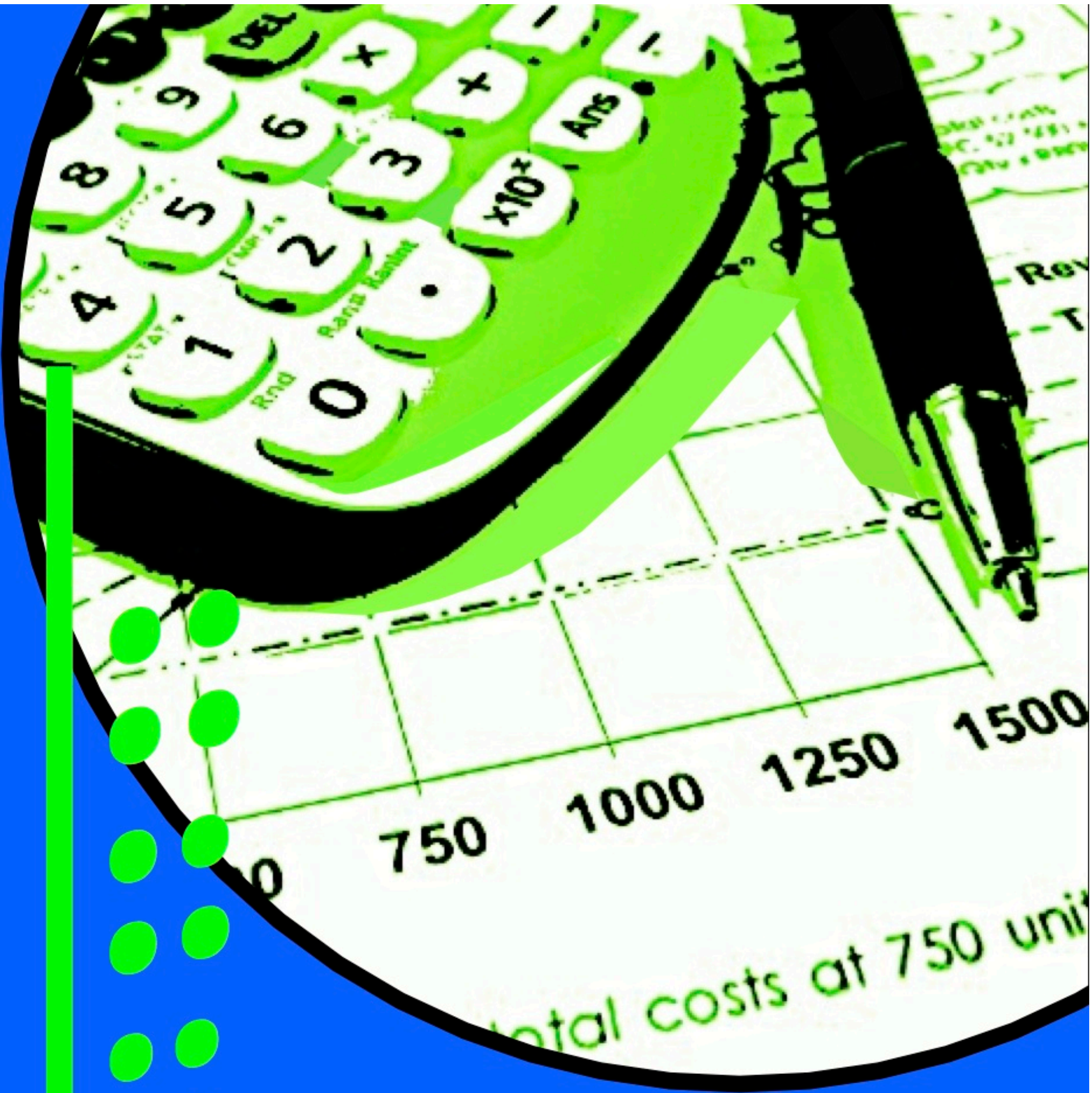
ACCOUNTING



EZ Revision Accounting

Grade 11

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EZ Learn

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5. Disposal of tangible assets

Whenever you see a QR code, use your QR reader to access a linked YouTube video on this topic.

Depreciation

At the end of the year, depreciation must be calculated for assets such as vehicles and equipment. It may be calculated:

- **On cost**: cost price x % depreciation = depreciation for the year
- **On carrying value / book value / diminishing balance**: (cost price – accumulated depreciation) x % depreciation = depreciation for the year.

Debit	Credit
Depreciation **(Statement of Income)**	Accumulated depreciation on vehicles / equipment **(Statement of Financial Position)**

Asset disposal

When an asset such as vehicles or equipment is sold, you have to take into account both the cost price as well as the accumulated depreciation. It is therefore not a straightforward transaction. To make things easier, an **Asset Disposal** account is created, and **all the amounts involved are transferred to this account**. The profit or loss can then be calculated in this account.

In an exam

This can appear as an adjustment in preparing financial statements, or you may be asked to draw up the ledger accounts.

- The transaction may have been left out completely (record the entire transaction from scratch, following the steps below)
- The transaction may have been partially recorded (take this into account and only record that which was NOT recorded)
- Part of the transaction may have been recorded incorrectly (reverse the incorrect entry and then record the transaction properly)

ALWAYS use T-accounts to record asset disposal if you are not asked to draw up the ledger accounts, as this adjustment can get very complicated. T-accounts will help to ensure you remember to record everything correctly, and will help you draw up your Tangible Assets note to the financial statements much more easily!

Step 1

Open the cost (Vehicles / Equipment) and Accumulated Depreciation accounts with the given balances in T-accounts, or the General Ledger if required. (If using T-accounts, leave some space above the balance in case you want to recreate what happened during the year by taking into account transactions which were recorded and are therefore included in the balance.)

Step 2
Calculate and **record the depreciation** on the asset sold for the current year, remembering to calculate it for the **correct number of months** until it was sold.
The required information could be given to you in two ways:

- The accumulated depreciation on the item up to the beginning of the year may be given to you. In this case, calculate depreciation as normal for this item only.
- The purchase date of the item may be given to you. In this instance, you will have to work out the accumulated depreciation up to the beginning of the year as well as for the current year. Draw up a simple table and then calculate the depreciation for each year of the asset's life as follows:

Year end date	*Depreciation*
(Year 1)	(Amount of depreciation for correct number of months)
(Year 2)	(Depreciation for year)
…	(Depreciation for year)
(Date sold in current year)	**(Amount of depreciation for correct number of months) – record this amount**
TOTAL:	(Total depreciation to be **written off to asset disposal** – see point 3)

Step 3
Transfer all relevant amounts to Asset Disposal:

- **Cost price** of sold item
- **Accumulated depreciation** on sold item (accumulated depreciation to beginning of current year PLUS current depreciation just calculated and recorded!)
- **Selling price** of sold item (contra account is bank if sold for cash, debtors if sold on credit, creditors if traded in)

Remember to record these in ALL the contra accounts at the same time!!

Step 4
Calculate the balancing figure in Asset Disposal and record it as the **Profit or Loss** on Sale of Asset. (HINT: to easily see if it is a profit or loss, look at which side of the Profit or Loss on Sale of Asset account it appears – a credit is a profit, a debit a loss).

Don't forget!

- If the asset was traded in, record the purchase of the new asset in the asset account.
- At the year end calculate the depreciation on the remaining assets, both old and new.
  OLD: use the **balance in the cost account**, excluding any new purchases. If depreciation is to be calculated on the diminished balance / carrying value, calculate the **balance in the Accumulated Depreciation Account** and subtract this from the balance in the cost to find the book value of the old assets. Calculate depreciation at the required rate (%) for the full year.
  NEW: Use only the cost price, regardless of the method of calculating depreciation. Calculate depreciation at the required rate (%) for the **correct number of months** that the asset has been owned.
  Add these two (OLD and NEW) figures together to find depreciation for the year and record this. (Depreciation on the sold asset has already been recorded).
- If completing General Ledger accounts, balance all the Statement of Financial Position accounts, and close off the Nominal Accounts to Profit and Loss.

Financial Statements

Statement of Income

Other operating income
  Profit on sale of asset
Operating expenses
  Loss on sale of asset
  Depreciation

Statement of Financial Position

NON CURRENT ASSETS
Tangible assets (note 1)
CURRENT ASSETS
Trade and other receivables (includes adjusted debtors figure)
Cash and cash equivalents (includes adjusted bank figure)
CURRENT LIABILITIES
Trade and other payables (includes adjusted creditors figure)

Notes to the financial statements

1. Tangible assets

When drawing up this note, ALWAYS take the figures directly from your T-accounts (or General Ledger accounts if these were required) for the cost price and the accumulated depreciation. Make sure that you use ALL the figures ONCE.

For each column of the Tangible Assets note, use the following two accounts. Tick off each amount as you use it to ensure you don't forget anything!

Cost (Vehicles / Equipment account)

1. Balance b/d 3. Bank / Creditors	4. Asset disposal
7. Balance b/d	

Accumulated depreciation

5. Asset disposal	2. Balance b/d 6. Depreciation (on SOLD item during year) 6. Depreciation (year end on OLD & NEW)
	8. Balance b/d

Cost	1
Accumulated depreciation	(2)
Carrying value at beginning of year	**1 – 2**
Movements	
Additions at cost	3
Disposals at carrying value	(4-5)
Depreciation for the year	(6+6)
Carrying value at end of year	**1-2+3-(4-5)-(6+6)** EQUALS 7-8
Cost	7
Accumulated depreciation	(8)

My mistakes

5.1. Barbara Williamson (60 marks; 35 minutes)

Sharika Bhoodhia is very proud of herself as she has drawn up her financial statements for the year ended 28 February 20_8 all on her own, and her business shows a pleasing profit of R45 000. However, when she shows them to you, you notice that the profit on sale of asset shown in the Statement of Income is very high at R20 000, and no depreciation is shown under operating expenses. When you discuss this with her, she explains that the profit is the amount she received for the vehicle that was traded in for the new vehicle, and she has not calculated depreciation because it is not an amount that was actually paid.

Information:

1. The following (correct) balances appeared in the books of Bhoodhia Traders on 1 March 20_7:
   Vehicles R100 000
   Accumulated depreciation on vehicles R60 000
2. On 30 June 20_7 an old delivery vehicle was traded in for R20 000 when a new vehicle was purchased at a price of R120 000. The old vehicle had originally cost R70 000 and had accumulated depreciation of R49 000 on 1 March 20_7.
3. Depreciation should be calculated at 20% p.a. on the carrying value.

Required:

1. Explain to Sharika

1.1. Why her profit on sale of asset is incorrect. (4)

1.2. The importance of calculating and recording depreciation. (3)

2. Show the following general ledger accounts as they should appear for the period 1 March 20_7 to 28 February 20_8:

2.1. Vehicles (6)

2.2. Accumulated depreciation on vehicles (15)

2.3. Depreciation (6)

2.4. Asset disposal (8)

3. Draw up the correct the Vehicles column of the Tangible Assets note to the Statement of Financial Position on 28 February 20_8. (13)

	Vehicles
Cost	
Accumulated depreciation	
Carrying value (1 March 20_7)	
Movements	
Carrying value (28 February 20_8)	
Cost	
Accumulated depreciation	

4. Calculate the correct net profit for the year. (5)

60

5.10. Barbara Williamson (55 marks; 35 minutes)

Information relating to Famous Brands

The questions in this test are based on information taken from the annual report of Famous Brands for the year ended 28 February 2017. Some information has been adapted or simplified for the purpose of this test.

Note: The figures given in the annual report are in R'000 i.e. thousands of rands. Keep this in mind when completing your calculations.

Question 1 Theory **(10 marks, 8 minutes)**

Required

Refer to the note below to answer the following questions.

1.1. The first paragraph actually explains the accounting definition of an asset.

1.1.1. What is the "economic benefit" that a business expects to receive as a result of having the asset? (1)

1.1.2. Give an example of how the **cost** of an asset can be reliably measured. (1)

1.2. "Property, plant and equipment are initially measured at cost". What accounting principle is being applied here? (1)

1.3. Calculate the rate and method of depreciation that is applied to computers (IT equipment). Assume that there will be no residual value (3)

1.4. "The depreciation charge for each period is recognised in profit or loss …". What type of account is depreciation – an asset, equity, liability, income or expense? (1)

1.5. The last paragraph deals with the disposal of tangible assets.

1.5.1. In which financial statement would you expect to find a profit or loss on the disposal of a tangible asset of Famous Brands? (1)

1.5.2. How is this profit or loss calculated? Explain in your own words, NOT those in the note given. (2)

Information

The note below forms part of the Accounting Policy of Famous Brands, and relates to its Tangible Assets (Property, Plant and Equipment).

5. Property, plant and equipment

The cost of an item of property, plant and equipment is recognised as an asset when:

- it is probable that future economic benefits associated with the item will flow to the Group; and
- the cost of the item can be measured reliably.

Property, plant and equipment are initially measured at cost. Costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. If a replacement cost is recognised in the carrying amount of an item of property, plant and equipment, the carrying amount of the replaced part is derecognised.

Property, plant and equipment are carried at cost less accumulated depreciation and any impairment losses, and are depreciated on the straight-line basis over their expected useful lives to their estimated residual value. Land is not depreciated.

The useful lives of items of property, plant and equipment have been assessed as follows:

Item	Average useful life
Buildings	50 years
Leasehold property	Over expected remaining term of the lease
Plant and machinery	5 to 15 years
Furniture, fixtures and office equipment	4 to 10 years
Motor vehicles	5 to 8 years
IT equipment	5 years

The residual value, useful life and depreciation method of each asset are reviewed at the end of each reporting period. If the expectations differ from previous estimates, the change is accounted for as a change in accounting estimate.

Each part of an item of property, plant and equipment, with a cost that is significant in relation to the total cost of the item, is depreciated separately.

The depreciation charge for each period is recognised in profit or loss unless it is included in the carrying amount of another asset. Depreciation commences once the asset is brought into use.

The gain or loss arising from the derecognition of an item of property, plant and equipment is included in profit or loss when the item is derecognised. The gain or loss arising from the derecognition of an item of property, plant and equipment is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

10

Question 2 General ledger accounts (35 marks, 20 minutes)

Information

1. The following simplified details relating to Computer Equipment appeared in the note for Property, Plant and Equipment on 28 February 2017.

	Computer equipment (R'000)
Cost	40 188
Accumulated depreciation	(32 941)
Carrying value at beginning of year	7 247
Additions at cost	25 145
Disposals at carrying value	(945)
Depreciation	(7 338)
Carrying value at end of year	24 109

2. Assume that the disposals took place on 31 May 2016 for cash.

Required

2.1. Calculate the proceeds from the disposal of computer equipment (i.e. amount received) if a profit of R100 000 was made. (3)

2.2. Calculate the depreciation on the sold computer equipment if it had originally cost R5 000 000. (4)

2.3. Complete the following General Ledger accounts of Famous Brands for the year ended 28 February 2017. **Show all amounts as R'000** i.e. as given in the information.

2.3.1. Computer equipment (6)

2.3.2. Accumulated depreciation on computer equipment (9)

2.3.3. Asset disposal (9)

2.4. Calculate the depreciation for the whole year on the **old** computer equipment. The depreciation on the new equipment was calculated pro rata for only a few days. (4)

35

Question 3 **Tangible assets note** **(10 marks, 7 minutes)**

Information

The following extract from the financial statements appeared in the annual report of Famous Brands.

Statements of financial position

at 28 February 2017

	Notes	Group 2017 R000	2016 R000
Assets			
Non-current assets		**4 315 513**	1 436 377
Property, plant and equipment	1	**1 397 601**	286 448

Additional information:

1. Additions and acquisitions cost a total of R1 278 072 000.
2. Some assets were disposed of during the year. R10 004 000 was received from the disposal of the property, plant and equipment. A profit was made on this disposal.
3. Depreciation for the year amounted to R94 347 000.

Required

Recreate the total column of the Property, Plant and Equipment (Tangible Assets) note from the information given. (10)

Property, plant and equipment	**Total R'000**
Cost	**584 645**
Accumulated depreciation	
Carrying value at beginning of year	
Movements	
Other movements	**(67 481)**
Carrying value at end of year	
Cost	
Accumulated depreciation	**(965 937)**

10

9. Partnerships

Records of partnerships

A partnership is a form of ownership very similar to a sole proprietorship, but with more owners (2 to 20). The business does not have legal personality, and as such the partners are jointly and severally responsible for the business' debts.

As a result, agreement must be reached on the capital to be contributed by each partner, and how the profits will be shared between them. As some partners may either contribute more capital, or spend more time managing the business, "interest" and "salaries" may be allocated. These are not actual expenses of the business, but help to distribute profits in a fair manner. Once partners have been compensated for their contributions (monetary or time), the remaining profit is shared out according to an agreed ratio.

Owners' equity accounts (Capital and Drawings) are created for each partner, as well as a Current Account for each to record the division of profits. Accounts for the partners' salaries, interest etc. will be opened at the end of the year to show amounts due to partners' Current Accounts, and to calculate the appropriation of profits.

In an exam

✓ You may be asked to draw up various **ledger** accounts.

- Capital for each partner will not change at all during the year, except for where changes in capital contributions are made.
- Drawings for each partner represent any money taken out by that partner, INCLUDING partner's salaries (as this is not considered to be an actual business expense). At the end of the year, Drawings is closed off to the partner's Current Account.
- Current Accounts for each partner will show the changes during the year – salaries, interest and profit due are credited to this account, with Drawings debited as a closing transfer. The balance then represents the money that may be taken out as further drawings by the owner. It is possible for Current Accounts to have a debit balance – this means that they have drawn out more than they were actually entitled to.

Current account: A

Drawings: A	GJ	XXX	Balance	b/d	XXX
Balance	c/d	XXX	Salary: A	GJ	XXX
			Interest on capital	GJ	XXX
			Appropriation account	GJ	XXX
		XXX			XXX
			Balance	b/d	XXX

- The Appropriation Account shows exactly how profits are to be distributed in ALL forms of ownership (except a sole trader, where there is no need for this).

Appropriation account

Salary: A	GJ	XXX	Profit and loss	GJ	XXX
Salary: B	GJ	XXX			
Interest on capital	GJ	XXX			
Current account: A	GJ	XXX			
Current account: B	GJ	XXX			
		XXX			XXX

The net profit (shown on the credit side) is allocated to partners as Salaries and Interest (debit side). The **remaining profit** is then divided between the partners according to the profit sharing ratio. For example, if the ratio A:B is 3:2, A will get 3/5 of what is left over after having allocated salaries and interest, while B will get 2/5. CHECK YOURSELF: The account should not have a balance at the end!

✓ You may be asked to show the Equity part of the Statement of Financial Position, and / or the **Capital and Current Account notes**. Use the same information / calculations as above, but lay it out in the financial statements as follows:

Statement of Financial Position

EQUITY AND LIABILITIES		
Owners' equity		XXX
Capital	7	XXX
Current accounts	8	XXX

Notes to the financial statements

1. Capital	Partner A	Partner B	Total
Balance at beginning of year	XXX	XXX	XXX
Contribution of capital during the year	XXX	XXX	XXX
Withdrawal of capital during the year	XXX	XXX	XXX
Balance at end of year	XXX	XXX	XXX

2. Current accounts			
Balance at beginning of year	XXX	XXX	XXX
Profit as per Statement of Income	XXX	XXX	XXX
Salaries to partners	XXX	XXX	XXX
Interest on capital	XXX	XXX	XXX
Primary division of profit	XXX	XXX	XXX
Final division of profit (share of remaining profit)	XXX	XXX	XXX
Drawings during the year	(XXX)	(XXX)	(XXX)
Balance at end of year	XXX	XXX	XXX

- As with a number of notes, these show the **beginning** balance, **middle** or what happened during the year, and **end** balance.
- Separate columns are shown for each partner, and these are then added in the total column. An additional column may also be used to show the previous year's figures in comparative financial statements.
- Each partner's total share of the profit can be calculated after working out how profits are to be divided, although the total profit should be entered immediately in the total column.
- The final division of profits is how the remaining profits (net profit less primary division i.e. salaries and interest) are shared in the agreed ratio.

Year-end adjustments

When faced with a question which requires you to deal with adjustments, be sure to

- Work methodically and
- Remember ALWAYS to use TWO accounts

1. Work through the trial balance, methodically entering each account where it needs to go on your answer sheet (income and expenses to the Statement of Income, assets, equity and liabilities to the Statement of Financial Position). Open brackets with the given amount.
2. Work through each adjustment separately, identifying the TWO accounts involved and adjusting EACH accordingly by showing amount to be added or subtracted in the brackets already opened for that account. Where you encounter complicated adjustments such as asset disposal, draw up T-accounts for difficult accounts ONLY, entering amounts into the brackets immediately once you have worked out what to do. You will find T-accounts for tangible assets and accumulated depreciation extremely helpful in drawing up the tangible assets note!
3. Calculate the totals and complete the financial statements.

If you are at all unsure about a transaction, complete rough T-accounts for this adjustment.

Accrual basis adjustments (matching)

Many of the income and expense accounts will not accurately reflect the actual amount earned or incurred for the year, and will therefore have to be adjusted. It is usually easy enough to determine the income or expense account involved. When determining the contra-account, ask yourself these two questions:

1. Is it an income or an expense?
2. Is it still owing (accrued) or already paid (prepaid / received in advance)?

You will then know whether it is a Prepaid Expense, Accrued Expense, Accrued Income (Income Receivable) or Income Received in Advance (Deferred Income).

Debit	Credit
Prepaid Expenses and Accrued Income represent amounts of money due to the business, and are therefore assets, similar to debtors. **(Statement of Financial Position)**	Relevant income / Expense account **(Statement of Income)**
Relevant income / expense account **(Statement of Income)**	Both Income Received in Advance and Accrued Expenses are amounts owed by the business, and therefore liabilities, similar to creditors. **(Statement of Financial Position)**

In an exam

You may be required to do some complicated calculations here in working out the correct income / expense amount.

✓ **Loans / investments**:

- You will need to calculate the amount of interest due for the year, and compare it to the amount in the trial balance. Adjust for the difference. Where the **interest rate** or **amount of loan / investment has changed** during the year, use a time line to clearly see the time periods / number of months involved. Plot in the relevant interest rates and amounts owed for different parts of the year. You can then easily calculate the interest relating to the current year.
- If you are told that an amount is to be **repaid** during the following year, this portion of a loan must appear as a current liability in the Trade and Other Payables note, and this portion of an investment must appear as a current asset in the Cash and Cash Equivalents note. The balance of the account will appear as non-current.

✓ **Rent**: is sometimes increased during the year. Draw a timeline as above to help you calculate the correct amounts. If the increase is given, but not the original rent amount, create an algebraic equation based on the information drawn on your timeline to assist you in your calculations.

Stock adjustments

At the end of the year, the actual stock on hand must be reflected in the Statement of Financial Position. A physical stock take will be undertaken to determine the value of stock on hand. Because this is not always the same as is reflected in the accounting records, adjustments usually need to be made.

In an exam

You will be given an adjustment where you are told the actual amount of trading stock and other items such as stationery, packing material, consumable stores etc. on hand according to the stock take.

1. Adjust each account separately, i.e. record the trading stock adjustment first, and then the consumable stores / stationery / packing material adjustments.
2. Identify the asset account to be shown in the Statement of Financial Position, which will be Trading Stock or Consumable Stores on hand. The actual stock count amount must be the end balance in this account.
3. Find the missing figure in the asset account, which is the amount to be adjusted.

Trading Stock

Balance b/d (trial balance figure) **Missing amount – surplus**	**Missing amount - deficit**
Balance b/d (stock take figure)	

Consumable stores on hand

Missing amount – stationery / packing material / consumable stores	
Balance b/d (stock take figure)	

4. Record the adjustment as necessary – the contra account will be an expense / income account to be shown in the Statement of Income i.e. Trading Stock Deficit, Stationery, Packing Material or Consumable Stores.

Provision for bad debts

The financial statements should accurately reflect the actual state of affairs of the business. As such, provision needs to be made for debts that it is expected might not be settled.

In an exam

You will be given an adjustment where you are told to adjust the provision for bad debts account.

1. The calculated provision amount must be the end balance in the Provision for Bade Debts account (and is subtracted from Trade debtors in the Trade and other receivables note).
2. The difference between what it was and the new balance is the adjustment that needs to be made – an expense (or income) that will appear on the Statement of Income.

Find the missing figure in the asset account, which is the amount to be adjusted.

Provision for bad debts

Missing amount – adjustment income	Balance b/d (trial balance figure) **Missing amount – adjustment expense**
	Balance b/d (adjusted to figure)

Trade and other receivables

Net trade debtors	XXX
Trade debtors	XXX
Provision for bad debts	(XXX)

Analysis of financial statements

The whole point of keeping records of business transactions is to provide useful information to management. The process of recording these transactions and summarising them into financial statements must be followed up by analysis and interpretation, to identify possible problems, causes and solutions, i.e. provide useful information for management decision making.

In an exam

- You will usually be asked to calculate and comment on certain aspects of given financial statements, possibly for consecutive periods. You will need to have a good understanding of what the financial statements and different calculations actually mean in order to comment properly. Your comment can also include comparisons with similar businesses, previous years, etc.
- You could also be given certain ratios, and then be required to work these backwards to calculate missing figures. For example, if you know the value of current assets and are given the current ratio, you can determine current liabilities.

Analysis of income and expenses

Financial indicator	Formula	Compare to	What it means
Percentage gross profit on sales (gross profit margin)	$\frac{gross\ profit}{sales} \times 100 = \%$	Previous years, intended gross profit margin	Portion of sales earned as gross profit, available to cover operating expenses and net profit
Percentage gross profit on cost of sales	$\frac{gross\ profit}{\cos t\ of\ sales} \times 100 = \%$	Intended mark-up on cost.	This is the actual mark-up achieved. A difference from intended mark-up could indicate stock loss due to theft (if periodic inventory is used), or trade or other discounts given, incorrect mark-up calculations etc.
Operating profit percentage on sales	$\frac{operating\ profit}{sales} \times 100 = \%$	Previous years, net profit	Portion of sales earned as operating profit, before interest.
Net profit percentage on sales (profit margin)	$\frac{profit\ before\ tax}{sales} \times 100 = \%$	Previous years, Operating profit	Portion of sales earned as net profit, after interest
Operating expenses as a percentage of sales	$\frac{operating\ expenses}{sales} \times 100 = \%$	Previous years, gross profit margin	Portion of sales used to cover operating expenses.

Liquidity

Liquidity is the ability of a business to pay its debts as they become due. A liquid business will have a healthy cash flow. As this looks at short-term cash flow, current assets are compared to current liabilities. However, stock may not necessarily be easy to sell, and so an acid test ratio can also be calculated, which excludes stock.

Financial indicator	Formula	Compare to	What it means
Current ratio	*current assets : current liabilities*	2 : 1 would generally be considered safe	How easily debts are able to be paid (from cash, debtors and stock) as they become due
Acid test ratio	*(current assets – inventory) : current liabilities* Use ONLY trading inventory (i.e. exclude consumable stores on hand)!	1 : 1 would be considered safe	Stock is excluded as it is not always easy to sell. This shows how easily debts can be paid without selling stock.
Rate of stock turnover	$\dfrac{cost\ of\ sales}{average\ trading\ inventory} = no.\ of\ times$	How long it takes the stock to perish or become outdated	How long stock sits on the shelf i.e. how long it takes to sell. This period should obviously be less than the time taken to perish or become outdated.
Stock turnover period in days	$\dfrac{average\ trading\ inventory}{cost\ of\ sales} \times 365 = no.\ of\ days$		
Average debtors' collection period	Use ONLY trade debtors. $\dfrac{average\ trade\ debtors}{credit\ sales} \times 365 = no.\ of\ days$ If credit sales is not available, use the total sales figure.	Debtors' payment terms of business, normal terms of 30 days, or industry norm e.g. retail clothing 6 to 12 months	How long debtors actually take to pay. This should be less than terms of business or industry norm.
Average creditors' payment period	$\dfrac{average\ trade\ creditors}{credit\ purchases} \times 365 = no.\ of\ days$	Business's creditors' terms, usually 30 to 60 days, but may be more.	Terms should be less than those prescribed by suppliers to avoid interest charges. If discounts are offered, payment should be made in these shorter terms to take advantage of these.

Remember to only use trade creditors!

If credit purchases is not given, use the cost of sales.

When calculating these time periods, the same basic calculation is used for each:

$$\frac{\textbf{Statement of Financial}\ \text{(average stock, debtors or creditors)}}{\textbf{Statement of Income amount}} \times 12\ \text{(months) OR } 365\ \text{(days)}$$

(cost of sales, credit sales or credit purchases / COS)

If you can shorten stock and debtors' periods to less than the creditors' payment period, no working capital will be needed, improving cash flow / liquidity!

Solvency and gearing

Financial indicator	Formula	Compare to	What it means
Solvency ratio	$\textit{total assets} : \textit{total liabilities}$	Less than 1 : 1 means insolvency (bankruptcy) 2 : 1 is usually considered safe	Whether or not the business is solvent, and the risk of **bankruptcy**. The higher the ratio, the safer the business.
Debt-equity (gearing)	$\textit{non-current liabilities} : \textit{owners' equity}$	1 : 1 would be considered safe	The amount of borrowed money compared to the owners' investment. A low ratio indicates that the business is **lowly geared**, meaning banks would see the business as **creditworthy** and would grant a loan..
Return on capital employed	$\frac{\textit{profit before interest on loan}}{\textit{average equity and non current liabilities}} \times 100 = \%$	Interest on loans, or prime interest rate	A return higher than the interest rate means the business is **positively geared**, and a loan is **profitable**.

Return on equity

Interested parties will want to see how successful the business actually is, and so profits are compared to capital invested in the business. The return on capital employed (above) calculates the profitability of the business as a whole (profit before interest expense), given the total investment (including loans etc.). Return on owners' equity calculates the actual return obtained by the owners (profit after tax) as a result of their input. These figures can be compared to the possible return on other investment options, i.e. prevailing interest rates offered.

Financial indicator	Formula	Compare to	What it means
Return on equity for whole partnership	$\frac{\textit{net profit}}{\textit{average equity}} \times 100 = \%$	Return on other investment e.g. interest on fixed deposit	Whether or not the investment in the business is worthwhile.
Return on one partner's equity	$\frac{\textit{partner's share of net profit}}{\textit{partner's average equity}} \times 100 = \%$		

Remember that equity includes both capital and current accounts!

My mistakes

9.1. Barbara Williamson **(35 marks, 30 minutes)**

Information relating to Wonka Chocs:

Wonka Chocs is a business that makes and sells chocolates and sweets. The partnership is owned by Charlie and Paddy. The financial year end is 31 May.

1. The following balances appeared in the Pre-adjustment Trial Balance on 31 May 20_8:

Capital: Charlie	100 000
Capital: Paddy	200 000
Current account: Charlie	Cr. 55 000
Current account: Paddy	Dr. 20 000
Drawings: Charlie	50 000
Drawings: Paddy	90 000

2. The following Appropriation account was drawn up on 31 May 20_8:

Appropriation account

20_8 May	31	Interest on capital	GJ	30 000	20_8 May	31	Profit and loss	GJ	250 000
		Salary: Charlie	GJ	190 000			Current account: Charlie	GJ	25 000
		Salary: Paddy	GJ	80 000			Current account: Paddy	GJ	25 000
				300 000					300 000

3. Additional information:

3.1. The profit for the year ended 31 May 20_7 was R260 000.

3.2. The capital remained unchanged for the year.

Question 1 — General ledger accounts (20 marks, 12 minutes)

1.1. Calculate the interest rate on capital accounts. (2)

1.2. Complete the following accounts in the General Ledger for the year ended 31 May 20_8:

1.2.1. Current account: Paddy (11)

1.2.2. Interest on capital (7)

20

Question 2 **Partnership agreement and analysis of appropriation (15 marks, 18 minutes)**

2.1. Use the information provided to determine the main points of the partnership agreement stipulating how the profit is divided between the two partners. (6)

-
-
-

2.2. Who spends more time and effort running the business? Give a reason for your answer. (2)

2.3. Emma is a little concerned that the appropriation of profit has reduced, rather than increased, her current account.

2.3.1. Did Wonka Chocs make a profit or a loss for the year ended 31 May 20_8? (1)

2.3.2. Explain to her why this amount has reduced her current account balance. (2)

2.4. Comment on the salaries provided for the partners. (2)

2.5. Charlie is worried about the cash flow of Wonka Chocs. Suggest a reason for the problem, and suggest a possible solution. (2)

15

9.2. Barbara Williamson (50 marks, 30 minutes)

Tladi Boso Traders is a partnership owned by Mathapelo Tladi and Olwethu Boso. The business is voluntarily registered for VAT.

Information for the year ended 30 June 20_0:

1. Operating profit was calculated as 20% of sales.
2. Interest on the loan is calculated at 10% p.a. The loan remained unchanged during the financial year ended 30 June 20_0.
3. The physical stocktake showed trading stock worth R10 000 and consumable stores on hand R2 000 on 30 June 20_0.
4. The business has financed its debtors and inventory using a bank overdraft which has a balance of R30 000 on 30 June 20_0.
5. A total of R42 000 was paid for rent. This includes rent for July and August 20_0.
6. VAT of R4 000 is due to be received from SARS as a result of input tax being greater than output tax for the VAT period ending 30 June 20_0.
7. The partnership agreement stipulates the following:

7.1. Mathapelo Tladi is entitled to a salary of R42 000 p.a.

7.2. Olwethu Boso earns a salary of R4 000 p.m.

7.3. Interest on capital is calculated at 5% p.a.

7.4. Profits and losses are shared in the ratio of capital contributions, which did not change during the year.

7.5. During the year, a total of R95 000 was drawn by partners.

Required:

Fill in the missing information denoted by an asterisk (*) to complete the following:

1. Statement of income for the year ended 30 June 20_0 (7)

Sales	*
*	(325 000)
Gross profit	*
*	(195 000)
Administration	70 000
Marketing	*
Rent expense	36 000
Operating profit	130 000
Interest expense	*
Net profit for the year	*

2. Statement of financial position as at 30 June 20_0 (15)

ASSETS	
*	
Tangible assets	*
Current assets	*
Inventory	`*
Trade and other receivables	*
*	3 000
Total assets	946 000
EQUITY AND LIABILITIES	
*	800 000
Capital	*
Current accounts	80 000
Non-current liabilities	
Loan: Bell Bank	*
Current liabilities	*
Trade and other payables	16 000
*	*
Total equity and liabilities	*

3. Notes to the financial statements for the year ended 30 June 20_0

3.1. Trade and other receivables (7)

*	*
*	*
*	*
	25 000

3.2. Current accounts (21)

	Tladi	**Boso**	**Total**
Balance at 1 July 20_9	*	60 000	*
Net profit as per income statement	*	58 000	120 000
Salaries	*	*	*
Interest on capital	*	12 000	*
*	66 000	*	126 000
Final distribution of profit	*	*	(6 000)
*	*	(63 000)	*
Balance at 30 June 20_0	25 000	*	*

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9.3. Barbara Williamson Paper 2 (60 marks, 72 minutes)

Information relating to Yorvetti Traders for the financial year ended 30 June 20_2:

Yorvetti Traders manufactures finger toys i.e. finger skateboards, finger soccer balls etc. for a growing market of young children who need to develop their fine motor skills. A small factory was built eight years ago, and stock is kept at low levels so that less space is needed. Good supplier relationships ensure that orders can be quickly filled, so customer orders are usually produced only when their orders are placed.

Sean York & Marco Vietti
Trading as Yorvetti Traders
Extract from the **Statement of income (income statement) for the year ended 30 June 20_2**

Sales	1 800 000
Cost of sales	(1 000 000)
Gross profit	800 000
Operating expenses	(498 000)
Operating profit	302 000
Net profit	250 000

Sean York & Marco Vietti
Trading as Yorvetti Traders
Statement of financial position (balance sheet) as at 30 June 20_2

	20_2	20_1
ASSETS		
Non-current assets	962 000	1 106 000
Current assets	174 000	162 000
Inventory	12 000	15 500
Trade and other receivables	74 000	65 000
Cash and cash equivalents	88 000	81 500
Total assets	1 136 000	1 268 000
EQUITY AND LIABILITIES		
Partners' equity	520 000	510 000
Capital	500 000	500 000
Current accounts	20 000	10 000
Non-current liabilities	600 000	650 000
Current liabilities	116 000	108 000
Trade and other payables	116 000	108 000
Total equity and liabilities	1 136 000	1 268 000

Additional information:

1. The majority of Yorvetti Traders' customers are retailers to whom a trade discount of 20% is usually given.
2. All sales are on credit.
3. Trade and other payables includes R50 000 of the loan repayable on 1 July each year.
4. The loan was originally taken out eight years ago to finance the building of the factory, and the business has always made the repayments on time.
5. 90% of purchases are on credit. Suppliers' terms vary between 30 to 60 days.

Required:

1.

1.1. Calculate the mark-up achieved for the year ended 30 June 20_2. (3)

1.2. Marco is worried that this percentage is lower than the mark-up of 100% consistently used when pricing their products. Do you agree with him? Explain. (3)

2. By how much did tangible assets depreciate during the year ended 30 June 20_2, if no tangible assets were bought or sold? (2)

3.

3.1. Calculate the current ratio for 20_2. (3)

3.2. Calculate the acid-test ratio for 20_2. (4)

(Please turn over)

3.3. Calculate the average stock carrying period. (4)

3.4. Calculate the average debtors' collection period. (4)

3.5. Calculate the average creditors' payment period. (6)

3.6. Sean is very concerned about the liquidity position of Yorvetti Traders on 30 June 20_2, based on the current ratio calculated above. Explain to him why, in fact, he has no need to worry. (6)

4.

4.1. The business has no financial assets, and interest expense consists only of interest on the loan. The loan agreement stipulates that R50 000 is repaid every year on 1 July. What is the interest rate on the loan? (5)

4.2. Calculate the return on capital employed for 20_2. (6)

4.3. Calculate the debt : equity ratio on 30 June 20_2. (3)

5. Yorvetti Traders would like to expand further to take advantage of the success they have already achieved, but require a further loan in order to do this. If you were their bank manager, would you approve their loan? Explain all your considerations and conclusion. (7)

6. Sean and Marco share remaining profits in the ratio 2 : 3. However, of the R250 000 net profit as per the Statement of Income, Marco only earned R80 000. He does not remember the other stipulations in the partnership agreement. Suggest TWO reasons why he might not have earned the R150 000 he was expecting. (4)

60