ACCOUNTING GRADE 11 EXEMPLAR 2 MARKING GUIDELINES

QUESTION 1

Calculations

Ratio	2007 Calculations	2006
1. Current	7000: 600 **11.67: 1**	**3.60 : 1**
2. Acid Test	2500: 600 **4.17:1**	**0.93 : 1**
3. Operating Expenses on Sales	1650/10 000 **16.5%**	**20%**
3. Number Days Stock on hand	4250/5000 * 365 **310 days**	**240 days**
4. Debtors Collection Period	1900/10 000* 365 **69.4 days**	**50 days**
5. Creditors Payment Period	95/500 * 365 **69.4 days**	**91 days**
6. Debt: Equity	5000: 5000 **1:1**	**1.35 : 1**
7. Return on Owners Equity: Reginald	(2595-1038)/[3500+860]/2 * 100 **71.4%**	**28%**
8. Interest Rate of Loan	765/ [5000+3500]/2 *100 **18%**	

Liquidity situation

Very liquid, well above rough guides of 2:1 and 1:1 for current and acid test ratios. Far more liquid then last year. Problem is too much tied up unproductively in accounts' receivable and cash. {too much stock not an appropriate answer}

Stock Levels

Yes, despite having 310 days on hand, supply is unreliable and scarce as well as current stock will avoid the potential import surcharge of 50%. In addition storing and handling cost will be low while obsolescence is not a problem.

Control of working capital

Apart from stock the control is poor. Debtors are late in paying by 25 days and have weakened since last year. Creditors are been paid 20 days early without any financial benefit. Possibly could generate goodwill from suppliers. Need to tighten up on debtor's collection by offering greater settlement discounts, sending out accounts or reminders timeously; however, with this type of clientele the threat of legal action probably would be inappropriate. Extend time payment to creditors to full 90 day term. Once debtors are effectively controlled the excess cash reserves should be invested.

Control of operating expenses

Yes, as the percentage has improved by 3.5% since last year. Less rand of each sale is going out as an operating expense.

Loans used

In the purchase of tangible assets, the purchase of shares as an investment and also the increase of the investment in working capital particularly debtors, repayment of creditors and the reduction of bank overdraft.

Comment on Gearing

High but has been reduced since last year as equity has increased by more than long term loans.

Reginald's offer

Reject offer despite immediate capital gain of R2 200 000. His return is excellent - approximately 7 times money market rates and has the potential to increase further due improving economy climate as well as reduction on tax on the rich. Given current money market rates of 10%, his current earnings of R1 557 000 converts to an investment amount of R15 570 000. This means the current offer is way too low even making allowances for lack of risk.

Investment in Putco

No, as it has not generated any dividend return as well as the current market price would result in a loss of R20 000 if investment had to be cashed in.

QUESTION 2

a. Function of Internal Auditor

To ensure the business policy and procedures are correctly applied and assets are protected.

b. Difference between Internal and External

Internal does not report to external owners and is an employee whilst external reports to owners on reliability of financial statements.

c. Transparency

No, as there is a conflict of interests, which he has failed to declare. He has put his own needs before that of the business and therefore acted in a manner that lacked transparency.

d. Possible types of fraud

As he controls the whole process, he could order items for himself and take these items for his own but authorize payment to the creditors using business funds. As this stock would be missing from the stock takes, he could authorise this to be written off as a stock deficit. As the new stock controller is appointed by him and is his niece, he could influence her to work in cahoots with him.

e. The risk of fraud be reduced

Separation of functions. Buying, receiving and recording.
Regular stock takes.
Incentive schemes to employees to reduce level of theft.
Independent and regular stock checks.
Two signatures on cheque payments to creditors.

e. Accountability

M Warner is branch manager and can delegate tasks, but he cannot delegate accountability. He employed her despite her lack of qualifications as she was his niece.

QUESTION 3

1. Break even

6000 000 / (12 000 – 7 000) = 1 200 units

2. Breakeven on contract

6 000 000 / (15 000 – 9 000) = 1 000 units

3. Profit

15 000 * 1 000	= 15 000 000	or	1 000 * 4 285	=	4 285 000
12 000 * 2 500	= 30 000 000		2 500 * (12 000 -10 715)	=	3 212 500
10 715 * 3 500	=(37 502 500)				
Profit	7 497 500				7 497 500

NB Costing must be R10 715 by R 3 500 as workers would not have a differentiated wage packet depending whether working local or export. Would have to be calculated on the higher value.

4a. Selling price pound equals R20

1000 * 20 = R20 000

4b. Selling price pound equals R11

1000 * 11 = R11 000

5. Effected of exchange rate

If exchange rate weakens, the business profit will improve, as pounds earned will be converted into rand at a higher exchange rate. Income will increase but costs, which are in rand already, remain the same.
Vice versa if exchange rate weakens.

6. Effect of accepting contract on costs

The business will have an increased variable cost structure as all wages have increased (and unlikely employees will accept reduction in future years) and therefore local sales will not be as profitable per unit in future years.

7. **Accept or Reject**

Reject. Contract is not necessarily going to be renewed and therefore accepting it runs the risk of increasing future costs with lost local sales of 500 units. These customers may not necessarily be regained due to them being left in the lurch by the business accepting a foreign order. In addition, the contract exposes the business to potential foreign exchange rates losses if the rand appreciates. The rand by its nature tends to be volatile.

QUESTION 4

PART A

1. 200 000 * 14 / 100 = 28 000

2. 342 000 * 14 / 114 = 42 000

3. (300 000 – 200 000) / 200 000 * 100 = 50%
   OR
   (42 000 – 28 000) / 28 000 * 100 = 50%

PART B

1. 42 000 – 28 000 – (51 300 * 14 / 114) = 7 700

2. Invoice as it is a Closed Corporation