The Southern African Institute of Government Auditors

Qualifying Examination for Registered Government Auditors

Paper 2: Accounting

November 2011

INSTRUCTIONS TO CANDIDATES

1 Maximum marks: **160**.
2 Total time available **four hours**.
3 The marks allocated to each question are an indication of the expected length and required depth of the answer.
4 Ensure proper planning and avoid exceeding the time you have allocated for each question as suggested by the number of marks allocated to the question.
5 Present your arguments in a clear, well structured manner, using precise language and professional terms, where appropriate.
6 No books or notes are allowed in the examination room.
7 All working papers must be handed in together with all paper provided for the examination (including unused answer sheets).
8 Answers written in pencil will not be marked.
9 You are reminded that this examination will be held under the rules as set out in the document “RGA-QE Examination Matters & Examination Policy 2011”.
10 You are required to observe all Examination Instructions on the separate sheet of paper handed to you before commencement of this examination.

SAIGA
ADVANCING AUDITING AND ACCOUNTABILITY

QUESTION 1 **(80 marks)**

Annual Financial Statements for the Public Service 2011

PART A **(65 marks)**

The aim of the Department of Social Contributions, is to improve the quality of life of the poor, the vulnerable and the marginalised within South African society through an integrated and caring system of social development grants and services. However, the Department has recently experienced a period with little capacity in its finance section. As a result the financial records are in quite disarray.

Please receive the information that appeared in the financial records of the Department for the end of the financial year 31 March 2011:

1 The Department does not have many opportunities to collect its own revenue. The revenue that it did collect for the 2010/11 financial year is the following:

	R
Parking for senior managers	3 800
Recoveries of private telephone expenses	1 950
Breach of study contracts	4 200
Sale of capital equipment	23 500

*All departmental revenue from the previous year was paid over to the Revenue Fund before 31 March 2010. For the 2010/11 financial year R30 000 was paid to the Revenue Fund before 31 march 2011.

2 Other revenue sources for the Department in the 2010/11 financial year were the Annual Appropriation that amounted to R14 million (of which R13.5 million was requested during the year), and Aid Assistance* that was received from Brazil for the following purposes:

	R	**R**
	Income	**Expense**
Financing a budget reform seminar	35 000	31 000
Financing of study bursaries awarded to successful applicants outside of the employ of government	100 000	75 000
Funds for the construction of a pension collection office in the Pofadder district	200 000	190 000
The donation of a mobile Automatic Teller Machine (ATM) *(In Kind)*	R50 000 (fair value)	

*All unused aid assistance should be repaid to the RDP fund.

3 The following assets and liabilities was indicated on 31 March 2011:

	R	**R**
	Balance 31 March 2011	**Balance 1 April 2010**
Receivables*	21 700	34 800
SOCPEN advances	17 800	12 000
Payables (current)	9 000 (cr)	10 200 (cr)

*Receivables to the amount of R10 000 was recorded in the books of the Department in the 2010/11 financial year, but the expenditure occurred in the 2009/10 financial year.

4 The following expenditure were recorded in the 2010/11 financial year:

	R
Employee severance packages	47 000
Basic salaries	5 600 000
Employer medical aid contribution	570 000
Employer pension contribution	480 000
Employee study bursaries	120 000
Employee uniform expense	29 000
Consultants	254 000
Entertainment	124 700
Rent on land	60 000
Computer software	57 300
Motor vehicles	312 000
Social pensions	4 900 000
Other goods and services	535 900

5 Information was received from the bank reconciliation section pertaining to the financial year:

	R	**R**
	Balance: 31 March 2011	**Balance: 1 April 2010**
PMG account	433 230	47 630 (cr)
Deposit account	2 500	1 700
Cheques payable	3 080 (cr)	4 170 (cr)
EBT payment account	12 090 (cr)	8 300 (cr)
Bank adjustment account	190	200 (cr)
Petty cash	7 000	7 000

6 During the year an amount of R1 300 was written off due to the indigent status of a debtor.

7 An investigation of unauthorised expenditure revealed the following:

	R	**Action in 2010/11**
Opening balance: 1 April 2010	15 000	
Social pensions – recorded 20 June 2009	7 000	Approved without funding
Capital equipment – recorded 15 April 2008	5 000	Approved with funding
Entertainment – recorded 20 September 2010	8 200	Decision pending

REQUIRED:
(No comparative figures needed for statements or notes)

(a) Compile a Statement of Financial Performance for the Department of Social Contributions for the year ending 31 March 2011. (16)

(b) Compile a Statement of Financial Position for the Department of Social Contributions on 31 March 2011. (9)

(c) Compile a Cash Flow Statement for the Department of Social Contributions on 31 March 2011. (14)

(d) Show the following notes to the annual financial statements. (17)

i Unauthorised Expenditure
ii Voted funds to be surrendered to the Revenue Fund
iii Net cash flow available from operating activities

(e) Use the information from the constructed trial balance to present the year opening and closing transactions for the annual appropriation, funds requisition (summarised for the year), expenditure against voted funds and departmental revenue in **ledger account format**. **Show only the following accounts:** (9)

i. Exchequer Grant Account
ii. Revenue Accrual Account

PART B **(15 marks)**

The purpose of the Annual Financial Statements (AFS) is to present a true and fair view of an entity's financial performance, financial position, changes in net assets and cash flows that is useful to a wide range of users. Although this concept is largely understood by finance officials in government, few can with confidence reflect on the reasons for the current transition to accrual based accounting in the public service and the link of the format of the AFS to the Economic Reporting Format (ERF).

REQUIRED:

In order to better comprehend certain aspects, the Chief Financial Officer of the Department of Social Contributions kindly requested that you submit to him a written explanation pertaining to the following matters:

(a) What is the rationale behind the decision to develop Standards of GRAP using the accrual IPSASs for the South African public sector? (2)

(b) How would you define the "modified cash basis of accounting" in the South African context? (2)

(c) The ERF is based on principles in the Government Finance Statistics (GFS) with amendments to cater for South African specific circumstances. What is the purpose of the GFS? (3)

(d) Government departments are not yet ready for the application of the GRAP Standards and have to follow the guidance of the Departmental Financial Reporting Framework issued by the National Treasury. What information, to facilitate oversight and decision making, is provided by the Departmental Financial Reporting Framework (current format of AFS)? (8)

QUESTION 2 **(40 marks)**

QUESTION 2.1 **(10 marks)**

The following relates to the financing of a capital project.

Initially the project to upgrade certain roads was going to be financed from MIG. Work commenced on 1 July 2010.

By 31 March 2011, an amount of R14 158 000 had been spent and financed from MIG proceeds.

On 31 March 2011, the Municipality was informed that the balance of expenditure would no longer be financed from MIG. On 5 April 2011 CoGTA sent a letter stating that R4 500 000 would be paid to the Municipality on 1 July 2011 to finance these road projects.

The Municipality decided to raise a loan of R2 000 000 at an interest rate of 10% per annum. Interest is payable monthly. The loan was received on 1 May 2011. It was paid into an investment account. The transactions reflected on the investment statement were as follows:

Date	Description	Debit R	Credit R	Balance R
01-May-11	Deposit			2 000 000.00
31-May-11	Withdrawal	1 855 345.00		144 655.00
31-May-11	Interest		12 328.77	156 983.77

No other entries were processed in this bank account for the year ended 30 June 2011.

The Municipality organised a bank overdraft to finance the balance of the expenditure of R2 565 244. This overdraft will be repaid using the CoGTA monies that will be received on 1 July 2011. The interest paid on the bank overdraft was R23 192 in April 2011, R24 255 in May 2011 and R25 567 in June 2011.

The Mayor opened the roads with a lavish ceremony on 31 May 2011. The opening ceremony cost R5 000.

REQUIRED:

(a) Calculate what interest should be capitalised to these road projects (if any). (7)

(b) Explain how the interest on the bank overdraft can be allocated to capital projects (use the information available to support your explanation). (2)

(c) Explain if the opening ceremony cost can be capitalised to the cost of the roads. (1)

QUESTION 2.2 **(10 marks)**

- ☐ The municipality purchases ten computers with ten Windows software.
- ☐ A municipality creates its own website. The costs incurred are categorised into the following stages:

Planning stage –	feasibility study, defining hardware and soft specs, evaluating alternative products
Graphical design stage –	purchasing hardware, developing software, installing applications, testing
Content development stage –	creating, preparing & uploading information
Other stage –	admin and other overhead expenditure, training of employees

REQUIRED:

(a) Discuss whether the Windows software should be capitalised as an intangible asset. (2)

(b) Indicate which of the cost of the above stages will be capitalised as an intangible asset. (8)

QUESTION 2.3 **(7 marks)**

A municipality has a fire engine with a hydraulic ladder. The original estimated useful life of the ladder was 25 years. The municipality utilises the straight line method for depreciation. The chief fire officer indicates to you in June 2011 that research which he has undertaken indicates that the useful life of these ladders are 20 years.

Detail of the hydraulic ladder on **30 June 2010** was as follows:

Date of acquisition:	1 July 2009
Cost:	R1 200 000

REQUIRED:

(a) Indicate if the change in useful life is a correction of error or a change in accounting estimate. (2)

(b) Indicate what the carrying value of the ladder should be in the fixed asset register as at 30 June 2010 and 30 June 2011 to comply with GRAP. (5)

QUESTION 2.4 **(13 marks)**

For the following question refer to the amortisation table given below to support your workings.

	R	R
Initial (30 June 2010)		736 695.90
Year 1	36 834.80	773 530.70
Year 2	38 676.53	812 207.23
Year 3	40 610.36	852 817.59
Year 4	42 640.88	895 458.47
Year 5	44 772.92	940 231.39
Year 6	47 011.57	987 242.96
Year 7	49 362.15	1 036 605.11
Year 8	51 830.26	1 088 435.37
Year 9	54 421.77	1 142 857.14
Year 10	57 142.86	1 200 000.00

REQUIRED:

Please answer, with reasons, the following short questions.

(a) A municipality is required to establish a landfill site. A community is currently residing on the site and have to be relocated. Can the cost of relocation be allocated to the cost of establishing a landfill site? (2)

(b) The audit for the year ending 30 June 2011 is conducted after year end. The estimated cost of the audit is R1 million. Indicate if a provision should be made at year end for audit fees. (2)

Other situation (audit fees)

(c) The auditors conduct an interim audit prior to 30 June 2011 at a cost of R250 000. The invoice was submitted but was not paid at 30 June 2011. Should the municipality recognise a provision at year end? (2)

(d) A municipality constructs a landfill site by 30 June 2010. In terms of its licensing conditions, it must rehabilitate the landfill site at the end of its estimated useful life. The estimate of the rehabilitation costs is R1 200 000. An appropriate discount rate is 5%.

Calculate the amount of the provision that must be raised as at 30 June 2010 and show what journals will be processed at 30 June 2010. (3)

(e) Show what journal entries will be processed in this regard (d) for the year ended 30 June 2011 and the amount of the provision. Support your answer by referring to GRAP 19. (4)

QUESTION 3 **(40 marks)**

THIS QUESTION COMPRISES OF TWO SEPARATE AND *NON-RELATED* PARTS

PART A **(36 marks)**

Protea Manufacturing Limited is engaged in the production and distribution of cricket equipment and has various investments in property, plant and equipment and other companies.

Protea Manufacturing Limited has a 65% share of the ordinary share capital of Bats-for-Africa (Pty) Limited. Bats-for-Africa (Pty) Limited supplies raw materials to Protea Manufacturing Limited for the production of cricket bats.

Additional information

Property, plant and equipment

1 The following Property, plant and equipment items were included in the Statement of Financial Position as at 28 February 2010:

	Cost	**Accumulated depreciation and impairments**	**Carrying amount**
	R	**R**	**R**
Land	1 100 000	-	1 100 000
Manufacturing buildings	2 800 000	(980 000)	1 820 000
Manufacturing equipment	758 000	(331 625)	426 375
Computer equipment	354 000	(156 000)	198 000
Delivery vehicles	518 000	(175 400)	342 600

2 Depreciation on property, plant and equipment is written off as follows:

Manufacturing buildings	20 years	Straight-line method
Manufacturing equipment	15% per year	Reducing-balance method
Computer equipment	6 years	Straight-line method
Delivery vehicles	4 years	Straight-line method
Land	None	

3 Protea Manufacturing Limited purchased new manufacturing equipment during the financial year for R795 900. The manufacturing equipment was ordered on 10 April 2010 and was shipped on 30 May 2010. The manufacturing equipment arrived at their premises in Wattloo on 20 July 2010.

The installation costs and fees charged by the engineers amounted to R25 500 on 31 August 2010, the date of completion.

Import duties amounted to R65 000 and transport cost amounted to R88 000. Cost of testing the machine amounted to R17 900. Some of the test units could be sold for R10 000 and the equipment has a residual value of R250 000.

The manufacturing equipment was available for use as intended by management on 31 August 2010 and was taken into use on 15 September 2010.

4 On 31 October 2010 Protea Manufacturing Limited sold a delivery vehicle for R100 000. The cost price of the delivery vehicle was R170 000 on 1 August 2008 when it was purchased.

5 During the financial year ended 28 February 2011 the company decided to alter the policy relating to the amount at which manufacturing buildings are carried in the financial statements. The manufacturing buildings are revalued at net replacement value in terms of the revaluation model in *IAS16*, *Property, plant and equipment*.

Depreciation for the **current year** will be calculated on the new revalued amount. The revaluation reserve will be transferred to equity when used. On revaluation, the accumulated depreciation of the equipment is offset against the gross carrying amount.

The manufacturing building was revalued on 1 March 2010 and is regarded as owner-occupied. Internal valuers will perform revaluations on an annual basis from 28 February 2011 onwards. On 1 March 2010, the *gross replacement value* of the manufacturing building amounted to R5 160 000.

Impairments

6 During the financial year ended *28 February 2010* there was a vast improvement in computer technologies globally that resulted in the decrease of computer equipment sales, per an international economic report issued. Management was of the opinion that the computer equipment included in the annual financial statements might be impaired.

7 On *28 February 2010* the computer equipment can be sold to a knowledgeable, willing buyer for R220 000. Sales commission to an agent will amount to 10% of the total sales price. Management determined that the value in use of the computer equipment is R196 800 using an appropriate discount rate of 6%.

8 Global computer sales made a marginal recovery during the financial year ended 28 February 2011.

9 On 28 February 2011 the computer equipment can be sold to a knowledgeable, willing buyer for R165 000. Sales commission to an agent will amount to 10% of the total sales price. Management determined that the value

in use of the computer equipment is R149 750 using an appropriate discount rate of 6%.

10 The cost price of the computer equipment was R354 000 on 1 September 2007 when it was purchased.

Government grant

11 Protea Manufacturing Limited was awarded a government grant of R250 000 on 1 March 2010 to subsidise 25% of future wages incurred by the company over a three year period. Protea Manufacturing Limited has complied with all the conditions laid out to obtain the grant.

Wages incurred and paid during the year ended 28 February 2011 amounted to R650 000.

It is the accounting policy of Protea Manufacturing Limited to present such a grant as an adjustment to expenses.

General

12 It is the accounting policy of the company to account for Property, plant and equipment in accordance with the cost model.

13 The estimates of depreciation method, useful life and residual values are reviewed annually and have remained unchanged for all assets, except otherwise stated.

14 There had been no indication of impairment at the end of any of the financial years since acquisition of any of the assets of Protea Manufacturing Limited, except otherwise stated.

15 Profit of Protea Manufacturing Limited for the year ended 28 February 2011 **after** taking into account the above transactions amounts to R1 281 200.

16 The corporate taxation rate is 28%.

REQUIRED:

(a) Prepare the journal entries with regards to the government grant and related salary information for Protea Manufacturing Limited for the year ended 28 February 2011 in accordance with Statements of Generally Accepted Accounting Practice. (5)

(b) Prepare the Profit before taxation **note** to the Statement of Comprehensive Income of Protea Manufacturing Limited for the year ended 28 February 2011 in accordance with Statements of Generally Accepted Accounting Practice. (6)

(c) Prepare the Other Comprehensive Income **section** to the Statement of Comprehensive Income of Protea Manufacturing Limited for the year ended 28 February 2011 in accordance with Statements of Generally Accepted Accounting Practice. (5)

(d) Prepare the Property, plant and equipment note to the Annual Financial Statements of Protea Manufacturing Limited for the year ended 28 February 2011 in accordance with Statements of Generally Accepted Accounting Practice. (20)

No comparative figures are required.
Show all calculations.
No total columns are required.
Round all amounts to the nearest Rand.
Accounting policy notes are not required.

PART B **(4 marks)**

Granchester Mining Limited acquired a mining licence for R1 570 000 and a piece of land for R2 880 000 on 1 January 2009, cash. This licence is valid for five years and the company plan to use the licence for five years, as they signed an agreement with the community according to which they will cease all commercial activities regarding mining after five years. As part of the mining activities, a mining shaft was installed on the land.

In terms of the mining licence, Granchester Mining Limited is obligated to restore the land and remove the mining shaft at the end of the licence's useful life. Future decommissioning costs are expected to be R120 000. The company uses a discount rate of 6% to calculate the present value of the decommissioning costs.

The following schedule reflects the unwinding of the discounted decommissioning costs:

Date	Years to decommissioning date	6% discount factor	Present Value R
01/01/2009	5	0,747	89 671
31/12/2009	4	0,792	95 051
31/12/2010	3	0,840	100 754
31/12/2011	2	0,890	106 800
31/12/2012	1	0,943	113 208
31/12/2013	0	1,00	120 000

REQUIRED:

Prepare the provision for decommissioning cost note to the Annual Financial Statements of Granchester Mining Limited for the year ended 31 December 2010 in accordance with Statements of Generally Accepted Accounting Practice. (4)