

ACCOUNTING

Time: 3 hours

300 marks

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**READ THE FOLLOWING INSTRUCTIONS CAREFULLY**

1. This paper consists of 12 pages. Please check that your question paper is complete.
2. Read the questions carefully.
3. There is a **complete** Answer Book. There is a clearly marked page for each answer. **Use the areas marked "rough work" for doing your rough calculations.**
4. It is in your own interest to write legibly and to present your work neatly.
5. You may **not** use green or red ink. **You may use a pencil, but please use a soft, dark pencil.**
6. Do not abbreviate the names of contra accounts.
7. The allocation of marks and the appropriate time to be taken for each question are as follows:

Question	Topic	LO: AS	Marks	Time
1.	Accounting equation, internal control and salaries and wages	LO 1 AS 3 and LO 3 AS 2, AS 3 and AS 5	66	40 min
2.	Financial statements and concepts	LO 1 AS 1 and AS 4; LO 2 AS 1	84	50 min
3.	Cost Concepts	LO 1 AS 5; LO 2 AS 2, LO 3 AS 2	40	24 min
4.	Ratio Analysis	LO 1 AS 4	60	36 min
5.	Budget Concepts and ethics	LO 2 AS 3; LO 3 AS 4	50	30 min
			<b>300</b>	<b>180</b>

**QUESTION 1      The Accounting equation, internal control and salaries and wages  
(40 min; 66 marks)**

**1.1      The Accounting Equation**

Use the following source documents of Daisy Den Florists and analyse the transactions according to the headings on the answer sheet provided.

**NOTE:**

- The undertaking maintains a mark-up on cost price of 25%.
- Daisy Den uses the perpetual (continuous) inventory system.
- Assume that the business has a favourable bank balance, unless otherwise indicated.
- Show the effect that each transaction will have on the accounting equation by entering the appropriate amount in the appropriate column A, OE and L. Using the sign + or -, indicate whether the component increases or decreases.
- The net effect on the accounting equation is not required.

(35)

**SOURCE DOCUMENTS**

1.1.1 (Bank is **unfavourable**)

<b>CHEQUE COUNTERFOIL</b>	
No. 005	
1 Oct 2006	
To:	City Council
For:	Deposit on Water and Electricity
Amount:	R250,00

1.1.2

<b>RECEIPT (duplicate)</b>	
<b>DAISY DEN FLORISTS</b>	
10 Oct 2006	
RECEIVED	
FROM:	B. Barry
AMOUNT:	Two hundred and forty three rands and seventy five cents
FOR:	Payment of account
DISCOUNT:	2½ %
Daisy	
<hr style="width: 20%; margin: 0 auto;"/> WITH THANKS	

1.1.3

<b>PETTY CASH VOUCHER</b>		Date: 15 October 2006
<b>DAISY DEN FLORISTS</b>		
PAYEE FOR WHAT RECEIVED	AMOUNT	
Donation to local high school	Rand 75	Cents 50
SIGNATURE ...Sharon (chief cashier).....		
FOLIO...N13.....ACCOUNT...Donations....		
AUTHORISED BY...Daisy.....		

1.1.4

<b>INVOICE (duplicate)</b>			
<b>DAISY DEN FLORISTS</b>			
Rosebank Mall shop 21 P.O. Box 23 Johannesburg 2000			
28 Oct 2006			
Ms J. Jones 23 High Street Parktown North 2000			
2	Bouquets @	R70 each	R140,00

1.1.5

<b>DEBIT NOTE (duplicate)</b>			
<b>DAISY DEN FLORISTS</b>			
Rosebank Mall shop 21 P.O. Box 23 Johannesburg 2000			
29 Oct 2006			
MN Traders 234 Industrial Road Denver 2091			
10	Rolls of ribbon @	R5 each	R50,00

**1.2 Internal Control**

Daisy Donald, the owner of Daisy Den Florists, has several problems. These are:

- Cash is missing from the cash register. She suspects a sales assistant, but does not have proof. At present she has three sales assistants all who have access to the cash register.
- Flowers from her main supplier, MN Traders, are arriving late and in poor condition and this is resulting in customer orders being delayed.
- On special occasions such as Valentine's Day and Mother's Day, turnover is way below budgeted target.

**Answer the following questions**

- 1.2.1 Explain what is understood by a system of good internal accounting control. (3)
- 1.2.2 Describe TWO main controls, for each, that Daisy should apply in her business to solve:
- (a) the problem of cash disappearing from the cash register; (4)
- (b) the unsatisfactory service from her main supplier MN Traders. (4)
- 1.2.3 Suggest a possible reason for her sales target not being met and outline a possible solution to the problem. (4)

**1.3 Salaries and wages**

You are provided with an extract from the Salaries Journal of Daisy Den Florists for September 2006, the financial year-end of the business:

**Extract from the Salaries Journal for September 2006**

Name	Gross salary	Deductions				Net salary	Cheque	Employer's contribution
		PAYE	Pension Fund	Medical Aid	Total			Medical Fund
P. Moketsi	4 405	911	675	380	2 005	2 400	146	380
I. Smith	6 250	1 390	880	380	2 650	3 600	147	380
P. Jones	3 119	550	400	250	1 200	1 919	148	250
	<b>13 774</b>	<b>2 851</b>	<b>1 955</b>	<b>1 010</b>	<b>5 855</b>	<b>7 919</b>		<b>1 010</b>

The following balances were taken from the General Ledger on 29 September 2006:

Pension Fund	R504,00
Medical Aid Fund	R126,00
Medical Aid contributions	R126,00

**NOTE:**

- All employees belong to the Rose Pension Fund. For every one rand the employee contributes to the pension fund, the employer contributes R1,50.
- The employer contributes on a rand for rand basis to the Discovery Medical Aid Fund.
- The details of an employee, A. Amos, whose appointment on 1 September 2006 were omitted from the Salaries Journal for September 2006 by mistake. The details of his salary were as follows:
 

Monthly salary	R4 080
Deductions: PAYE	(R1 008)
Pension Fund	(R204)

It is the policy of the business not to deduct or contribute to medical aid in the first month of employment.
- Cheque 149 was issued to the Rose Pension Fund in settlement of the due amount at the financial year-end.

**Required:**

Reconstruct the following accounts in the ledger of Daisy Den Florists. Folios are required and both accounts must be properly balanced / closed off on 30 September 2006:

- 1.3.1 Pension Fund (11)
- 1.3.2 Medical Aid contributions (5)

**66 marks**

**QUESTION 2      Financial statements and concepts**  
**(50 min; 84 marks)**

Charles Branson owns a men's clothing shop called Atlantic Fashions. His bookkeeper has drafted an Income Statement for the year ended 28 February 2006, but she has made a few errors and not taken any adjustments into consideration.

**Required**

- 2.1 Draw up the correct Income Statement for the year ended 28 February 2006. (44)
- 2.2 Prepare the notes to the Balance Sheet on 28 February 2006. (20)

**Note:**

- All adjustments to figures must be shown in brackets next to the account.
- Only those notes to the balance sheet opened on the answer sheet need to be completed.

2.3 Answer the questions that follow.

(20)

### Information

1. Income Statement prepared by the bookkeeper for the year ended 28 February 2006

Sales	473 680
Cost of sales	(260 000)
Other operating income	19 490
Rent income	16 440
Discounts allowed	250
Interest on investments	2 800
Operating expenses	(72 229)
Telephone	2 995
Water and electricity	2 724
Insurance	5 200
Stationery	2 340
Packing material	2 556
Bad debts	2 644
Debtors allowances	625
Advertising	1 800
Discount received	345
Salaries	48 000
Interest expense	3 000
<b>NET PROFIT FOR THE YEAR</b>	<b>160 941</b>

2. Extract of balances from the general ledger as at 28 February 2006

Balance sheet accounts section	Debit	Credit
Capital		295 286
Drawings	32 500	
Land and buildings	200 000	
Other fixed assets	98 500	
Fixed deposit: Nedbank (14% p.a.)	20 000	
Trading inventory	28 500	
Debtors control	16 580	
Bank	2 300	
Cash float	200	
Petty cash	100	
Mortgage Loan: Nedbank (18% p.a.)		40 000
Creditors control		21 480

### Adjustments and additional information:

1. A debtor, Z Morgan, returned stock with a selling price of R864, but the transaction has not been entered. It is the policy of the business to use a mark-up policy of 50%.
2. The account of a debtor, S Williams, R276 must be written off as irrecoverable.

3. The bookkeeper of the business made a mistake when she recorded the rent income in the general ledger. She recorded that the business had received rent for March 2006, but further investigation revealed that no rent had been received for this month. Take note that according to the lease agreement the rent income would increase by R120 as from 1 September 2005.
4. The owner withdrew stock at cost R400 for personal use, but this was omitted from the accounting records.
5. J. Small a debtor, whose account had previously been written off as irrecoverable, paid his outstanding amount in full. The bookkeeper put through the following journal entry:
 

Debit	Bank	R320
Credit	Debtors Control	R320
6. S. Stephen, a debtor who owes R450 for the last three months, must be charged interest on his overdue account at a rate of 8% p.a.
7. The salaries account had been understated by R2 500.
8. The owner gave equipment to the value of R900 on 1 March 2005 as additional capital contribution. The bookkeeper included this donation as part of the advertising cost to the business and no other entries were passed. The owner made no other capital contributions.
9. According to a physical stocktaking on 28 February 2006 the following was on hand:
  - Stationery, R114
  - Trading stock, R27 000
10. The mortgage loan is repaid in equal annual instalments of R10 000 on 1 July every year and all payments have been made. The bookkeeper did not take this information into consideration when drawing up the Income Statement.

### 2.3 Answer the following questions:

- 2.3.1 The preparation of financial statements forms part of financial accounting. Explain to Charles Branson why it is important for management not only to consider financial accounting, but to also take managerial accounting into consideration. (4)
- 2.3.2 The owner of the business is particularly concerned over his credit department's management of trade debtors. Mention **three** ways in which the management could improve their control of trade debtors. (6)
- 2.3.3 Charles Branson does not understand the importance of accounting concepts that must be applied when financial statements are to be drawn up. To assist Charles in his dilemma, match each of the concepts in Column A to the appropriate transaction mentioned in Column B. On your answer sheet you need only write the letter of column B next to the question number in column A. (5 x 2 = 10)

Column A – Accounting Concept	Column B – Application
1. Matching 2. Prudence 3. Materiality 4. Consistency 5. Historical Cost	A. Stock is valued as first-in-first-out and a change to last-in-first-out must be disclosed. B. A retailer buys men's T-shirts at R65 each and plans to sell them for R125 each, yet records the value of the inventory at its cost price. C. Interest on overdraft is shown as a separate amount in the Income Statement. D. The owner of the enterprise wins R2 000 in a competition. This is not reflected in the Income Statement of the business. E. Whenever a debtor settles an account, discount should be recorded at the same time. F. Land and buildings are shown in the Balance sheet at R250 000, even though an estate agent says that it could be sold for R500 000. G. Trading stock is shown in the Balance sheet at R10 000, even though the business would only get R7 000 if the stock is sold at a flea market the next day.

**84 marks**

**QUESTION 3      Cost Concepts (24 min; 40 marks)**

Max Stephens, the owner of Max's Souvenirs, is a budding entrepreneur who has been approached by the Soccer World Cup 2010 promotions committee to manufacture world cup jewellery to be worn by international dignitaries. Unfortunately Max does not have a flair for numbers, has to prepare a presentation to the committee to ensure he gets the tender and needs your assistance on various issues.

Max has provided you with the following cost data for the month ending 31 May 2006:

Cost of stock of raw materials	R37 720
Factory rent	R19 810
Delivery expenses	R3 200
Labour cost of factory supervisor	R5 000
Water and electricity	R980
Packaging costs	R620
Telephone	R400
Wages of jewellery makers	R3 420

Additional information:

1. The business donated raw materials worth R350 to a local AIDS charity. This was omitted from the accounting records.
2. Jewellery is to be sold at a mark-up of 50% on cost.
3. 300 pieces of jewellery were manufactured in May 2006.
4. VAT of 14% must be added to the selling price of the jewellery sold.



**Required:**

- 3.1 Explain the difference between a fixed cost and a variable cost and use an example for each from Max's business to help explain the difference. (6)
- 3.2 Water and electricity is regarded as a semi-variable cost. Explain what this means. (4)
- 3.3 Calculate the total cost to manufacture the 300 pieces of jewellery. (4)
- 3.4 Based on his May 2006 cost data, at what price should the jewellery be sold? (7)
- 3.5 Outline **two** ways in which the installation of a computerised financial package could ensure that the business's VAT returns are sent timeously to the South African Revenue Services. (4)
- 3.6 One of the jewellery makers will in June 2006 receive a wage increase of 33⅓% and his deductions are expected to increase by 5%. Joe has provided you with the following cost data of the wage earner for May 2006:  
 Gross wage R1710  
 Deductions:  
     SITE R85,50  
     UIF R10,00  
     Staff association R5,00  
 Calculate the expected net wage payable to the jewellery maker in June 2006. (5)
- 3.7 Using all the information at your disposal, describe **five areas** that Max should focus on when he gives his presentation to the Soccer World Cup 2010 Promotions committee, thus ensuring he receives the tender. (10)

**40 marks**

**QUESTION 4      Ratio Analysis (36 min; 60 marks)**

Joe Martins, the owner of Sunshine Traders, would like to sell his business. He has decided to invite a group of potential buyers to a PowerPoint® presentation where he will highlight some of the key areas of the business, thus making the business a suitable investment.

Unfortunately Joe needs assistance in the preparation of his PowerPoint® presentation.

The following information was taken from the financial records of Sunshine Traders:

1.

<b>Condensed Income Statement for the year ended 31 December</b>	<b>2005</b>	<b>2004</b>
Sales	124 000	109 000
Cost of sales	(69 000)	(63 000)
Gross profit	55 000	46 000
Other operating income	7 000	6 000
Operating expenses	(48 000)	(35 000)
Operating profit before interest paid	14 000	17 000
Net Interest paid / received	(2 000)	(2 000)
Net profit for the year	12 000	15 000

2.

<b>List of balances from Post Closing trial balance on 31 December</b>	<b>2005</b>	<b>2004</b>
Capital	200 000	206 000
Fixed Assets	170 000	190 000
Trading stock	18 000	26 000
Debtors control	19 000	23 000
Bank (favourable)	3 000	1 000
Loan: Nedbank	80 000	100 000
Fixed Deposit	80 000	80 000
Creditors control	10 000	14 000

**Required:**

4.1 Use the given information to calculate the following financial indicators (ratios/percentages) for 2005 on the table provided on the answer sheet. Show your workings as the table will be used as part of the PowerPoint® presentation. The ratios for 2004 are shown in brackets.

- 4.1.1 Gross profit on turnover (2004; 42%) (3)
- 4.1.2 Gross profit on cost of sales (2004; 73%) (3)
- 4.1.3 The return on owner's equity (2004; 7%) (5)
- 4.1.4 Current ratio (2004; 3,6:1) (5)
- 4.1.5 Acid test ratio (2004; 2,2:1) (4)

4.2 One of the potential buyers, Donald Trump, has sent you a list of questions he would like answered at the presentation. Assist Joe in providing suitable answers to the following questions.

- 4.2.1 What is the liquidity position of Sunshine Traders in 2005? Use ratios to substantiate your opinion. (6)
- 4.2.2 As the owner of Sunshine Traders are you pleased with the return on your investment in the business? Substantiate your answer. (4)
- 4.2.3 Outline **three** aspects of the business that would make the purchase a good investment. Each aspect outlined, must be substantiated with a suitable ratio or percentage. (6)
- 4.2.4 Was the business able to maintain its intended mark-up of 100% on the cost price of goods sold? Suggest **two** possible reasons for not maintaining the 100% mark-up. (4)
- 4.2.5 As a potential buyer of the business, mention **two** other factors that I would need to consider, other than financial data, in order to make an informed decision on the purchase of the business. (4)

- 4.3 One of the areas that Joe would like to focus on in his presentation is his investment and proper management of his working capital.
- 4.3.1 Describe what is meant by the term **working capital**. (4)
- 4.3.2 Calculate the working capital of the business for 2004 and 2005 respectively. (6)
- 4.3.3 Briefly comment on whether you agree that Joe has been successfully managing his working capital. (6)

<b>60 marks</b>
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**QUESTION 5      Budget Concepts and ethics**  
**(30 min; 50 marks)**

Britney Spears is the owner of Hollywood Traders, a business specialising in offering safari tours and selling souvenirs to tourists. She is concerned over spending limits in the business for February 2006.

You are provided with the Cash Budget for the two months ended 28 February 2006.

**Hollywood Traders**  
**Cash Budget for the two months ended 28 February 2006**

	<b>2006 January</b>	<b>2006 February</b>
<b>CASH RECEIPTS</b>		
Fee income	5 400	11 100
Cash from debtors	20 148	9 753
Sale of fixed asset	2 000	
Loan		10 000
<b>TOTAL RECEIPTS</b>	<b>27 548</b>	<b>30 853</b>
<b>CASH PAYMENTS</b>		
Cash purchase of trading inventory	1 800	2 160
Payments to creditors	10 862	2 200
Interest on loan		7 200
Drawings		15 000
Purchase of equipment		13 000
Operating expenses:		
Salaries	8 960	8 960
Other operating expenses	2 133	2 677
<b>TOTAL PAYMENTS</b>	<b>23 755</b>	<b>51 197</b>
<b>CASH SURPLUS (SHORTFALL)</b>	<b>3 793</b>	<b>(20 344)</b>
Bank (opening balance)	(703)	3 090
Bank (closing balance)	3 090	?

**Answer the following questions:**

- 5.1 The management team at Hollywood Traders feels that the drawing up of a Cash Budget is a waste of time, because the same information will also be reflected in the Income Statement of the business.  
Outline to the management team the difference in drawing up a Cash Budget and an Income Statement and mention **two** advantages of the Cash Budget as a management instrument over the Income Statement. (8)
- 5.2 Calculate the budgeted closing balance for the bank for February 2006. (2)
- 5.3 Is Britney justified in her concerns over spending limits in the business for February 2006? Identify **three** areas of concern, substantiating each concern with evidence from the given cash budget and suggest a possible solution for each of the outlined concerns. (9)
- 5.4 Britney has an option to purchase a game farm and diversify her business. In order to purchase the new venture she will need a substantial loan from the bank. To this end the bank manager has requested Britney to provide the budgeted cash payments for March 2006.
- Calculate the budgeted cash payments for March 2006 using the following information:
- The budgeted salary for January and February is based on the salary of four employees. Each employee was employed at the same time and their pay packages are the same. The business expects that one of the employees will retire in February 2006 and an employee earning half the salary of the employee said to be retiring will replace him.
  - Other operating expenses are expected to increase by 33⅓% in March 2006, based on January's other operating expenses.
  - The cash purchase of trading inventory is expected to show the same increasing trend in March 2006 as from January 2006 to February 2006, but the payment to creditors should decrease by 25% from the previous month.
  - The business will need to maintain the interest payments on the loan.
  - Drawings by the owner will decrease by 40%.
  - The business does not intend to purchase any fixed assets in March 2006. (15)
- 5.5 A delegation of Hollywood Traders employees approached Britney on an issue relating to salary increases. They were concerned over the fact that they had not received a salary increase in the past twelve months, yet the owner was budgeted to take out drawings of R15 000 in February 2006. They also felt that the owner has miscalculated the budget for February 2006 and was using this as leverage in the salary negotiations. Briefly explain whether you think the approach taken by Britney in the salary negotiation process is ethical. (8)
- 5.6 Britney is considering selling her business to an international group of investors. The group of investors wish to experience a safari tour and see the tourist turnover before making a final decision. As the request of the group of investors was on short notice, Britney organises all her employees to bring their family members and friends to come along on the safari. Briefly explain whether you think what Britney is planning to do is ethical. (8)

**50 marks****Total: 300 marks**