

TOPIC 2: COMPANIES FINANCIAL STATEMENTS

Learner Note: Make sure you are able to answer theory type of questions.

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: **79 marks** **48 minutes** *(Adapted from New Era Study Guide)*

COMPANY FINANCIAL STATEMENTS**1.1 BOTSO-BOTSO STORES LTD**

The financial year-end is 30 June. Their inexperienced accountant prepared the final accounts and the Post-closing Trial Balance of the business on 30 June 2009 without taking certain adjustments into account.

REQUIRED:

- | | | |
|-------|--|------|
| 1.1.1 | Calculate the correct net income after tax after taking all the adjustments into account. | (21) |
| 1.1.2 | Complete the following notes to the Balance Sheet on 30 June 2009: | |
| | • Retained income (Accumulated profits) | (7) |
| | • Trade and other receivables | (15) |
| | • Trade and other payables | (14) |
| 1.1.3 | Complete the Balance Sheet on 30 June 2009.
(Show calculations in brackets where the notes are not required.) | (22) |

FIGURES OBTAINED FROM THE POST-CLOSING TRIAL BALANCE ON 30 JUNE 2009	Debit R	Credit R
Ordinary share capital R2 per share		500 000
Retained income (1 July 2008)		85 000
Ordinary share premium		30 000
Fixed assets at book value	780 540	
Loan MAP Bank		140 200
Fixed deposit :Heeda Investments	30 000	
Trading stock	104 000	
Debtors' control	28 450	
Provision for bad debts		1 250
Bank		23 000
SARS: PAYE		3 200
SARS: Income tax	46 000	
Cash float	1 000	
Creditors' control		67 340
Net income before tax and additional adjustments		140 000
	989 990	989 990

ADDITIONAL INFORMATION:

The accountant calculated the **net income before tax** to be R140 000. The following adjustments and other information were not taken into account:

- The amount due by debtor G.Galu, R700, must be written off as irrecoverable and the provision for bad debts must be adjusted to R1 105.
- A credit note from creditor Ngele Suppliers for merchandise returned on 28 June 2009 had not been entered, R820.
- A physical stocktaking on 30 June 2009 showed that the following were on hand:

Trading stock	R98 000
Consumable stores	<u>R 540</u>
	<u>R98 540</u>
- 50% of the fixed deposit at Heeda Investments will mature on 31 March 2010

5. The loan from MAP Bank has been debited with R44 400 that is 12 payments of R3 700 per month including the interest. The accountant has calculated that the following:
- | | |
|--------------------------------------|----------|
| Beginning of the year (1 July 2008): | R184 600 |
| End of the year (30 June 2009): | R162 124 |
- An adjustment for interest must be made.
Over the next financial year this loan will reduce by R26 000.
6. Advertisements include an amount of R6 240 for a billboard advertisement at the Garwa High School for a period of two years commencing on 1 September 2008.
7. The salary of one employee Kala Hoendier was not taken into account in June 2009. His salary and all the amounts owing for salary deductions will be paid on 2 July 2009.

GROSS SALARY	DEDUCTIONS			NET SALARY
	SARS: PAYE	Pension Fund	UIF	
R10 000	R3 000	R900	R100	R6 000

The business contributes on a rand-for-rand basis to the Pension Fund and UIF. These contributions are not included in the totals above.

8. Income tax for the financial year has been calculated to be R42 500.
9. The directors declared a final dividend of 7½ cents per share

ACTIVITY 2

Instructions:

1. Read through the question 2, taking careful note of the marks allocated for each question and the time you should spend on each question
2. Use your notes from the previous sessions to assist you to answer these questions
3. After 10 minutes you will be asked to stop working by your tutor, so that you can ask questions and to confirm you are on the right track
4. Complete the activity for homework and bring your answer to the next session

CASE STUDY: 20 marks 20 minutes

ESKOM BONUSES 'NOT ON'
Daily News, Monday 14 April 2008

Johannesburg: The Democratic Alliance said a comment by public enterprises minister Alec Erwin that Eskom executives deserved performance bonuses was laughable.

DA Spokesman Manie van Dyk said the executives did not deserve any bonus.

“Given the frequency with which power cuts have occurred and the 14% price hike of electricity, bonuses are not warranted,” Van Dyk said.

Speaking at a conference in Rustenburg last week, Erwin had said a decision to give the bonuses had been made and was supported because Eskom executives had done well in the past financial year.

“If we treat our senior executives badly, we will struggle to keep them. We must treat people fairly,” he said.

Van Dyk said Erwin’s comments showed that Eskom’s inability to supply power would have no bearing when bonuses were paid. – SAPA

QUESTIONS:

- 2.1 Bonuses to executives are paid in many businesses. Why then is the DA arguing that the Eskom directors should not be receiving theirs? Discuss fully by referring to the current situation in the country. (6)
- 2.2 What do you understand by the term ‘performance bonuses’? Why do you think Eskom have decided to pay their directors performance bonuses? (4)
- 2.3 In view of your answer to no. 1 and 2 above do you believe it is unethical to pay the bonuses to the directors? Why? (4)
- 2.4 Why do businesses pay performance bonuses in lieu of salary increases? Discuss fully. (2)
- 2.5 From an internal control point of view how would the accountant keep track of what bonuses to pay out? Discuss fully. (4)

SECTION B: ADDITIONAL CONTENT NOTES

THE BALANCE SHEET

The balance sheet should include all assets, liabilities and equity information, thus reflecting the financial status of the enterprise as at a particular date.

The following are among the items included in the balance sheet:

Assets	Equity and Liabilities
Fixed assets <ul style="list-style-type: none"> • Land & Buildings • Vehicles • Equipment 	Shareholders equity <ul style="list-style-type: none"> • Ordinary share capital • Ordinary share premium • Retained income
Financial assets <ul style="list-style-type: none"> • Fixed deposits > than 12 months • Investments 	Non current liabilities <ul style="list-style-type: none"> • Mortgage loans > than 12 months
Current assets <ul style="list-style-type: none"> • Inventory • Receivables • Cash on hand and at the bank (includes fixed deposits < than 12 months) 	Current liabilities <ul style="list-style-type: none"> • Payables • Bank overdraft • Short term loans i.e. loans < than 12 months

Distinctive features in the format of the Balance sheet of a company and the notes to the financial statements:

1. COMPANIES			
BALANCE SHEET – TRADING BUSINESS (Continuous inventory system)			
Name of company _____			
BALANCE SHEET AT _____			
	Notes	R	R
ASSETS			
(This section is the same as in a sole proprietor)			
Total assets			XXXXX

EQUITY AND LIABILITIES			
Equity and reserves			XXXXX
Ordinary share capital / equity	7		XXXX
Share premium	8		XXXX
Retained income	9		XXXX
Non-current liabilities			XXXXX
Mortgage bond (> 12 months)			
Current liabilities			XXXXX
Trade and other payables (creditors)	10		XXXX
Bank overdraft (if any)			XXXX
Short term loans (loans payable within 12 months)			XXXX
Total equity and liabilities			XXXXX

Note: This is not the full balance sheet. It only illustrates the distinctive features of a company balance sheet.

Pay special attention to the Equity and reserves section

COMPANIES

2. NOTES TO THE FINANCIAL STATEMENTS TRADING BUSINESS (Continuous inventory system)

5. Trade and other receivables (debtors)	
Trade debtors	XXX
Provision for bad debts (new amount calculated)	XXX
Net trade debtors	XXX
Prepaid expenses	XXX
Accrued income	XXX
Insurance claim	XXX
Deposit for water and electricity	XXX
*South African Revenue Services: Income tax (if SARS has been overpaid)	XXX
	XXX

*Compare the SARS: Income tax amount in the trial balance to the tax for the year as reflected in the adjustments. If the amount in the trial balance is higher than the tax for the year, then the difference between the two amounts will appear as above.

7. Ordinary Share capital	
AUTHORISED	
xxxx ordinary shares of Rx each	XXXXX
ISSUED	
xxxx shares issued at Rx on the last day of the previous year	XXXX
xxxx shares at Rx each issued during the financial year	XXXX
xxxx shares at Rx on closing date	XXXX

- State number of shares and the par value.

8. Share premium		
Balance on the last date of the previous year		XXXX
xxx shares issued during the financial year at a premium of x cents		XXX
Balance on the last day of the current year		XXXX

- **State the number of shares issued at a premium and the premium amount.**

9. Accumulated profits / Retained Income		
Balance on the last day of previous year		XXX
Net profit (loss) after tax for the year / period		XXX
Ordinary dividends		(XXX)
Paid (interim)		(XX)
Recommended (final)		(XX)
Balance on the last day of the current year		XXXX

- **The amount for the recommended or the final dividend will always be the same as the balance of the shareholders for dividend account**

10. Trade and other payables (creditors)		
Trade creditors		XXX
Accrued expenses		XXX
Income received in advance		XXX
Creditors for salaries (net salaries)		XXX
Pension fund (deduction + contribution)		XXX
Medical fund (deduction + contribution)		XXX
Shareholders for dividends (amount of final dividend)		XXX
South African Revenue Services		XXX
- *Income tax (if an amount is still owed to SARS)		XXX
- PAYE		XXX
- Vat Control		XXX
		XXX

***Compare the SARS: Income tax amount in the trial balance to the tax for the year as reflected in the adjustments. If the amount in the trial balance is less than the tax for the year, then the difference between the two amounts will appear as above.**

Note:

- These are not all the notes to the financial statements, but only those that are different in a company.
- The information in brackets is used to show the amounts that make up a particular item.

SECTION C: HOMEWORK

QUESTION 5: COMPANY REPORTING 70 marks 40 minutes**5.1 SABUSO LTD.**

You are provided with information relating to Sabuso Ltd.

REQUIRED:

- 5.1.1 Calculate the correct net profit before tax. (12)
- 5.1.2 The following note to the financial statements. (8)
- Tangible Assets
- 5.1.3 Complete the Balance Sheet on 28 February 2008.
(Where notes are not required show workings in brackets.)
NB: Certain figures have been provided. (25)
- 5.1.4 Answer the following questions:
- 5.1.4.1 (a) What is meant by a 'Statutory Income Statement'? (2)
- (b) Why is the Statutory Income Statement published by a company instead of the detailed Income Statement. (2 points) (4)
- 5.1.4.2 Briefly explain one of the concepts that constitute GAAP and give a practical example of its application. (4)
- 5.1.4.3 Certain individuals are of the opinion that the published financial statements are not an accurate representation of a business affairs. List 2 main points that could lead to this conclusion. (4)
- [59]

INFORMATION:

- The following figures were identified from the ledger on 28 February 2008.

	R
Equipment	275 000
Accumulated Depreciation on Equipment	86 000
Loan : ABSA	?
Fixed Deposit : FNB	10 000
Fixed Deposit : Barclays	65 000
Retained Income (1 March 2007)	30 000
Ordinary Share Premium	27 500
Petty Cash	5 000
Creditors Control	16 600
Ordinary Share Capital	300 000
Bank	6 000 Cr
Depreciation	22 000
Director's Fees	18 000

• **ADJUSTMENTS AND ADDITIONAL INFORMATION:**

The figures in the Pre-Adjustment Trial Balance indicated the next profit before tax to be R377 200 but the following adjustments have not yet been taken into account:

1. The company purchased additional equipment on credit for R70 000 on 28 February 2008. The equipment was received but no entry was made.
2. Depreciation on equipment, R22 000 was recorded. On investigation it was revealed that the amount should have been R25 000.
3. The bookkeeper has correctly calculated the Inventories and Trade and Other Receivables figures for the Balance Sheet. He, however, omitted the Trading Stock surplus, R9 000 and an increase in the provision for bad debts R1 500 from the profit and loss account.
4. In terms of their contracts, the directors are entitled to the following amounts each year:
5. **The loan account from ABSA is reflected below.**

Loan : ABSA

2008				2007					
Feb	28	Bank	CPJ	72 000	March	1	Balance	b/d	320 000
		Balance	c/d	?	Feb	28	Interest on loan	GJ	51 200
				371 200					371 200
							Balance	b/d	?

- The interest on the loan was omitted from the profit and loss account.
 - Repayments including interest amounted to R6 000 per month.
 - Capital repayments on the loan will amount to R5 500 per month in the next financial year.
6. The Fixed Deposit at Barclays will fall due on 1 April 2008.
 7. No amounts are due to SARS for Income Tax or VAT. Both accounts have debit balances.
 8. No final dividends were declared payable due to poor profits.

5.2 CORPORATE GOVERNANCE AND ETHICS**11 marks**

Study the information provided and then answers the questions that follow:

QUESTIONS**5.2.1 Refer to Example A.**

(a) To which interested party is this report aimed? (1)

(b) Who prepared this statement? (1)

5.2.2 Assume that you are a shareholder (of the company in **Example A**) and are dissatisfied with the company's performance. Shareholders have proposed a vote of no confidence in the Directors. What characteristics should shareholders look for in appointing the directors? List two points. (4)

5.2.3 Refer to example B

(a) Give one reason why 'successful businesses build strong relationships with many stakeholders and social partners.' (2)

(b) Explain why 'adherence by both employees and employers to given rules is good for business'. (Explain one good point) (3)

[11]**INFORMATION:**

EXAMPLE A	The financial performance is expected to improve during the year but additional cash and working capital will be required. The year-end cash balances are expected to increase and would facilitate a further return of cash to shareholders.
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EXAMPLE B	<p>Successful businesses need to build strong and vibrant relationships with many stakeholders and social partners. Adherence by both employees and employers to given rules is good for business. Ethics is a form of corporate advertising for the private as well as the public sector.</p> <p style="text-align: center;"><i>Dr Engelo Nicolaidis (Senior Lecturer - University of Johannesburg)</i></p>
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SECTION D: SOLUTIONS AND HINTS TO SECTION A

QUESTION 1

1.1.1 CALCULATION OF CORRECT NET INCOME			
Net income before adjustments		140 000	
Do not mark details One mark for operation (+ or –) & one mark for figure in each case If figure cannot be identified then no marks Use of brackets for negatives is acceptable If no bracket or no sign, assume it is positive		Pluses R 34 325 8 marks	
		Minuses R 81 304 12 marks	Amount /
	+ / -		
Bad debts	✓	- 700	✓
Provision for bad debts	✓	+145	✓
Trading stock deficit	✓	- 5 180	✓
Consumable stores on hand	✓	+ 540	✓
Interest on loan	<input checked="" type="checkbox"/>	- 21 924	✓✓
Advertising	✓	+ 3 640	✓
*Salary * May be split or combined R11 000: 4 marks in total	✓	- 10 000	✓
*Pension & UIF contributions	✓	- 1 000	✓
Income tax	✓	- 42 500	✓
		63 021	✓ <input checked="" type="checkbox"/> Inspection

TOTAL: 21

5.1.2 BOTSO-BOTSO STORES LTD NOTES TO THE FINANCIAL STATEMENTS – 30 JUNE 2009		
RETAINED INCOME		
Balance at beginning of year	85 000	✓
Net profit after tax the year	63 021	5.1.1 ✓
<i>Ordinary share dividends</i> ✓	18 750	✓
Balance at end of year	Inspection	129 271 ✓✓

[7]

TRADE AND OTHER RECEIVABLES/		
Trade debtors (28 450 ✓ - 700✓)	27 750	✓
Provision for bad debts (1250 – 145)	(1 105)	✓✓
	26 645	Inspection ✓
SARS: Income tax (46 000✓ – 42 500✓)	3 500	✓
Prepaid expenses	3 640	✓✓
\$\$\$ May be directly in BS or as Cash & cash equivalents /	33 785	Inspection ✓

TOTAL: 15

TRADE AND OTHER PAYABLES/		
Trade creditors (67 340✓ - 820✓)	66 520	✓
Creditors for salaries	6 000	✓✓
SARS: PAYE/ (3 200✓ + 3 000✓)	6 200	✓
Pension fund	1 800	✓✓ If/ R900
UIF	200	✓✓ If R100
Shareholders for dividends / \$\$\$	18 750	✓
\$\$\$ May be directly in BS /	99 470	✓ Inspection
** Current portion of loan – alternative		

[14]

5.3 BOTSE-BOTSE STORES LTD BALANCE SHEET AT 30 JUNE 2009		
ASSETS		
NON-CURRENT ASSETS	780 540	✓
FINANCIAL ASSETS		
Fixed deposit Heeda Bank (30 000-15 000)	15 000	✓
CURRENT ASSETS	148 325	✓ Inspection
<i>Inventories</i>	98 540	✓✓
Trade and other receivables/	33 785	✓ See Note
Cash and cash equivalents/ (15 000+1000)	16 000	✓
TOTAL ASSETS	943 865	✓ Inspection

EQUITY AND LIABILITIES		
SHAREHOLDERS EQUITY		659 271 <input checked="" type="checkbox"/> Inspection
Ordinary shareholders equity		500 000 ✓
Ordinary share premium		30 000 ✓
Retained income		129 271 <input checked="" type="checkbox"/> See Note
NON-CURRENT LIABILITIES		136 124 Any figure/
Loan MAP Bank (162 124 – 26 000)		136 124 <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> <input checked="" type="checkbox"/>
CURRENT LIABILITIES		148 470 <input checked="" type="checkbox"/> Inspection
Trade and other creditors/		99 470 <input checked="" type="checkbox"/> See Note
Current portion of loan **		26 000 ✓✓
Bank overdraft/ (23 000 ✓ ✓)		23 000 ✓
** Current portion of loan may be in the Note		943 865 <input checked="" type="checkbox"/> Inspection

TOTAL: 22

ACTIVITY 2: 20 marks 20 minutes

CASE STUDY – COMPANIES

2.1	At present the country is experiencing an electricity shortage due to mis-management and not keeping up with power supplies. ✓ ✓ Electricity charges have also increased considerably due to this mis-management ✓ ✓ Therefore the DA is arguing that the directors have also not performed well and should not receive bonuses. The public and businesses are suffering from the electricity shortage and the directors should not be benefiting at a time like this. Learners to give any reasonable explanation. ✓ ✓	(6)
2.2	Performance bonuses are paid for very good work / work achieved above the budget or expectations. ✓ ✓ Eskom feel their directors have performed well, despite the electricity shortage. ✓ ✓	(4)
2.3	Learners to give their own opinions but must be substantiated. ✓ ✓ ✓ ✓	(4)
2.4	To encourage workers to work extra hard / to give of their best / to go the extra mile, etc. ✓ ✓	(2)
2.5	Would have to have budgets with pre-determined criteria of what people should achieve. ✓ ✓ All work must then be monitored according to clear and transparent quarterly review assessment criteria in order to determine if the results were better and who was responsible for this. ✓ ✓ Any feasible answer.	(4)

[20]

! **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.