

CONSOLIDATION EXERCISES**SECTION A: TYPICAL EXAM QUESTIONS****HINTS:**

- Always answer in point form
- Make sure you learn your theory on companies
- Open ended questions do not have one correct answer

QUESTION 1: 70 marks 43 minutes

CASH-FLOW STATEMENT AND RATIO ANALYSIS

The information given below was extracted from the financial statements of Manchester Ltd, distributors of exquisite perfumes.

REQUIRED

- 1.1 Prepare the following:
- 1.1.1 Complete the note for reconciliation between profit before taxation and cash generated from operations. (8)
- 1.1.2 Prepare the Cash-Flow Statement for the year ended 28 February 2009. (28)
All workings must be shown in brackets to earn part-marks.
- 1.2 Calculate the following for 2009:
- 1.2.1 Current ratio (3)
- 1.2.2 Acid-test ratio (4)
- 1.2.3 Net asset value per share (4)
- 1.2.4 Debt/Equity ratio (Gearing ratio) (3)
- 1.3 Explain why the directors decided to reduce the long-term loan significantly during the current financial year. In your opinion, was this a wise decision? Explain, quoting evidence (figures/financial indicators) from the question. (6)
- 1.4 Calculate the premium at which the new shares were issued. (6)
- 1.5 Comment on the return on shareholders' equity, earnings and dividends earned by the shareholders. Quote evidence (figures/financial indicators) from the question. (5)
- 1.6 The existing shareholders are unhappy with the price at which the additional shares were sold. Discuss, quoting ONE figure or financial indicator to support your answer. (3)

INFORMATION:

1.	Extract from the Income Statement	R
	Depreciation	33 500
	Interest expense	164 450
	Net profit before tax	844 300
	Income tax (rate 30% of net profit)	?

2.	BALANCE SHEET	28 February 2009	28 February 2008
	ASSETS		
	Non-current assets	3 490 885	3 017 500
	Fixed/Tangible assets at carrying value	3 440 885	2 967 500
	Fixed deposit at PDV Bank	50 000	50 000
	Current assets	320 000	231 250
	Inventories	251 250	110 250
	Trade debtors	60 000	76 000
	Cash and cash equivalents	1 250	45 000
	SARS – Income tax	7 500	0
	TOTAL ASSETS	3 810 885	3 248 750
	EQUITY AND LIABILITIES		
	Capital and reserves	3 120 000	1 443 000
	Ordinary share capital (par value R5)	2 085 000	1 050 500
	Share premium	268 970	0
	Retained income	766 030	392 500
	Non-current liabilities	300 000	1 525 000
	Loan: Enid Bank at 15% p.a.	300 000	1 525 000

	Current liabilities	390 885	280 750
	Trade creditors	209 945	220 475
	Bank overdraft	47 500	0
	Shareholders for dividends	133 440	52 525
	SARS – Income tax	0	7 750
	TOTAL EQUITY AND LIABILITIES	3 810 885	3 248 750

3. ADDITIONAL INFORMATION:

- A. Additional new shares were issued at a premium halfway through the year on 31 August 2008. These shares did not qualify for interim dividends.
- B. Fixed assets were sold for R100 000 cash at carrying value.
- C. Earnings and dividends per share were as follows:

	2009	2008
Earnings per share	189 cents per share	135 cents per share
Total dividends	72 cents per share	105 cents per share
Interim dividends	40 cents per share	80 cents per share
Final dividends	32 cents per share	25 cents per share

- D. You are also provided with the following financial indicators:

	2009	2008
% return on shareholders' equity	26%	21%
% return on capital employed (after tax)	24%	10%
Net asset value per share	?	687 cents

- E. The price of the shares on the Johannesburg Securities Exchange (JSE) has fluctuated between 680 cents and 780 cents over the past year.

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QUESTION 2: 30 marks 18 minutes**DEBTORS' COLLECTION AND CASH BUDGET**

Africa Ceramics is owned by Joe Tyler. He sells a wide range of ceramic tiles. The following information was extracted from the books:

REQUIRED:

- 2.1 Complete and total the Debtors' Collection Schedule for November and December 2009. (13)
- 2.2 Refer to Information 3 below. Compare the budgeted figures to the actual figures for October to comment on each of the following. State TWO points in each case (6)
- Advertising
 - Repairs and maintenance
 - Delivery expenses
- 2.3 (a) Explain TWO problems you have identified and quote figures from the question to support your answer. (4)
- (b) Give ONE point of advice in each case. (4)
- 2.4 By looking at the Cash Budget in Information 3 and assuming all other items are in line with the budget, would you expect the bank balance at the end of October to be favourable or unfavourable? Give a reason for your answer. (3)

INFORMATION:**1. DEBTORS' COLLECTION SCHEDULE OF AFRICA CERAMICS FOR THE PERIOD ENDING 31 DECEMBER 2009**

Month	Credit sales R	DEBTORS' COLLECTION		
		October 2009 R	November 2009 R	December 2009 R
August	360 000	64 800		
September	540 000	270 000		
October	450 000	129 600		
November	420 000			
December	420 000			
TOTALS		464 400		

2. EXPECTED COLLECTION FROM DEBTORS

- 75% of all sales are expected to be on credit.
- 30% of debtors settle accounts during the transaction month to benefit from a 4% discount for prompt payment.
- 50% of debtors settle accounts in the month following the transaction month.
- 18% settle accounts during the second month after the transaction month.
- 2% is written off as irrecoverable after 60 days.

3. BUDGETED AND ACTUAL FIGURES:

At the end of October, the following actual figures were identified and compared to the budgeted figures:

From the Projected Income Statement:	OCTOBER BUDGET R	OCTOBER ACTUAL R
Total sales	600 000	672 000
Cash sales	150 000	70 000
Credit sales	450 000	602 000

From the Cash Budget:	OCTOBER BUDGET R	OCTOBER ACTUAL R
Collections from debtors	464 400	238 588
Purchase of trading stock	375 000	420 000
Advertising	15 000	25 000
Repairs and maintenance	16 500	3 800
Delivery expenses	20 000	42 000
Bank balance at end of month	120 000	?

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REQUIRED:

- 1.1.1 What is the purpose of the Cash Budget? (2)
- 1.1.2 Rent increases annually on 1 April. What is the percentage increase that will be applicable from 1 April 2010? (4)
- 1.1.3 Depreciation amounts to R4600 per month, but does not appear in the cash budget. Is this a mistake? (3)
- 1.1.4 Bally, the owner, has applied to increase his loan from R120000 to R300 000. He expects it to approved, and for the money to be available in March 2010. Calculate the loan's interest rate. (6)
- 1.1.5 What is the mark-up percentage on cost price, assuming that creditors are paid after 60 days, and assuming that 30% of all stock purchases are on credit (Stock is replaced in the same month). (8)
- 1.1.6 Wages and Salaries for March and April are higher than usual, because the owner hired two students for the two months. What did each earn, and was it a good decision? (3)

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SECTION C: SOLUTIONS AND HINTS TO SECTION A**QUESTION 1**

1.1.1	Reconciliation between profit before taxation and cash generated from operations	
	Net profit before tax	844 300
	Adjustments i.r.o.	
	Depreciation	33 500
	Interest on borrowed funds	164 450
	Operating profit before changes in working capital	1 042 250
	Changes in working capital Check operation	<input checked="" type="checkbox"/> (135 530)
	Inventory	Figure ✓ Operation ✓ (141 000)
	Debtors	Figure ✓ Operation ✓ 16 000
	Creditors	Figure ✓ Operation ✓ (10 530)
	Cash generated from operations Check operation	<input checked="" type="checkbox"/> 906 720

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1.1.2 MANCHESTER LIMITED

CASH FLOW STATEMENT FOR THE YEAR ENDED 28 FEBRUARY 2009

CASH FLOW FROM OPERATING ACTIVITIES	Check operation	<input checked="" type="checkbox"/> 337 165
Cash generated from operations	See 1.1.1	<input checked="" type="checkbox"/> 906 720
Interest paid	Figure must correct & outflow	✓ (164 450)
Dividends paid 52 525 ✓ + 217 480 ✓ – 133 440 ✓ OR – 52 525 – 217 480 + 133 440 OR 52 525 1 mark + 84 040 2 marks	If one part correct, figure must be outflow	<input checked="" type="checkbox"/> (136 565)
Taxation paid 7 750 ✓ + 253 290 ✓ + 7 500 ✓ OR – 7 750 – 253 290 – 7 500	If one part correct, figure must be outflow	<input checked="" type="checkbox"/> (268 540)
CASH FLOW FROM INVESTING ACTIVITIES	Check operation figure must show correct flow	<input checked="" type="checkbox"/> (506 885)
Purchase of fixed assets 3 440 885 ✓ – [2 967 500 ✓ – 100 000 ✓ – 33 500 ✓] OR 3 440 885 – 2 967 500 + 100 000 + 33 500 OR –3 440 885 + 2 967 500 – 100 000 – 33 500	If one part correct, figure must be -ve	<input checked="" type="checkbox"/> (606 885)
Proceeds from the sale of fixed assets		✓ 100 000
CASH FLOW FROM FINANCING ACTIVITIES	Check operation	<input checked="" type="checkbox"/> 78 470
Proceeds of shares issued 1 034 500 ✓✓ + 268 970 ✓ OR 2 085 000 (1 mark) – 1 050 500 (1 mark) + 268 970 (1 mark) OR 2 353 970 (2 marks) – 1 050 000 (1 mark)		✓ 1 303 470
Repayment of long term loans	Figure ✓ Outflow ✓	(1 225 000)
Net change in cash and cash equivalents	Check operation, do not accept 46250 or 47500 or 1250	<input checked="" type="checkbox"/> (91 250)
Cash and cash equivalents at the beginning of the year	Must be +ve	✓ 45 000
Cash and cash equivalents at the end of the year	Figure must be -ve	✓ (46 250)

Fixed Assets T-account	
2 967 500	100 000
606 885	33 500
	3 440 885

[28]

1.2 Calculate the following for 2009:**1.2.1 Current ratio**

$$\checkmark \quad \checkmark \quad \checkmark \quad 320\,000 : 390\,885 = 0,8 : 1 \text{ (accept } 0,82 : 1) \quad (3)$$

1.2.2 Acid-test ratio

$$\checkmark \checkmark \quad \checkmark \quad \checkmark \quad 68\,750 : 390\,885 = 0,2 : 1 \text{ (Accept } 0,18 : 1) \quad (4)$$

1.2.3 Net asset value per share

$$\checkmark \quad \checkmark \checkmark \quad R3\,120\,000 / 417\,000 \text{ shares} = 748,2 \text{ cents or } R7,48 \quad (4)$$

1.2.4 Debt/Equity ratio (Gearing ratio)

$$\checkmark \quad \checkmark \quad \checkmark \quad 300\,000 : 3\,120\,000 = 0,1 : 1 \text{ or } 0,096 : 1 \quad (3)$$

1.3 Explanation of directors' decision: ✓✓

Any one reason:

- The sale of extra shares has brought about an inflow of cash
- In the previous year the ROTCE (10%) was lower than the interest rates (15%).
- In the previous year the company was highly geared with a very high debt/equity ratio (> 1 : 1)

Opinion: Yes or No ✓**Explanation:** ✓✓ **Evidence:** ✓

Any one explanation for Yes:

- The debt/equity ratio is now very low (0,1 : 1) which indicates a low-risk situation
- The saving on interest has increased the profits as indicated by EPS from 135c to 189c or ROSHE from 21% to 26%
- The company is now in a positive gearing situation with ROTCE of 24% which is much higher than the interest rates.

Any one explanation for No:

- The directors have over-reacted because the evidence shows that they should now consider taking out more loans (ROTCE of 24% exceeds interest rates) and debt/equity ratio of 0,1:1 is low, indicating low risk
- The short-term liquidity is now a problem as the acid-test ratio is now 0,2:1 and the current ratio is 0,8:1
- The net change in cash was a negative of R91 250 which has caused short-term liquidity concerns. (6)

1.4 Returns on shareholders' equity

Quote financial indicator ✓	Any valid <u>specific</u> comment related to the indicator, e.g. ✓
ROSHE has increased from 21% to 26% OR: ROSHE is now 26% OR: ROSHE increased by <u>5%</u> points OR: ROSHE increased by 23,8%	This exceeds the returns on alternative investments

Earnings

Quote financial indicator ✓	Any valid <u>specific</u> comment related to the indicator, e.g. ✓
EPS has improved from 135c to 189c OR: EPS is now 189c OR: EPS increased by 54c or 40%	This compares well to the value of the share

Dividends

Quote financial indicator ✓	Any valid <u>specific</u> comment related to the indicator, e.g. ✓
DPS has declined from 105c to 72c OR: DPS is now 72c OR: DPS decreased by 33c or 31,4%	The company is retaining more of its profits OR: This increases the NAV OR: The dividend payout rate dropped to less than 50% of profits OR: Increases the infrastructure of the company (6)

1.5 Calculate the premium at which the new shares were issued.

Number of shares issued = $(2\,085\,000 - 1\,050\,500) / R5 = 206\,900$ shares

$268\,970 \checkmark\checkmark\checkmark / 206\,900 \checkmark$

= R1,30 (5)

1.6 Quoting of figures / financial indicator ✓

Comment

Expected responses:

- The shares were issued at a price of R6,30 which is lower than the NAV (R6,87 or R7,48) which means that the existing shareholders are being disadvantaged
- The shares were issued at a price of R6,30 which is lower than the market price (R6,80 to R7,80) which means that the existing shareholders are being disadvantaged (3)

TOTAL MARKS: 70

QUESTION 2

2.1 DEBTORS' COLLECTION SCHEDULE OF AFRICA CERAMICS FOR THE PERIOD ENDING 31 DECEMBER 2009

Month	Credit sales R	DEBTORS' COLLECTION		
		October 2009 R	November 2009 R	December 2009 R
August	360 000	64 800		
September	540 000	270 000	✓✓97 200	
October	450 000	129 600	✓✓225 000	✓✓81 000
November	420 000		✓✓120 960	✓✓210 000
December	420 000			☑ 120 960
TOTALS		464 400	☑ 443 160	☑ 411 960

(13)

2.2 Any two valid and separate points in each case**Advertising**

Candidates must compare advertising to sales ✓

- This led to an increase in sales of R72 000
- Sales increased by only 12%
- Sales increased by R72 000 (credit sales up by R152 000, cash sales down by R80 000)
- One other factor: ✓
- Over-spent / Under-budgeted by R10 000 (investigate reason)
- Over-spent by 66% / Under-budgeted by 66% (investigate reason)
- They used a different strategy, e.g. advertise on TV instead of in press.

Repairs & maintenance Any two valid comments ✓ ✓

- Under-spent / Over-budgeted by R12 700
- Consider if this is wise – fixed assets must not be neglected as they generate income for the business and neglecting repairs will lead to more expenditure in future
- Repairs & maintenance was well-managed / Good use of equipment that is why they under-spent

Delivery expenses

Candidates must compare delivery expenses to sales ✓

- Does not correlate with sales which increased by 12% while delivery expenses increased by 110%
- Over-spend of R22 000 led to a R72 000 increase in sales
- One other factor: ✓
- Over-spent / under-budgeted by R22 000 / they spent more than double the budget
- Investigate possible abuse / lack of control / poor strategies (e.g. out-sourcing might be too expensive)
- Poor maintenance of vehicles has led to high fuel costs

(6)

2.3 Any valid explanations related to numbers of customers based on information from the question, e.g.

	(a) Description of problem, quoting figures:	(b) Advice:
1	Describe problem ✓ Quote figure ✓ Credit sales were R152 000 more than expected, while cash sales were R80 000 less than expected (this creates a cash flow problem).	Comment (part-marks possible): ✓✓ Offer more favourable trade discounts to customers who buy for cash
2	Describe problem ✓ Quote figure ✓ Collections from debtors are R225 812 less than budget / This is expected to lead to increased bad debts (2%) or extra administration costs.	Comment (part-marks possible): ✓✓ Screen debtors more rigorously to determine creditworthiness OR Apply more stringent credit terms before debtors open accounts OR Follow-up on each debtor by way of statements, phone calls etc, or charge interest. OR Debtors need to be encouraged to pay quicker – offer discount and/or charge interest on overdue accounts.

(8)

2.4 Favourable or unfavourable balance? Unfavourable ✓

Reason: ✓✓

- Debtors collection is poor
- Cash sales are well under budget
- Cash purchases of trading stock have gone up
- Cash purchases are more than the cash sales and debtors collections

Also accept:

- Overall the variances on figures provided are negative
- Delivery expenses
- Advertising

(3)

[30]

Learner Note: From the above you can see the importance of understanding your concepts of companies. As you attempt the homework, you need to ensure that you are able to answer the questions in the allocated time frames. If you get stuck, you should refer either to the additional notes or your class teacher.