



NATIONAL SENIOR CERTIFICATE EXAMINATION
NOVEMBER 2021

ACCOUNTING: PAPER II

MARKING GUIDELINES

Time: 2 hours

100 marks

These marking guidelines are prepared for use by examiners and sub-examiners, all of whom are required to attend a standardisation meeting to ensure that the guidelines are consistently interpreted and applied in the marking of candidates' scripts.

The IEB will not enter into any discussions or correspondence about any marking guidelines. It is acknowledged that there may be different views about some matters of emphasis or detail in the guidelines. It is also recognised that, without the benefit of attendance at a standardisation meeting, there may be different interpretations of the application of the marking guidelines.

QUESTION 1 BUDGETS

1.1 The Projected Income Statement is used by management for planning. Study the Projected Income Statement and explain whether Sindi's Boutique's plan is a successful one or not.

- Sindi's Boutique has planned to make a loss. This is not a successful plan.

1.2 Describe what will ultimately happen to Sindi's Boutique if they keep on the path that they are on.

- They will become insolvent.
- They will close down.
- The capital will be eroded.

1.3 The sales have reduced significantly since lockdown. **Explain in detail** a factor that could have contributed to this.

- The economic decline means that people have less disposable income. They will cut down on luxuries like expensive clothing.
- Lowering of demand due to reduced social gatherings.
- Fear to go shopping because of the virus.

1.4 Looking at the Projected Income Statement, what two strategies could Sindi implement to help make her business profitable again.

- Change what she sells to include different/cheaper clothing.
- Cut down on expenses like finding a shop that charges less rent.
- Control debtors better like doing better credit checks so that she cuts down on the bad debts.
- Advertise to her target market, e.g., magazines that have articles about matric dances and weddings, or that wealthy ladies would read.
- Use electricity-saving lights after the shop is closed.
- Pay off loan to reduce the interest expense.

1.5 Complete the Debtors Collection Schedule for February 2022

Debtors Collection Schedule for February 2022

	Credit sales	February
October	278 000	13 900
November	296 400	177 840
December	362 000	36 200
January	275 120	275 120 × 0,05 13 756
		Do not calculate

- 1.6 Complete the Cash Budget for February 2022. Show the calculations next to the applicable item in the Cash Budget.

Cash Budget for February 2022

Receipts	Do not calculate
Cash sales	53 004
Cash from debtors	Do not calculate
Asset disposal $7\,000 - 4\,230 + 120$	2 890
Payments	Do not calculate
Cash purchases of stock $53\,004 \times 100/20 \times 100/210 = 126\,200$ $126\,200 + 6\,500 = 132\,700$ $132\,700 \times 60/100 = 79\,620$	79 620
Payments to creditors	74 100
Employee costs $55\,020 \times 101/131$	42 420
Rent expense $62\,700 - 13\,650$	49 050
Electricity	50 000
Other $4\,000 + 1\,110$	5 110
Loan repayment	23 000
Interest on overdraft	3 945
Cash surplus (deficit)	(30 495)
Bank balance at the beginning of the month	(200 325)
Bank balance at the end of the month	(230 820)

- 1.7 1.7.1 What does the solvency ratio of a business measure?

- The solvency ratio tests the risk of the business to become insolvent/bankrupt.
- It tests the ability of the business to pay their total liabilities with their total assets.

- 1.7.2 Calculate the expected solvency ratio of Sindi's Boutique on 28 February 2022.

$$\begin{aligned}
 &1\,245\,776 : (1\,254\,000 + 72\,400) + 230\,820 \\
 &1\,245\,776 : 1\,557\,220 \\
 &0,8 : 1
 \end{aligned}$$

- 1.8 Sindi is considering closing Sindi's Boutique down and filing for bankruptcy (insolvency). This means that the courts will sell all her assets, business as well as personal, to pay off her debts. She is considering starting a new online shop after that.

Discuss one advantage and one disadvantage of keeping her shop open or declaring bankruptcy, closing it down and going online. Advise Sindi on what she should do and then explain the main reason for your advice.

The advantage of keeping the shop open may not be the same reason given for the disadvantage of closing the shop down. You may not repeat your reasons.

Keeping her shop open:

Advantage

- She will not lose her private assets by declaring bankruptcy.
- She has customers and a reputation and will not need to start from scratch – can adapt what she has now.

Disadvantage

- High overhead costs that are unmanageable will lead to worse debt and interest.
- She is heavily in debt and if she cannot change, she will make even more debt and can possibly lose more of her personal assets.

Closing her shop down, declaring bankruptcy, and going online:

Advantage

- She will not have debt hanging over her head as the court will write it off.
- Trading online will have low costs and she can run it from home. Should be able to make a profit quickly.
- Her debt will not grow bigger and bigger.
- More and more people will probably start buying online as it is the way of the future.

Disadvantage

- She will need to find customers and build up a reputation from scratch.
- She may need to learn how to market online and learn new skills.
- She will need to get new suppliers and develop a new market.
- She will lose her private assets.
- Business is not suited for online.
- Start up costs of web design and marketing costs.

Your advice and explanation

Any advice that makes sense.

QUESTION 2 COMPANY ANALYSIS

- 2.1 2.1.1 Both Dis-Chem and Clicks earn income from advertising on behalf of other companies. This is recorded in "Other Income". Explain, by doing a calculation, which company was the most effective in earning other income in 2020.

Dis-Chem: $(28,67 - 22,95) / 22,95 \times 100 = 24,92\%$
Clicks: $(27,28 - 20,98) / 20,98 \times 100 = 30,03\%$

OR

Dis-Chem: $28,67 - 22,95 = 5,72$
Clicks: $27,28 - 20,98 = 6,3$

Clicks is more effective
Clicks has a bigger difference between gross profit and total income.

- 2.1.2 Analyse which company was more profitable. Substantiate your answer with four points.

Clicks

- Although their mark-up was not as high, they earned more other income,
- they controlled their expenses better (their expenses on sales decreased by a fraction, vs Dis-Chem's whose expenses rose),
- and their expenses were less than Dis-Chem's. 19,23% vs 23,6%.
- Clicks's operating profit on sales was higher by 2,26%
- and their net profit on sales was higher by 2,82%.
- This means that Dis-Chem's financing cost percentage was higher than Clicks's.
- Clicks's net profit improved, while Dis-Chem's decreased.
- Clicks has three times the net profit of Dis-Chem.

- 2.1.3 Most companies' profitability dropped significantly during 2020. Explain the probable reason why **Clicks's** profitability increased during this time.

- Clicks could keep on trading through lockdown when most companies had to close down.
- People bought a lot of health products and sanitisers to try and keep healthy through the pandemic.

2.2 2.2.1 Calculate the number of days' stock on hand for **Dis-Chem** for 2020.

$$\frac{(4\,840\,424 + 4\,339\,208) \times \frac{1}{2} \times 365}{19\,219\,000}$$

87,17 days

2.2.2 Explain how selling health foods would impact **Dis-Chem's** number of days' stock on hand. (Will it make the period longer or shorter, and why?)

- Shorten the period
- Food has a shorter shelf life than the other products it sells, and it will probably need to be sold in less than 3 months.

2.2.3 Summarise Clicks's liquidity by writing down three **detailed** points. Write a conclusion stating whether they will be able to pay off their current debts.

- The current ratio is 1,2 : 1 and the acid test ratio is 0,59 : 1. This means that about half of the current assets is stock which is the right balance.
- Their stock turnover rate increased by 4 days, and it is a good rate for their products.
- The Trade and Other Receivables amount changed very little but is being collected 6 days faster than the previous year.
- Clicks has high cash reserves – good liquidity that is immediately available.
- The creditors payment period dropped by 13 days. This is bad for liquidity but is probably because Clicks has the cash to pay them sooner and chooses to do so.
- The current ratio remained constant between the two years at 1,2:1. The acid test ratio dropped a bit from 0,62 to 0,59, but is still half of the current ratio which shows that the assets and liabilities are in balance.

Conclusion: Clicks will be able to pay off their current debts.

2.3 Dis-Chem's goal is to expand their operations by 18 new stores per year. They expect this expansion to cost R370 million in the next financial year.

2.3.1 List two disadvantages for **Dis-Chem** should they issue more shares to finance their expansion.

- They will dilute the ROCE, ROSE, EPS
- If they pay dividends, it will cost them more.
- Dilute current shareholders' percentage of control. They may be unhappy and get rid of their shares.
- Dilute the market value of the shares.

2.3.2 Calculate what the new debt–equity ratio would be should **Dis-Chem** increase their loan by R370 million.

R'000

$ \begin{array}{r} 3\,075\,932 + 370\,000 : 2\,620\,371 \\ 3\,445\,932 : 2\,620\,371 \\ 1,32 : 1 \end{array} $
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2.3.3 Discuss whether **Dis-Chem** should finance the new stores by increasing their loan or by issuing more shares. You need to discuss three points in your answer.

Loan

- Although the debt–equity ratio shows they have high risk,
- they are positively geared, the 12% being higher than the 4,5% interest.
- Interest on the loan is an expense, therefore decreasing their profit and their income tax expense. Paying dividends on the shares will not decrease their tax.
- They will be able to pay off the loan and get rid of the interest expense, whereas they will need to pay dividends on the shares from now onwards.
- The shares will dilute the EPS, ROCE, ROSE.

New shares

- They already have bank overdrafts, so it will help their liquidity not to pay more interest on loans.
- They will need to pay back the loan, but they will not have to pay back the shares.
- They do not have to pay dividends, but they always have to pay the interest.
- The bank may not give them the loan as they are high risk.

2.4 Study the share information and equity then answer the following questions.

2.4.1 Calculate the Net Asset Value for Dis-Chem for 2020.

$$\frac{2\,620\,371\,000}{860\,085\,000} = \text{R}3,05 \text{ (304,67 cents) or 305 cents}$$

2.4.2 **Dis-Chem's** share value increased significantly when they listed on the JSE (it nearly doubled) at the end of 2016 but has been dropping ever since. Explain a likely reason why the share price has been dropping ever since.

- The company has not performed up to expectations, so the investors have been disappointed and sold their shares.
- The share price has dropped since 2019 due to the drop in profits, no dividends, so the investors no longer want to invest in Dis-Chem and are selling their shares.

2.4.3 List two reasons why Clicks's EPS is much bigger than Dis-Chem's.

- Clicks had a better net profit.
- Clicks issued fewer shares.

2.4.4 **Dis-Chem** decided not to declare final dividends on 31 August to preserve cash flow. Explain a point that **supports** this decision.

- They already have a bank overdraft.
- The future impact of the coronavirus is uncertain.

2.5 If you had R10 000 to spend on either Dis-Chem shares **or** Clicks shares, which would you buy? Discuss three factors that led you to this decision.

Clicks

- Has better profitability.
- Has better return (ROSE) (EPS) (return increased).
- Dividends have increased (DPS).
- Clicks has a better dividend-to-earnings ratio.
- Has better liquidity.
- Market share value is increasing.
- Net Asset Value is increasing.
- Any valid point, e.g., it is established and has a good track record.

Dis-Chem

- Has more growth potential.
- The shares offer better value for money.
- Even though its profitability and return are not as good as Clicks's, it is still good and has the potential to improve.
- Net asset value increased by a higher percentage than Clicks'.

2.6 Discuss how the King Code should have influenced Dis-Chem's decision to increase the price of face masks by such a large amount.

- The King Code explains Corporate Governance (ethical behaviour), so they should have been directed by what was ethical.
- The King Code also explains how a company should be socially accountable. They should have thought about the impact of the price hike on the community.

2.7 Dis-Chem was found guilty by the Competition Tribunal and fined R1,2 million. The Competition Commission originally wanted to fine them 10% of their sales.

2.7.1 Do you think it would have been ethically correct for the Competition Tribunal to fine Dis-Chem 10% of their sales? Explain your reason.

No

- The masks are only one of very many products and their sales would only contribute a fraction of that.
- Paying nearly R2,5 billion in a fine would cause Dis-Chem to make a huge loss – about a R2,4 billion loss.
- It would also cause Dis-Chem to be at risk of going insolvent.
- The shareholders own Dis-Chem, and this would affect their investment very negatively.

Yes

- Exploitation of people in a pandemic is ethically incorrect.
- The standard practise (law) is that the fine should be 10% of total sales.

2.7.2 Discuss the financial impact on Dis-Chem should their fine have been 10% of their sales. Explain how this would have affected their Statement of Financial Position (The Balance Sheet).

- They would not have had the money to pay the fine and it would have increased their current liabilities and possibly the non-current liabilities if they needed a loan to pay the fine.
- The net loss would have eroded their retained earnings completely.

QUESTION 3 RECONCILIATIONS

- 3.1 Fill in the age analysis as it would appear at the bottom of Fun Fitness's statement from Muscle Machines. Ignore all errors and omissions and use **only** the figures given in the statement. Show all the figures that go into each block. You do not need to total each block.

90 Days	60 Days	30 Days	Current
88 000 – 88 000	74 800 – 12 200	4 400 + 120 000	3 730

- 3.2 Jay made the decision to keep Muscle Machines as his supplier even though Fun Fitness does not always have the cash flow to be able to pay within 30 days of statement. Analyse whether Jay made the correct decision. Use figures or calculations in your analysis.

- Fun Fitness receives a 12% trade discount and has to pay a 5% penalty of interest if their payment is late.
- If they had to pay after 90 days, they would be charged 10% interest which means that they would only be getting a 2% discount.
- If Fun Fitness can only pay after 90 days, then they should go with the other creditors as they would be getting a 3% trade discount rather than 2%.
- If they can pay in the 60-day period, then they would be getting the equivalent of a 7% discount which is better than the 3%.
- Muscle Machines also gave them a 7% discount which is more than the interest they are getting charged. It would depend on the interest that the other creditors offered after 90 days to determine whether it would be the correct decision or not.

1 Mark	2 Marks	3 Marks
They have mentioned the trade discount only, or interest only, or both but did not link them.	They have mentioned both the trade discount and the interest and linked them.	They have drawn a valid conclusion.

- 3.3 Calculate the average number of days that Fun Fitness is taking to pay Muscle Machines.

$$\begin{aligned}
 (133\,150 + 152\,760) \div 2 &= 142\,955 \\
 790\,800 - 80\,700 &= 710\,100 \\
 \frac{142\,955}{710\,100} \times 365 &= 73,48 \text{ days (74 days)}
 \end{aligned}$$

3.4 Calculate the percentage discount Muscle Machines gave Fun Fitness when they paid. Comment on whether it was a financially sound decision to grant Fun Fitness discount.

- 7%
- Muscle Machines should not have granted the discount because Fun Fitness did not pay within the 30 days stipulated.
- The discount was more than the interest charged on that same debt, so Muscle Machines would end up losing 2% even though Fun Fitness paid late.

3.5 Reconcile the statement received from Muscle Machines to their account in the Creditors Ledger of Fun Fitness. Show the amounts that would go into the Creditors Reconciliation Statement and the amounts that would be entered into the Creditors Ledger account.

	Creditors Reconciliation Statement	Creditors Ledger
Incorrect balance	190 730	152 760
1. Trade discount	(14 400)	
2. Invoice 77		(24 000)
3. Discount received	Or + 6 160	(6 160)
4. EFT	(50 000)	
5. Interest	3 730 – 3 130 (600)	3 130
	Do not calculate	Do not calculate

3.6 3.6.1 Explain the main difference between the work the internal auditor does and the work an external auditor does.

- An internal auditor looks at the processes and procedures.
- An external auditor verifies that the financial statements are a fair reflection of the company's finances.
- OR an external auditor verifies the accuracy of financial statements, which gives the shareholders the assurance that the information contained therein can be relied upon.

3.6.2 External auditors are supposed to offer an unbiased audit. Explain what this means.

- They are not allowed to have any connection to the company they are auditing.
- Outsider opinion since the external auditors are not part of the company.

Candidates may give examples of how they are unbiased to show that they understand what it means.

Examples:

- They are not allowed to own shares in that company.
- They are not allowed to have family who works there.
- They are not allowed to accept gifts.
- They are not allowed to socialise with the directors/managers.

3.6.3 Discuss two processes an internal auditor should look at when auditing creditors.

- The process of drawing up the creditors reconciliation.
- The process of entering the source documents (invoices, debit notes, EFTs) into the journals (CJ, CAJ, CPJ).
- The process of posting these journals to the ledger accounts.
- Whether the creditors are being paid within their terms.
- Procurement process – how they select their creditors.

Total: 100 marks