

TOPICS 1 & 2: COMPANIES FINANCIAL STATEMENTS**SECTION A: TYPICAL EXAM QUESTIONS****HINTS**

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

QUESTION 2: 55 marks*(Adapted from New Era Study Guide)***COMPANY BALANCE SHEET, AUDITING AND STOCK**

You are provided with information relating to Topical Ltd at their year-end 30 June 2008.

REQUIRED:

- 2.1 Use the information provided to prepare the Balance Sheet of Topical Ltd on 30 June 2008. Show workings in brackets to earn part-marks. (43)
- 2.2 Auditing:
- 2.2.1 Briefly explain the difference in the work done by the internal auditor and the independent (external) auditor. (3)
- 2.2.2 Briefly explain how an auditor should check that the figures shown for equipment and stock in the financial statements are reasonable. (3)
- 2.2.3 What should the independent auditor do if he feels that the value for equipment is not reasonable? (3)
- 2.2.4 The independent auditor is aware that a new model of TV is now on the market. He knows that the TV's in stock at Topical Ltd cannot be sold at their normal selling price, and they probably would not be sold at their cost price either. What advice do you have for the auditor? Explain. (3)

INFORMATION:

1. The following information appeared in the books for fixed/tangible assets on 30 June 2008:

• Land and buildings (cost)	R198 000
• Vehicles (cost)	234 000
• Equipment (book/carrying value)	269 801
• Accumulated depreciation on vehicles	233 999
• Accumulated depreciation on equipment	52 200

2. The investment comprises a fixed deposit at Pretoria Bank, R347 548.
3. Inventories comprise trading stock only. There are no consumable stores on hand. The business sells only one type of TV set. During the year they sold 258 TV sets at a mark-up of 60%. The business uses the WEIGHTED AVERAGE method of valuing stock (round off to the nearest Rand). Purchases from the manufacturers were in bulk as follows:

Date	Unit cost	Quantity	Total purchases
10 July 2007	R4 000	120	R480 000
24 November 2008	R4 800	160	R768 000
18 April 2008	R5 300	50	R265 000

4. The authorised share capital comprises 400 000 ordinary shares of R2 par value. To date, 300 000 of these ordinary shares have been issued. Half of the issued shares were issued at a premium of 60 cents per share.
5. The following figures were obtained from the Retained Income note to the financial statements:

Retained income at the beginning of the year	R 114 000
Net income after tax	R 262 000
Interim dividends paid	R 51 000
Final dividends declared	22 cents per share

6. The loan statement from Sabie Bank reflected the following:

Balance at the beginning of the financial year	R 275 000
12 monthly payments of R6 100 each	R 73 200
Interest capitalised	R 32 500

Over the next financial year, the capital value of the loan will be reduced by R45 600.

7. The provision for bad debts is 5% of book debts. The following balances appeared in the ledger on 30 June 2008:

Debtors control	R 185 000
Creditors control	R 108 000
Income receivable (accrued)	R 3 800
Deferred income (received in advance)	R 6 400
Expenses payable (accrued)	R 7 300

8. No money is owed to SARS or owing by SARS for Income Tax at the end of the year.
9. The missing figure represents Cash & cash equivalents.

TOTAL: 55**QUESTION 4: COMPANY REPORTING 65 marks 39 minutes****4.1 SEBENZA LIMITED**

You are provided with information relating to **SEBENZA LIMITED**. The company sells entertainment equipment

REQUIRED:

- 4.1.1 Answer the following questions:
- 4.1.1.1 Explain the following concept in relation to companies:
- Separate legal entity (2)
 - Limited liability (2)
- 4.1.2 Calculate the correct net profit before tax (12)
- 4.1.3 The following note to the financial statements:
- Tangible Assets (10)
- 4.1.4 Complete the Balance Sheet on 31 December 2008
(Where the notes are not required show workings in brackets.)
NB. Certain figures have been provided. (27)

INFORMATION:

1. **Figures extracted from the Ledger accounts on 31 December 2008:**

Ordinary share capital (R5 par value)	R 800 000
Fixed deposit: Slamo Bank	30 000
Fixed deposit: Jigzo Bank	95 000
Creditors control	18 600
Petty cash	7 000
Ordinary Share Premium	80 000
Equipment	575 000
Accumulated depreciation on equipment	86 000
Mortgage loan from Palmbank	?
Bank	6 000(cr)
Depreciation	27 000
Directors fees	38 000

2. Adjustments and additional information:

The figures in the Pre-Adjustment Trial balance indicated that the net profit before tax amounted to R343 500 but the following adjustments have not been taken into account:

- 2.1 The company purchased additional equipment on credit for R170 000 on 31 December 2008. The equipment was delivered but no entry has been made.
- 2.2 Depreciation on equipment, R27 000 was entered in the books. On investigation it was found that the amount should have been R22 000.
- 2.3 The figure for Trade and other Receivables is **correct**. The bookkeeper however omitted the Trading Stock Deficit, R19 000 and the decrease in the provision for bad debts from R5 000 to R4 500 from the profit and loss account.
- 2.4 In terms of their contracts, the directors are entitled to the following fees for the year:
Snow R30 000 and White R23 000. White's fees have been paid in full. Snow has only been paid 50% of the amount due to her. Provide for Snow's outstanding amount.
- 2.5 Interest on the loan is capitalised. The loan statement from Palmbank on 31 December 2008 reflects the following:

Balance on 1 January 2008	320 000
Interest charged	47 600
Monthly payments including interest to Palmbank in terms of the loan agreement (12 months x R6 000)	72 000
Balance on 31 December 2008	?

- The interest for the year has not yet been entered in the books.
 - Capital repayments on the loan will amount to R8 500 per month in the next financial year.
- 2.6 The Fixed Deposit at Jigzo Bank will mature on 1 April 2009.
 - 2.7 No amounts are due to SARS for income tax or VAT. Both these accounts have debit balances.
 - 2.8 According to the bank statement, Cheque no. 786 for R2 000 issued to a creditor has not been presented for payment because it was post dated.
 - 2.9 Sebenza Limited did not declare a final dividend due to poor economic conditions which impacted on profits for the year
 - 2.10 The lease agreement with the new tenant included the following clause:
The rental of R2 400 per month for the period 1 April 2008 -31 December 2008 should be used to upgrade existing equipment of Sebenza Limited. The tenant honoured the agreement and the equipment of Sebenza Limited was upgraded. No entries have been processed as yet.

4.2 CORPORATE GOVERNANCE & AUDITING

Study the statement below and then answer the questions, which follow.

DIFFERENCE BETWEEN AUDITING AND ACCOUNTING

Generally, accounting is the writing up of books and the preparation of financial statements, while auditing involves the verifying of incomes and expenditure and also the verification of assets and liabilities in order to enable the auditor to compile a report

- 4.2.1 Why are auditors referred to as ‘independent’ auditors? (2)
- 4.2.2 In the annual report a shortened Income Statement is presented. This is also referred to as the ‘statutory’ Income Statement. Explain why it is accepted accounting practice that a short form is provided instead of the full Income Statement. List two points (4)
- 4.2.3 Mention one consequence for an independent auditor if he/she was negligent in performing his/her duties. (3)
- 4.2.4 The King Code developed in South Africa lists **seven important** characteristics for good governance: Discipline, independence, social issues and responsible management to name a few. Choose any **one characteristic not mentioned above** and briefly explain what is meant by it. (3)

SECTION B: ADDITIONAL CONTENT NOTES

SEE NOTES IN SESSION 2 AND 3

SECTION C: HOMEWORK

QUESTION 5: COMPANY REPORTING**65 marks 40 minutes****5.1 KAMBULO LTD**

You are provided with information relating to Kambulo Ltd.

REQUIRED:

- 5.1.1 Complete the Balance Sheet on 30 June 2008. (25)
- 5.1.2 Joan Kambo currently owns 65% of the issued shares. The directors have decided to issue all the unissued shares on 10 January 2009. What is the minimum number of new shares Joan Kambo must buy in order to keep control of the company? (5)

INFORMATION:

1. The authorised share capital comprises 800 000 ordinary shares of R4 par value each. By 30 June 2008, 500 000 shares had been issued as follows:
 - 200 000 of these shares were issued at par
 - 300 000 were issued at R5,40 each.
2. The mortgage loan statement from Kwezi Bank reflected the following:
 - Balance on 1 July 2007, R830 000
 - Interest capitalised for the year, R94 200
 - Repayments of R12 600 per month (this is to cover interest and loan repayments)
 The capital sum of the loan is expected to reduce by R60 000 over the next financial year.
3. The following balances were extracted from the post-adjustment trial balance on 30 June 2008:
 - Fixed assets at carrying value, R3 408 000
 - Creditors control, R280 000
 - Bank overdraft, R170 000
 - Cash float and petty cash, R8 000.
4. There are two fixed deposits at the KZN Bank.
 - One, valued at R360 000, matures on 30 June 2009
 - The other, valued at R80 000, matures on 31 December 2007.
5. The following financial indicators apply on the Balance Sheet date:
 - The debt / equity ratio is 0,2 : 1
 - The current ratio is 2 : 1
 - The acid-test ratio is 0,8 : 1.

5.2 CORPORATE GOVERNANCE & AUDITING

5.2.1 The following audit report was issued by the auditors of Kambulo Ltd:

Audit opinion – To the shareholders:

In our opinion, the financial statements fairly present, in all material respects, the financial position of the company and the group at 30 June 2008 and the results of their operations and cash flows for the year then ended in accordance with International Financial Reporting Standards, and in the manner required by the Companies Act in South Africa.

Trew & Frank

Chartered Accountants (SA)

Registered Accountants and Auditors

Durban 25 July 2008

- (a) Why is this audit report addressed to the shareholders? (3)
- (b) What is the significance of the reference to the CA (SA) qualification? (2)
- (c) Briefly explain how the firm of Trew & Frank arrives at the opinion that they express in this report. Provide two points. (4)
- (d) Should the shareholders be satisfied with this report? Explain. (3)
- (e) What action would be taken by the professional bodies such as SAICA if Trew and Frank were accused of being negligent in issuing this opinion and what consequences could there be for Trew & Frank? (4)

5.2.2 Consider the following press article (this is based on an actual case):

CEO found guilty of insider-trading charges

Chief Executive Officer of Felon Ltd, YB Goode, will pay about R5-million and cannot serve as the director of a public company for five years under a court order announced on Monday. He had been found guilty of fraud and of contravening the Companies Act and regulations of the JSE.

The amount of R5-million relates to losses which he avoided on the sale of shares in Felon Ltd in December 2007. YB Goode sold Felon Ltd shares a day before the government announced it had declined to approve Felon's new drug for the treatment of cancer, Curex. The share price fell about 80% percent immediately following the government's refusal to approve the Curex drug.

The presiding judge found that YB Goode had been in possession of the privileged information about the government's decision before deciding to sell the shares. He had deliberately not communicated this information to the public, some of whom had consequently lost significant amounts of their retirement funds when the share price subsequently declined.

Felon Ltd announced last week that YB Goode's contract as CEO had been cancelled. Goode was earning R8-million per year in this post.

- (a) In your opinion, has YB Goode been treated fairly by the judge and the company Felon Ltd? Explain your reason briefly. (4)
- (b) If you were a major shareholder of Felon Ltd, what personal characteristics would you look for in appointing the CEO and other directors to prevent a similar problem in future? Provide two points. (4)
- (c) Consider the case of Joan Kambo buying more shares in Kambulo Ltd (see 5.1 above). As CEO, what should she do before buying the new shares? Explain briefly. (4)

5.2.3 South Africa is playing a leading role in promoting good corporate governance. The King Code is often used as a good example of this. One of the recommendations of the King Code is that companies should be required to reflect in their annual reports the contributions that they make to benefit the community at large e.g. social and environmental issues.

- (a) Provide an example of a company that has been complying with this aspect of the King Code. Briefly explain the contribution that this company is making to the community. (3)
- (b) You heard a comment that companies should be primarily concerned about the interests of the shareholders, not the greater community. Explain why this opinion would not be supported in modern times. (4)

[65]

SECTION D: SOLUTIONS AND HINTS TO SECTION A
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QUESTION 2

2.1 TOPICAL LTD / BPK		
BALANCE SHEET AT 30 JUNE 2008	4	R
ASSETS / BATES		
NON-CURRENT ASSETS		815 350☑
Fixed / Tangible assets 198 000✓ + 1✓ + 269 801✓		467 802✓
Financial assets		347 548✓
CURRENT ASSETS		555 650☑
Inventories 72✓ X R4 585✓✓		330 120☑
Trade and other receivables 185 000✓ – 9 250 ✓+ 3 800✓		179 550☑
Cash and cash equivalents		45 980☑☑

TOTAL ASSETS		1 371 000☑
EQUITY & LIABILITIES		
CAPITAL & RESERVES		949 000☑
Ordinary share capital 300 000 X R2		600 000✓✓
Ordinary share premium 150 000 X 60cents		90 000✓✓
Retained income (114 000✓ + 262 000✓ – 51 000✓)– 66 000✓		259 000☑
NON-CURRENT LIABILITIES		
Loan from Lowveld Bank 275000✓ - 73200✓ + 32500✓ – 45 600✓		188 700☑
CURRENT LIABILITIES		233 300☑
Trade and other payables 108 000✓ + 6 400✓ + 7 300✓		121 700✓
Current portion of loan		45 600✓✓
Shareholders for dividends		66 000☑☑
TOTAL EQUITY & LIABILITIES /		1 371 000☑

TOTAL: 43

2.2.1	Internal auditor: Is employed by a company to establish and monitor internal control an on on-going basis. Independent auditor: Is appointed by the shareholders to express an opinion on the annual financial statements. ✓✓✓ <i>MARKS; Excellent = 3 Good = 2 Satisfactory = 2 Poor or wrong = 0</i>	(3)
2.2.2	He should count the stock and the equipment. Control with stock sheets or fixed asset register. Check calculations at cost price. ✓✓✓ <i>MARKS; Excellent = 3 Good = 2 Satisfactory = 2 Poor or wrong = 0</i>	(3)
2.2.3	He will ask the directors to rectify the matter so that the financial statements fairly present the value. If they do not do this, he must qualify his audit report so that the readers can be aware that there is a problem. ✓✓✓ <i>MARKS; Excellent = 3 Good = 2 Satisfactory = 2 Poor or wrong = 0</i>	(3)

4.13 Notes to the financial statements on 31 December 2008

Tangible Assets	Equipment
Cost at the beginning year	✓575 000
Accumulated depreciation at beginning of the year (86 000✓-27 000✓)	*☑(59 000)
Carrying value at the beginning of the year	☑516 000
Movements	
Additions at cost(170 000✓+21 600✓)	☑191 600
Depreciation	✓(22 000)
Cost at the end of the year	☑766 600
Accumulated depreciation at end of the year	✓(81 000)
	☑685 600

* NO METHOD MARK IF 86 000

[12]**4.1.4 SEBENZA LIMITED****Balance Sheet on 31 December 2008**

ASSETS	
Non-current assets	☑715 600
*Tangible assets SEE 4.1.3	☑685 600
*Fixed Deposit: Slamo Bank	✓30 000
Current Assets	☑752 000
Inventories	500 000
Trade and other receivables	150 000
*Cash and Cash Equivalents(7 000✓+95 000✓)	✓102 000
TOTAL ASSETS	☑1 467 600

EQUITY AND LIABILITIES	
Ordinary Shareholders' Equity	✓962 400
*Ordinary Share Capital	✓800 000
*Ordinary Share Premium	✓80 000
Retained Income	82 400
Non-current liabilities	193 600
*Loan: Palmbank(295 600 ✓-102 000✓)	✓193 600
Current Liabilities	☑311 600
Trade and other payables(18 600✓+170 000✓+15 000✓+2 000✓)	☑205 600
*Short term Loan(8 500✓x12✓)	☑✓102 000
*Bank Overdraft(6 000✓-2 000✓)	☑4 000
TOTAL EQUITY AND LIABILITIES	☑1 467 600

[27]

4.2 CORPORATE GOVERNANCE & AUDITING

4.2.1	<p><i>Any valid point</i>✓✓</p> <p>They cannot be influenced by the company or its directors as their opinion might be called into question. They might be accused of bias if they are not independent. The shareholders do not have access to the books of the company. The auditors do it for them and cannot be biased when they do this</p>
4.2.2	<p><i>Any two valid points</i>✓✓ ✓✓</p> <ul style="list-style-type: none"> • Easier to understand • Contains material items only(immaterial items not shown) • Confidential information need not be disclosed

(2)

(4)

4.2.3	<p>Good answer=3 Satisfactory=2 Poor=1 Incorrect=0</p> <ul style="list-style-type: none"> • He/she will not be re-appointed as an auditor • The affected party can lay complaints with professional bodies • He/she will face disciplinary procedures from SAICA AND IRBA✓✓✓ 	(3)
4.2.4	<p><i>Any one valid point</i> Identify ✓ explanation✓✓</p> <ul style="list-style-type: none"> • Transparency-Information should not be hidden from shareholders and other interested stakeholders(e.g. SARS, Registrar of companies) they have legal rights to have the information • Accountability-if errors are made, the person responsible must own up and attempt to correct the matter • Fairness in dealing with stakeholders-The directors must not favour any one stakeholder over another e.g. employees versus shareholders- both have rights 	(3)

TOTAL MARKS: 65



Learner Note: From the above you can see the importance of understanding your concepts of companies.