

TOPIC: CONSOLIDATION**SECTION A: TYPICAL EXAM QUESTIONS****Learner Note:**

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

QUESTION 1: 75 marks 45 minutes**CONCEPTS AND INTERPRETATION OF FINANCIAL STATEMENTS**

You are provided with information relating to Manic Limited for the year ended 30 June 2010.

REQUIRED

- 1.1 Concepts relating to companies are given in COLUMN A and descriptions in COLUMN B. Choose a description from COLUMN B that matches a concept in COLUMN A. Write only the letter (A – D) next to the question number (1.1.1 – 1.1.4)

COLUMN A		COLUMN B	
1.1.1	Liquidity	A	indicates the benefit that the owners receive from their investment in the business
1.1.2	Solvency	B	indicates the extent to which a business is financed by borrowed capital
1.1.3	Gearing	C	indicates whether the business can pay off immediate debts
1.1.4	Return on equity	D	indicates whether the business will be able to pay off all its debts

(4 x 2) (8)

- 1.2. Refer to the Note for Fixed Assets (Information D) and the Cash Flow Statement (Information C) for the year ended 30 June 2010, and prepare the Asset Disposal Account (General Ledger). (9)

- 1.3 Refer to the Cash Flow Statement (Information C).
- List the THREE most significant decisions that the directors made during the year. Quote figures from the Cash Flow Statement in each case. (6)
 - Comment on any TWO interesting points indicated in the Cash Flow Statement. Name TWO points and quote figures to support your answer. (4)
- 1.4 Refer to Information B. Calculate the following financial indicators on 30 June 2010:
- Operating profit on turnover (3)
 - Acid-test ratio (4)
 - Earnings per share (4)
- 1.5 Comment on the operating efficiency of the company for the year ended 30 June 2010. Quote TWO financial indicators or figures to support your comments. (6)
- 1.6 Comment on the liquidity of the company for the year ended 30 June 2010. Quote THREE financial indicators or figures to support your comments. (9)
- 1.7 Comment on the returns, earnings and dividends earned by the shareholders for the year ended 30 June 2010. Quote THREE financial indicators or figures to support your comments. (9)
- 1.8 Refer to the newspaper article (Information E) and answer the following questions:
- 1.8.1 Refer to paragraph 1.
Explain your opinion on the attendance of shareholders at the AGM. (3)
- 1.8.2 Refer to paragraphs 2 and 3.
Answer the following:
- What is meant by a *qualified audit report*? Explain.
 - How does this type of report affect the company and the shareholders? Explain.
 - Why did the independent auditors issue a qualified report in respect of this asset? Explain. (6)
- 1.8.3 Explain why several of the shareholders would think that the long-term prospects of the company are being threatened. Mention corporate governance in your answer. (4)

INFORMATION

A. Figures extracted from the financial statements on 30 June 2010:

	R
Sales	2 730 000
Depreciation	560 000
Operating profit	650 000
Interest on borrowed funds	210 000
Net profit before tax	440 000
Net profit after tax	308 000
Ordinary share dividends	390 000
Ordinary share capital (par value R2,00)	3 000 000
Loan from Hard Bank (14% p.a.)	2 800 000
Current assets	610 000
Trading stock	410 000
Trade and other receivables	180 000
Cash and cash equivalents	20 000
Current liabilities	360 000
Trade and other payables	150 000
Shareholders for dividends	210 000

B. The following calculations were done in respect of the past two financial years:

	2010	2009
Operating expenses on turnover	28,6%	33,1%
Operating profit on turnover	?	17,5%
Net profit after tax on turnover	11,3%	8,2%
Return on average shareholders' equity	8,6%	7,2%
Earnings per share	?	18 cents
Dividends per share	26 cents	12 cents
Return on capital employed	12,8%	22,1%
Debt-equity ratio	0,7 : 1	0,4 : 1
Current ratio	1,7 : 1	1,9 : 1
Acid-test ratio	?	0,7 : 1
Period of stock on hand	136 days	85 days
Debtors' collection period	23 days	30 days
Creditors' payment period	38 days	42 days

C. **CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 2010**

CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 2010	
CASH EFFECTS OF OPERATING ACTIVITIES	738 000
Cash generated from operations	1 370 000
Interest paid	(210 000)
Income tax paid	(132 000)
Dividends paid	(290 000)
CASH EFFECTS OF INVESTING ACTIVITIES	(4 348 000)
Fixed assets purchased	(4 858 000)
Fixed assets sold for cash	370 000
Investments redeemed	140 000
CASH EFFECTS OF FINANCING ACTIVITIES	3 580 000
Proceeds of issued shares	980 000
Loans raised	2 600 000
Cash surplus/deficit for the year	(30 000)
Cash and cash resources at the beginning of the year	50 000
Cash and cash resources at the end of the year	20 000

D.

FIXED ASSETS	Total	Land and buildings	Equipment
Carrying value – beginning of year	2 360 000	792 000	1 568 000
Cost price	3 592 000	792 000	2 800 000
Accumulated depreciation	(1 232 000)		(1 232 000)
Movements			
Additions	4 858 000	4 100 000	758 000
Disposals (1 March 2010)	(370 000)		(370 000)
Depreciation	(560 000)		560 000
Carrying value – end of year	6 288 000	4 892 000	1 396 000
Cost price	7 058 000	4 892 000	3 066 000
Accumulated depreciation	(1 670 000)		(1 670 000)

- E. As a shareholder of Manic Ltd, you did not attend the annual general meeting (AGM). You notice the following article in a newspaper, *The Daily Views*.

Paragraph 1	Several shareholders of Manic Ltd accused the directors of unwise decisions that in their opinion would threaten the long-term continuation of the company. Only 50 of the 6 000 shareholders of the company attended the AGM.
Paragraph 2	The company received a qualified audit report from the auditors based on an amount of R3 million that had apparently been spent on a residence in an elite area along the KwaZulu-Natal coast.
Paragraph 3	The directors' report stated that this asset was reflected in the company's Balance Sheet and was being used for business purposes to accommodate business partners from overseas countries. <i>The Daily Views</i> has found that this property was in fact being used for holiday purposes by the CEO and senior directors.
Paragraph 4	The CEO, Ben Crooke, was also criticised for accepting a 60% increase in his remuneration. Crooke defended the decision, saying that all remuneration in the company is reviewed by the board of directors which is appointed at the AGM each year.

[75]

QUESTION 2:**31 marks****18 minutes****STOCK SYSTEMS**

You are provided with information relating to Leather World. The business is owned and run by the owner Natasha Fox. Natasha buys and sells leather jackets and very exclusive handbags.

REQUIRED

- 2.1 Natasha suspects that a number of handbags have been shop-lifted from the stock purchased 7 March 2009. Calculate the number of bags stolen. (2)
- 2.2 Calculate the stock values that will appear in the Balance Sheet. Show all workings using the number of units and the appropriate unit value.
- Leather jackets (use the weighted average method) (6)
 - Handbags (use the FIFO method). (5)
- 2.3 Calculate the following for the handbags:
- Cost of sales (6)
 - Gross profit (3)
 - Mark-up % achieved. (3)

2.4 Natasha feels that he is not coping with both sections in her business. Her problems are:

- Leather jackets: She feels that the jackets only sell during the winter months and she carries the stock for the whole year.
- Handbags: She is disappointed in the sales of handbags and the gross profit. Because they are so expensive, she has to spend time controlling them very tightly and she cannot put her prices up any more.

Natasha is not sure whether she should:

- Continue with both departments; **OR**
- Specialise in one product only, and if so, which one would it be – leather jackets or handbags?

What would you advise? Explain your reason.

(6)

[30]

INFORMATION

1. The leather jackets are bought from a South African supplier, and the handbags are imported from the USA.
2. The leather jackets are valued using the Weighted Average method and the handbags are valued using First-in First-out method (FIFO).
3. The stocks were valued as follows at the beginning and end of the financial year.

	Leather jackets			Handbags			
	No. of units	Per unit	TOTAL (Including carriage)	No. of units	Per unit	Exchange rate	TOTAL (Including purchases expenses)
01/03/2009	80	R550	R44 000	100	\$45	R7,20=\$1	R32 400
29/02/2010	200	?	?	240	?		?

4. Purchases during the financial year:

	Leather jackets			Handbags			TOTAL COST (excluding purchases expenses)
	No. of units	Unit cost	TOTAL COST (excluding transport)	No. of units	Unit cost	Exchange rate	
07/03/2009	200	R560	R112 000	80	\$50	R7,00= \$1	R28 000
25/06/2009	250	R620	R155 000	220	\$50	R7,70= \$1	R84 700
02/02/2010	150	R700	R105 000	100	\$55	R8,00= \$1	R44 000
TOTALS	600		R372 000	400			R156 700

5. Purchases expenses:

- Carriage on purchases for the leather jackets were R13 000 and handbags were imported at carriage of R20 per handbag.
- Customs and import duties on handbags paid during the accounting period, R12 000.

6. During the financial year, the following sales were made:

Leather jackets: 480 units at R1 000 each = R480 000

Handbags: 235 units at R900 each = R211 500

7. Natasha has started to prepare the following information:

	Leather jackets	Handbags
Sales	R480 000	R211 500
Cost of sales	R321 750	?
Gross profit	R158 250	?
Mark-up % on cost	49,18%	?

2. Transactions during the year:

- Raw materials purchased on credit, R490 000
- Raw materials purchased for cash, R356 000
- Raw materials issued for production, R540 000
- Raw materials donated by the factory to the local school, R10 000
- Cost of transporting raw materials to the factory, R29 500
- Factory indirect materials bought for cash, 79 000
- Factory indirect materials returned to suppliers, R12 000
- Wages paid to factory workers who make the shoes, R756 000
- Salary paid to **employees**,R478 000. Included in this amount is the salary of the factory foremen R120 000
- Commission on sales, R90 000 (all sales are subject to a commission of 3%)
- Maintenance of factory equipment paid, R23 000
- Water & electricity paid, R49 000 (this is to be split between the factory, office and sales sections in the ratio 4:2:1 respectively)
- Rent paid, R157 200 (this is to be split across the various departments according to floor area - the factory accounts for 70% out of the total area). The rent for January 2009 was paid in advance, and the lease agreement provides for an annual 10% increase of rental effective from 1 January each year. Shaid's Shoe Manufacturers complies with the lease agreement.
- Depreciation on factory equipment amounts to R72 400.
- Bad debts,R34 000

1.2 You are provided with information relating to Gcenaphi Heaters, a business which manufactures only one type of heater

REQUIRED

Use the information to:

- 1.2.1 Calculate the gross profit (3)
- 1.2.2 Explain why it is important for a manufacturing business to calculate unit costs and a break -even-point each month (3)
- 1.2.3 Calculate the variable cost per unit for 2008 (4)
- 1.2.4 Calculate the break-even point for 2008 (4)

INFORMATION

- 1 There was no work-in-process at the beginning or end of the financial year
- 2 All heaters were sold at a fixed price of R114 each in 2008
- 3 Direct material cost per heater, R25.
- 4 Prime cost per heater, R55.
- 5 Total cost of production of finished heaters, R760 000.
- 6 Number of heaters completed during the year, 10 000.
7. Number of heaters sold during the year, 10 000.
8. Number of unsold heaters at the beginning of the financial year?? (The cost per unit of these heaters was the same as those that were produced last year.)
9. Administration costs for the year amounted to R240 000.
10. Selling and distribution costs for the year amounted to R117 000.
11. Number of unsold heaters at the end of the financial year, 300.

Gcenaphi Heaters use the FIFO method of valuation of finished goods

[50]

SECTION C: SOLUTIONS AND HINTS TO SECTION A

QUESTION 1

1.1

COLUMN	COLUMN
1.1.1	C ✓✓
1.1.2	D ✓✓
1.1.3	B ✓✓
1.1.4	A ✓✓

(8)

1.2

**General Ledger of Manic Limited
Asset Disposal Account**

2010 March	1	Equipment ✓	✓✓ 492 000	2010 March	1	Accumulated depreciation on equipment ✓	☑☑ 122 000
						Bank ✓	✓✓ 370 000
			492 000				492 000

(9)

1.3

Fixed assets purchased for R4 858 000 ✓✓
 Loans were raised for R2 600 000 ✓✓
 Shares were issued for R980 000 ✓✓

Name TWO points and quote figures to support your answer.

Any TWO valid points ✓✓ ✓✓

Possible answers:

- The significant increase in fixed assets (R2 600 000) should benefit the company in future by creating the capacity to earn bigger profits.
- The operating activities generated a positive cash flow of R1 370 000 before paying interest, dividends and income tax.
- The significant increase in loans of R2 600 000 would be a concern because ROTCE of 12,8% is lower than the interest rate on the loan from Hard Bank.
- The decline in cash resources from R50 000 to R20 000 could be a small concern especially as the investments were also reduced by R140 000.

(10)

1.4

Operating profit on turnover

$650\,000 \checkmark / 2\,730\,000 \checkmark \times 100 = 23,8\% \checkmark$

Acid-test ratio

$(610\,000 \checkmark - 410\,000 \checkmark) : 360\,000 \checkmark = 0,56 : 1$ or $0,6 : 1 \checkmark$

OR

$180\,000 + 20\,000 : 360\,000 = 0,56 : 1$ or $0,6 : 1$

Earnings per share

$R308\,000 \checkmark / 1\,500\,000 \checkmark \checkmark \text{ shares} = 20,5 \text{ cents} \checkmark$

(11)

1.5

Mention TWO relevant financial indicators ✓ ✓

Quoting of figures ✓ ✓

Mentioning the trends ✓ ✓

Possible answers:

- Operating expenses on sales improved from 33,1% to 28,6% indicating better control over the operating expenses.
- Operating profit on sales improved from 17,5% to 23,8% indicating improved profitability of the business.
- Net profit after tax on sales improved from 8,2% to 11,3% indicating better overall profitability even after payment of interest and tax.

(6)

1.6

Mention THREE relevant financial indicators ✓ ✓ ✓

Quoting of figures ✓ ✓ ✓

Mentioning the trends ✓ ✓ ✓

- Current ratio is approximately the same in both years (1,9 : 1 to 1,7 : 1) – This indicates that current assets exceed the current liabilities.
(NB. No norm – the business has existed on similar ratios for the past two years.)
- Acid-test ratio is approximately the same in both years (0,6 : 1 to 0,7 : 1). Although liquid assets are less than the current liabilities the business is obviously able to settle its current debts as they have existed with similar ratios for the past two years.
- Stock period has worsened from 85 days to 136 days. This could place strain on cash resources as stock is not being sold as quickly as it was in the previous year.
- Debtors' period has improved from 30 days to 23 days. This will assist the cash-flow situation as debtors are paying more quickly than the previous year.
- Creditors' period has decreased from 42 days to 38 days. This figure will have to be checked against the credit terms allowed by the creditors to ensure that the company's credit rating is not negatively affected.

(9)

1.7

Mention THREE relevant financial indicators ✓ ✓ ✓

Quoting of figures ✓ ✓ ✓

Mentioning the trends ✓ ✓ ✓

EPS improved from 18 to 20,5 cents per share.

DPS improved from 12 to 26 cents per share.

Although these indicators represent an improvement, the shareholders will be concerned that the company paid out more dividends than what was earned. This means that the company is not retaining any of its current profits for future expansion.

ROCE improved from 7,2% to 8,6%. Although there was an improvement, this return does not exceed returns on alternative investments and will, therefore, not satisfy the shareholders.

(9)

- 1.8.1 Good answer = 3 marks; satisfactory answer = 2 marks; poor answer = 1 mark; incorrect answer = 0 marks ✓✓✓

Expected response:

The shareholders should all try to attend the AGM or at least appoint a proxy to make decisions on their behalf at the AGM. The shareholders appoint the directors and the directors make the day-to-day decisions. When shareholders do not attend the AGM, they are effectively handing over more control to the directors.

(3)

- 1.8.2 **What is meant by a *qualified audit report*? Explain.**

Expected response: ✓✓

The independent auditors are specifically drawing attention to an aspect of the financial statements that is of major concern to them.

How does this type of report affect the company and the shareholders? Explain.

Expected response: ✓✓

The shareholders will not be able to rely on certain aspects of the financial statements when making their decisions about their investment in the company. The company will get a bad reputation and this will affect their ability to raise further capital or business in future.

Why did the independent auditors issue a qualified report in respect of this asset? Explain.

Expected response: ✓✓

The auditors are obviously not happy that this is a genuine business asset. The purchase has affected the loans that have been raised, and this has an effect on the profits earned. The directors have misrepresented this asset in the balance sheet and in the directors' report. The directors are receiving a benefit from this asset which should be declared in the financial statements, and might have tax implications.

(6)

- 1.8.3 Expected response: ✓✓ ✓✓

A significant asset has been purchased that is apparently not going to benefit the company in future – loans have been raised to finance this and interest will have to be paid on those loans.

The CEO has been granted a 60% increase in his remuneration despite the fact that the company has not performed extraordinarily well over the past years. It could be that the CEO is manipulating the remunerations committee to support his own agendas.

(4)

[75]

2.4 Yes/No

Excellent = 5-6 marks; Good = 4 marks; Satisfactory = 3 marks; Poor = 1 or 2 marks ✓✓✓✓✓✓

Response should cover: Viability of each product & valid solution to problem

Possible points to consider:

- Mark-up jackets 49,18% vs Mark-up handbags 90,19%
- Keep both lines but employ an assistant on a commission basis, OR
- Focus on one line, but strategies needed to double volume on that line (e.g. more advertising) to earn at least the same Gross profit,

OR

Better systems in place to control & sell stock of handbags, etc.

Any valid answer

(6)

[30]