

**ACCOUNTING: PAPER II**

Time: 2 hours

100 marks

**INSTRUCTIONS TO CANDIDATES**

1. This paper consists of 7 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 blank facing page on the left for rough work.**
4. It is in your interest to write legibly and to present your work neatly.
5. You may not use red or green ink, but you may use a pencil.
6. The allocation of marks and approximate time to be taken for each question are as follows:

QUESTION	LO	MARKS	APPROXIMATE TIME
1 RATIO ANALYSIS	LO 1	50	60
2 INTERNAL AUDIT	LO 3	20	24
3 COSTING CASE STUDY	LO 2	20	24
4 VAT	LO 1	10	12
<b>TOTAL</b>		<b>100 MARKS</b>	<b>120 MINUTES</b>

**QUESTION 1****LO 1****(50 marks 60 minutes)****Required:****Part A:** Calculate the ratios provided for on the answer sheet. (18)**Part B:** Answer the questions that follow. (32)**Information**

**R & R Jewellers** is a business specialising in exclusive gemstones. Approximately 80% of their revenue is the sale of emeralds, a gem imported mainly from Thailand. Supply sources are extremely limited and the availability of stock is both scarce and unreliable. The government is thinking of imposing an additional import duty of 50% on luxury items. As the economy rapidly expands, further cuts in the rates of personal income tax, particularly at the top incoming earning brackets, is expected.

All transactions are on credit. The suppliers in Thailand do not offer any settlement discount. The Thai suppliers are extremely strict in cutting off supply if their debtors do not meet their 90 day terms of credit.

The business policy as regards debtors is to allow 45 days credit. If the customer pays within 30 days they are granted a 1% settlement discount. During the current year, no debtors took advantage of this.

The business applies a strict percentage **mark-up of 100% on cost price**.

The business borrowed an additional R1 500 000 from the bank on the 1<sup>st</sup> January 2007. There has been no change in interest rates over the last 12 months.

**Extracted from the Income Statement of R & R Jewellers for year ended 30<sup>th</sup> June 2007**

Revenue		10 000 000
Cost of Sales		5 000 000
Operating Incomes		0
Operating Expenses		(1 650 000)
Investment Income		10 000
Interest on Loan		(765 000)
Net Profit for year		2 595 000

The effective profit sharing ratio between Reginald and Rupert is 3:2. **Rupert's profit share is therefore R1 038 000.**

**Extracted from Balance Sheet as at 30<sup>th</sup> June**

	2007	2006
Owners' Equity	5 000 000	2 600 000
Capital: Reginald	2 000 000	1 500 000
Capital: Rupert	1 500 000	1 000 000
Current: Reginald	800 000	60 000
Current: Rupert	700 000	40 000
Loan: RMB	5 000 000	3 500 000
Current Liabilities	600 000	1 500 000
Trade and Other Payables	600 000	1 300 000
Bank Overdraft	0	200 000
Tangible Assets	3 500 000	2 200 000
Investments 1 000 P&P Shares	100 000	
Current Assets	7 000 000	5 400 000
Inventories	4 500 000	4 000 000
Accounts Receivable	2 400 000	1 400 000
Cash	100 000	

**Questions: (Refer to calculations made in Part A).**

1. Comment on the liquidity situation at end of the current financial year. (3)
2. Is the stock level of **R&R jewellers** appropriate? Justify. (4)
3. Comment on the business' control of working capital. (Excluding stock). Suggest ways in which it could be improved. (8)
4. Has the new policy concerning operating expenses been effective this financial year? Justify. (2)
5. Identify at least two areas in which the additional loan raised was utilised in the business. (2)
6. Comment on the risk facing **R & R Jewellers**. Despite the increase in the loan explain how the risk is less in the current financial year. (3)
7. Rupert has offered his partner Reginald R5 000 000 to buy out his share of the business. What advice would you give Reginald concerning this offer? Should he accept or reject it? Is this offer fair? (8)
8. **R & R Jewellers** invested excess cash in the shares of Putco Ltd on 1 September 2006. The shares are currently listed at R75 each on the JSE. Would the owners be satisfied with this investment in your opinion? Justify. (2)

<b>50 marks</b>
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**QUESTION 2 (LO 3)****(20 marks 24 minutes)****INTERNAL AUDIT****Required:**

Read the information given and answer the questions that follow.

The business **Brookdale Distributors** is a partnership that has been operating for a number of years. They have branches scattered throughout South Africa and as a result of distance, not all branches are controlled directly by a partner. In some cases a manager is appointed to control a branch.

The branch situated in Newcastle has developed problems in the last year. There has been a decline in profitability as well as a marked increase in stock shortages. The business has employed an internal auditor RB Ford who, as part of his employment contract has visited and examined the functioning of the Newcastle branch.

In his investigation it has become apparent that the manager M Warner has taken over the responsibility for ordering, receiving and paying creditors for stock delivered. The old stockroom controller retired earlier in the year and M Warner appointed a new employee. He had interviewed and recommended her to the partners of the business. The internal auditor has examined her qualifications and her best attribute appears to be that she is M Warner's niece, a fact that he did not reveal to the partners.

1. What is the function or purpose of an internal auditor? (2)
2. How does internal auditor role differ from external auditor's role? (2)
3. Do you feel that in the above scenario that M Warner acted in an ethical manner? Justify. (2)
4. The internal auditor believes that M Warner could be using business funds to buy his personnel items. Explain how Warner could be doing this. (5)
5. How could the risk of above problem be reduced? (6)
6. If problems arose as result of the new stock controller's lack of qualification, who should be held accountable? Why? (3)

<b>20 marks</b>
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**QUESTION 3 (LO 2)****(20 marks 24 minutes)****COSTING CASE STUDY**

Study the information **for the year** that is given, and answer the questions that follow.

**AFRICAN WINDSURFER ENTERPRISES, (AWE)** is a South African manufacturer based in Durban.

Competition for windsurfers, in the South African market, is fierce. As a result of this **AWE** has the capacity to produce more units.

**AWE** has been approached by a company in the United Kingdom (UK) to contractually supply them with 1 000 windsurfers.

The current exchange rate is R15 = 1£. (Fifteen rand equal to one pound sterling).

**FACTORS RELATING TO AWE AND THE LOCAL MARKET**

- Windsurfers currently sell for R12 000 each.
- There are three local manufacturers supplying the market resulting in strong competition and tight profit margins.
- The maximum capacity that AWE can produce is 3 500 units.
- The current production and sales of AWE is 3 000 units.

**FACTORS RELATING TO THE PROPOSED CONTRACT**

- The selling price would be fixed at £1 000 per unit (windsurfer).
- The price would be ex-Durban. In other words, **AWE** would not have to pay any shipping or transport costs.
- The contract would be on a once-off basis. This means that it may, or may not, be repeated.
- The UK Company would insist on the supplier paying a wage to its employees based on European standards. This would result in **AWE** having to increase wages by 200%. See the table that follows.

**TABLE OF COSTS:**

COSTS PER UNIT in RANDS						Total Fixed Costs
	Raw Material	Direct Labour	Fixed Factory Overheads	Profit	Selling Price	
Existing cost structure (local sales)	6 000	1 000	2 000	3 000	12 000	6000 000
Contract cost structure (export sales)	6 000	3 000	1 715	4 285	15 000	6000 000

**REQUIRED:**

1. Work out the break-even volume if the export contract is not accepted. (2)
2. Work out the break-even volume if the export contract is accepted. (2)
3. Calculate the expected profit for the year, if the contract is accepted. (3)
4. Assuming that **AWE** accepted the contract, what would the selling price be, in rand, if:
  - 4.1 The exchange rate weakened to R20 = 1£? (1)
  - 4.2 The exchange rate strengthened to R11 = 1£? (1)
5. Describe the effect that a changing exchange rate has on profitability. (2)
6. Again, assuming that **AWE** accepted the contract, what implications would that have on remuneration (wages) to staff if the contract was not renewed? (3)
7. As the chief accountant of **AWE**, you have been asked for advice on the conditions of the contract. What comments would you make concerning price, exchange rates and costs? You must back up your answers with reasons. (6)

20 marks

**QUESTION 4 (LO 1)****(10 marks 12 minutes)****VALUE ADDED TAX****PART A:**

**NATAL INTERIORS CC** is a Close Corporation trading in designer furniture.

They have bought R200 000 worth of stock (**exclusive of VAT**) from a supplier, Affordable Furnishers.

This stock has subsequently been sold for R342 000 (**inclusive of VAT**).

**NB: It would be advisable to show all workings in answering this question.**

**Required:**

**On the transactions mentioned above:**

1. Calculate the input VAT.
2. Calculate the output VAT.
3. Calculate the percentage mark-up on cost achieved.

**PART B: (To be answered only after you have completed your answers to 1, 2 and 3 above).**

Assume that one of the debtors, G Purbrick, who owes **NATAL INTERIORS CC** R51 300 from the sales in Part A, disappears without trace. His debt is to be written off.

4. Taking all transactions into consideration calculate the total amount that **NATAL INTERIORS CC** would have owed or paid, to SARS.
5. Would the VAT have to be calculated on the Receipt or Invoice basis? Justify your answer.

<b>10 marks</b>
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