks
(a) Based on the information above, briefly explain the type of audit report you would issue for Fabulous Fashions for the year ended 31 March 2010.	2
(b) Draft only the relevant paragraphs of the audit report of Fabulous Fashions for the year ended 31 March 2010. (*You are not required to write out the paragraphs dealing with the report on financial statements and management's and auditors' responsibilities.*)	10

SUGGESTED SOLUTIONS TO PAPER 4: DIPAC49

PART A

(a) Factors to be considered with regard to the ability of Fabulous Fashions Ltd to trade in the foreseeable future

In terms of ISA 570 - Going Concern - the foreseeable future has to be judged in relation to specific circumstances, although the auditor should normally consider information that relates to one year after the balance sheet date. It would also be necessary to take into account events that will or are likely to occur later, for example where the entity is due to repay significant indebtedness.

Factors for consideration would be as follows:

Financial indicators

- The company is incurring losses. (1)
- Commencing in September 2010, the company is required to redeem one-quarter of the debentures each year until 2013. As the company is incurring losses, it is unlikely that these debentures can be redeemed. (2)
- The warehouse and office complex may need to be sold as they have been mortgaged in order to secure the debentures. The company would then not have premises from which to operate. (2)
- The overdraft facility is secured by a cession of book debts and a notarial bond over inventory. (1)
- The overdraft facility is almost fully utilised. Are continued operations dependent on additional financing? Is it available? (1)
- Unfavourable current ratio. At present it is 1:1 (R2 142 000:R2 464 000) (1)
  A favourable current ratio would be 2:1. (1)
- Unfavourable acid-test ratio. At present 1:1,4 (R2 142 000-R750 000:R2 464 000). (1)
  A favourable acid-test ratio would be 1:1. (1)

Operating indicators

- The company faces strong competition in the market. (1)
- Fashion items change owing to market trends and are therefore subject to obsolescence. (1)
- Designer Handbags Ltd, the wholly owned subsidiary, has recorded an operating loss. Has Fabulous Fashions in any way stood security for Designer Handbags Ltd? (1)

SUGGESTED SOLUTIONS TO PAPER 4: DIPAC49 continued

Other factors

The assets may be worth considerably more than book value and may alleviate the going concern doubts. (1)

Consider whether the above factors, which cause doubt about Fabulous Fashions' ability to continue as a going concern, are mitigated by other factors, e.g. specific management plans to overcome the going concern problems. (2)

General economic downturn/recession (1)

18

Maximum 14

(b) Audit procedures to be performed to satisfy yourself (provide convincing evidence) that the company will be able to trade in the foreseeable future

1. Review the current realisable value of the assets. (1)

2. - Obtain the future cash flow forecast and re-perform arithmetic calculations. (1)
   - Consider whether previous forecasts have been reliable. (1)
   - Consider the correlation between the forecast and actual performance to date. (1)
   - Evaluate the validity of the assumptions on which the forecast was based. (1)
   - Examine trends in the new period to determine whether management's assumptions are being upheld. (1)
   - Obtain confirmation of all third party commitments. (1)
   - Through discussion with management and their bankers, determine whether the company is likely to enjoy the ongoing support of its financiers. (1)
   - Compare the financial records to the forecast to confirm that all items, particularly those relating to expenditure, have been included in the cash flow. (1)
   - Obtain a management representation letter covering the items included in the forecast. (1)

3. Re-perform calculations on ratios, e.g. liquidity, solvency, "Altman Z score". (1)

4. Inspect the shareholders'/directors' minutes of meetings to identify any new projects or litigation against the company. (1)

5. Obtain a management representation letter on the going concern assumption. (1)

13

Maximum 8

SUGGESTED SOLUTIONS TO PAPER 4: DIPAC49 continued

(c) Risk-based internal audit and the provisions of King III

The risk-based approach places more emphasis on the internal auditor's understanding the risks associated with the strategic direction of the company and determining whether internal controls, processes and procedures address these risks adequately. (2)

The following areas should be included/addressed in the audit plan:

- The full range of risks facing the company, e.g. strategic, operational, financial and ethical. (1)

- Areas of high priority, greatest threat to the company, risk frequency and potential changes. (1)

The audit plan should indicate how assurance will be provided regarding the risk management process and how the plan reflects the level of maturity of the risk management process. (2)

Any changes to the audit plan should be timeously approved/ratified by the audit committee. (1)

7

Maximum 6

PART B

(a) Option 1: Unqualified audit report with emphasis of matter on going concern and "Report on other legal and regulatory requirements" paragraph owing to the fact that the continuation of the company's activities is dependent upon the public response to this offer. (2)

OR

Option 2: Qualified report owing to the uncertainty of the company continuing as a going concern and "Report on other legal and regulatory requirements" paragraph. (2)

4

Maximum 2

(b) OPTION 1

Opinion

In our opinion, the financial statements present fairly, in all material respects, (1)
the financial position of Fabulous Fashions Limited as at March 31, 2010, (1)
and its financial performance and its cash flows for the year then ended (1)
in accordance with International Financial Reporting Standards and in the manner required by the Companies Act of South Africa. (1)

SUGGESTED SOLUTIONS TO PAPER 4: DIPAC49 continued

Going concern

Without qualifying our opinion above, (1)

we draw attention to the facts stated in the director's report, that the company proposes an offer of shares during September 2010. (1)

Continuation of the company's activities is dependent upon the public response to this offer. (1)

The financial statements have been prepared on the going concern basis, which assumes that adequate finance will be obtained. (1)

Accordingly, the financial statements do not include any adjustments relating to the recoverability and classification of assets or to the amounts and classification of liabilities that might be necessary if the company is unable to continue as a going concern. (1)

Report on other legal and regulatory requirements

We have also audited the supplementary schedules, which are the responsibility of the directors and are set out on pages ... to ..., (1)

in accordance with International Standards on Auditing. (1)

In our opinion, these schedules have been properly prepared on the basis of the provisions of the Income Tax Act. (1)

12

Maximum 10

OPTION 2

Basis for qualified opinion

Based on the facts stated in the director's report, the company proposes an offer of shares during September 2010. (1)

Continuation of the company's activities is dependent upon the public response to this offer. (1)

This situation indicates the existence of a material uncertainty that may cast a significant doubt on the company's ability to continue as a going concern (1)

and, therefore, the company may be unable to realise its assets and discharge its liabilities in the normal course of business. (1)

The financial statements have been prepared on the going concern basis, which assumes that adequate finance will be obtained. (1)

Accordingly, the financial statements do not include any adjustments relating to the recoverability and classification of assets nor to the amounts and classification of liabilities that might be necessary if the company is unable to continue as a going concern. (1)

Opinion

In our opinion, except for the possible effects of the matter described in the "Basis for qualified opinion" paragraph, (1)

the financial statements present fairly, in all material respects, (1)

the financial position of Fabulous Fashions Limited as at March 31, 2010, (1)

and its financial performance and its cash flows for the year then ended (1)

in accordance with International Financial Reporting Standards. (1)

SUGGESTED SOLUTIONS TO PAPER 4: DIPAC49 continued

Report on other legal and regulatory requirements
We have also audited the supplementary schedules, which are the responsibility of the directors and are set out on pages ... to ..., (1)
in accordance with International Standards on Auditing. (1)
In our opinion, these schedules have been properly prepared on the basis of the provisions of the Income Tax Act. (1)
14

Maximum 10

MARKERS COMMENTS TO PAPER 4: DIPAC49

PART A

(a) (1)

- Many students merely listed the events or conditions that could cast doubt about the going concern assumption as listed in ISA 570 par A2 (financial and operating indicators). They did not apply these events or conditions to the given scenario and therefore lost the marks given for application.

  For example: Financial indicator: Adverse key financial ratios (student only received one mark for this condition).

  By naming the ratio (current ratio and acid-test ratio) and calculating them to explain why they are adverse / unfavourable, the student would have received the other three possible marks.

- Not all the events or conditions listed in ISA 570 par A2 were applicable. Many students wasted time writing down **all** the events and conditions directly from the ISA without considering their relevance.

- It appears as if students have not mastered the technique of using their open books to their advantage.

- Some students identified one or two factors and wrote pages on them. They therefore only obtained limited marks as they did not identify all the other factors. Study the memo to learn from it.

(a) (2)

- Students again merely listed the additional audit procedures in ISA 570 par A15 without considering their relevance or applying them to the given scenario. **Many** of the procedures listed in par A15 were not applicable.

- Students did not word the audit procedures correctly. It was apparent that students did not use ISA 500 par A14 – A25 for guidance with the wording of audit procedures. Also refer to tutorial letter 104, pages 12-16 in this regard.

MARKERS COMMENTS TO PAPER 4: DIPAC49 continued

(b)

- Students did dismally bad in this part of the question. Many students wrote their own definition of a risk and internal audit is, as they did not know what risk-based internal audit is. This was theory and students should have performed well in this part.

- Very few students included the areas that should be included in the audit plan.

PART B

(a)

- Two options were given in the scenario (Option 1: Unqualified report with emphasis of matter or Option 2: Qualified report owing to the going concern uncertainty). This was done to make it easier, as a student only had to give one of the options and then draft the audit report based on this option.

(b)

- The two options mentioned above were both marked as correct. Students even received marks if they said it should be an unqualified report in part (a), but gave the wording for a qualified report in part (b).

- The examples of the audit report in ISA 570 par A21 – A24 as well as ISA 700 was not used by the students. It seemed as though students did not make use of their ISA's at all. It is very important that you are familiar with the ISA's.

General

All the best for your preparation for the exams! Work through all your tests and tutorial letters, especially tutorial letter 107.