The Southern African Institute of Government Auditors

Qualifying Examination for Registered Government Auditors

Paper 2: Accounting

November 2013

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 clearly, using well structured, clear and precise language and appropriate professional terms.
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 2013".
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)**

PART A **(65 marks)**

The aim of the Department of Subsoil Minerals is to achieve the equitable distribution of access to mineral resources, and to develop South Africa's human resources to be able to manage a mining enterprise. The prudent management and use of South Africa's rich mineral resources is critical for sustainable socio-economic development. The following financial information is available for the Department's financial year ending 31 March 2013:

1 The Department's budget allocation for the 2012/13 financial year amounted to R4 100 000. Of this budget allocation the Department did not request R14 200 during the 2012/13 financial year. Unauthorised expenditure for the 2012/13 financial year further reduced the funds available to be requested.

2 Aid assistance was received from the private mining industry for the purchase of capital equipment for locally based miners just starting out in the industry, to the amount of R102 300. Of these funds R100 000 was spent during the year.

3 Departmental revenue was received on the following items:

Employee parking	R254
Mineral licences	R44 500
Sale of capital equipment	R21 300

*Departmental revenue of R60 000 was paid over to the revenue fund during the year.

4 The following expenditure was recorded in the 2012/13 financial year:

Salaries	R1 820 000
Employer medical aid contribution	R175 000
Employer pension fund contribution	R182 000
Employee study bursaries	R12 600
Consultants	R14 300
Entertainment	R14 700
Rent of land	R1 148 000
Computer software (capital)	R15 730
Motor vehicles (capital)	R12 000
Transfer to the State Mining Corporation	R490 000
Employee severance packages	R33 000
Authorised losses	R100

5 The Statement of Financial Position section of the trial balance included amongst others the following items:

	Balance 31 March 2012	Balance 31 March 2013
Paymaster general account	R1 303	R176 365
Deposit account	R70	R80
Petty cash	R300	R300
Receivables	R3 451	R2 587
Salary advances	R1 258	R1 582
Unauthorised expenditure	R2 000	R2 200
Cheques payable	(R2 387)	(R450)
Payables	(R4 153)	(R3 000)
Bank adjustment account	(R12)	R19
EBT payment account	(R1 830)	(R1 209)
Recoverable revenue	-	(R1 000)

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

(a) Compile a Statement of Financial Performance for the Department for the year ending 31 March 2013. (16)

(b) Compile a Statement of Financial Position for the Department as on 31 March 2013. (9)

(c) Compile a Cash Flow Statement for the Department for the year ending 31 March 2013. (17)

(d) Show the following notes to the annual financial statements. (14)

i Voted funds to be surrendered to the Revenue Fund.
ii Departmental revenue 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 year-closing transactions for each of the annual appropriation, funds requisitioned (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)**

When the Public Finance Management Act, Act 1 of 1999 was being drafted it was clear that the vision for public service accounting in South Africa was to apply the accrual basis of accounting. The familiar private sector documents, the statement of financial performance, statement of financial position etc., were thus listed as the annual financial statements that had to be compiled for the South African public service. Yet, immediately after the first year that these statements had been drafted, the appropriation statement was reintroduced and added to the list in the Treasury Regulations. This appropriation statement is, however, not familiar to accounting graduates at most tertiary institutions.

REQUIRED:

Explain, by means of a memorandum to all the newly appointed auditors, the objective, format and content of the appropriation statement. (15)

QUESTION 2 **(40 marks)**

You are an audit manager whose main responsibility is to ensure that audit staff are kept up to date with the latest technical developments in and changes to the GRAP standards. You are considering the following technical questions that have been asked by audit staff during the audits of a number of **municipalities** for the year ended 30 June 2013. The issues set out below have been raised by various audit teams and they have requested you to provide guidance on these issues in a technical memorandum which they can refer to during the audit process. Your guidance should be substantiated by references to the relevant GRAP standards, exposure drafts or directives issued by the Accounting Standards Board, where applicable.

REQUIRED:

(a) Swartland Municipality has a sewerage switching station on its asset register at 30 June 2013. The asset has a cost price of R20 million. It is regarded as a non-cash generating asset. It has a useful life of 20 years. The municipality makes use of the straight line method of depreciation. At 30 June 2013, according to the asset register, it has a remaining useful life of 15 years. The engineers have, however, indicated that it will be replaced with a new asset on 30 June 2016, to accommodate the higher-than-expected levels of usage. There is no active market for this type of asset at 30 June 2013, and the fair value is expected to be insignificant. The replacement cost for a similar new asset at 30 June 2013 is R22 million. Explain how you would calculate an impairment loss on this asset as at 30 June 2013 and then calculate the impairment loss. (8)

(b) The Overstrand municipality has a piece of land that stretches along the coast for approximately three kilometres. It is not part of a municipal park or resort. It is bordered by sea on the one side and rocky outcrops on the other. Most of the area is covered in fynbos. There are hiking trails and mountain bike single-tracks on the land that are well-patronised by hikers and mountain bikers. Permits for hiking and mountain biking are obtainable from the municipality at a nominal fee. The municipality has no intention of selling the land. Discuss how this land should be classified in the financial statements, based on a discussion of all the possible types of asset classes that could include land on the statement of financial position at year end for the financial year ended 30 June 2013. (5)

(c) The national government lent a reporting entity (a municipality), R20 million to enable the municipality to build a water treatment plant. After a change in policy, the national government has decided to write off (forgive) the loan. There are no stipulations attached to the write-off (forgiveness) of the loan. The national government has written to the municipality and advised it of its decision; it also enclosed the loan documentation, which has been annotated to the effect that the loan has been written off (waived). Explain how the municipality should account for the loan write-off (forgiveness). (2)

(d) Discuss how the proposals contained in ED 99 (Amendments to borrowing costs) will change the accounting treatment requirements set out in GRAP 5 (Borrowing costs). (3)

(e) How does a municipality account for rainwater which is caught up in municipal dams? Explain when, and at what amounts such rainwater could be accounted for? (5)

(f) Provide examples of two types of assets where the unit of production depreciation method would be applicable and also provide the measurement unit to measure usage of the asset. (2)

(g) Discuss whether accounting for investment property at cost price less accumulated depreciation, without reflecting the fair value of that investment property, achieves fair presentation. (4)

(h) Discuss whether a municipality must appoint an actuary at every reporting date to measure its defined benefit obligations. (5)

(i) A municipality has a choice of two options of where to present budgeted information in the financial statements. Name the two options. (2)

(j) Provide four examples of adjusting events occurring after the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised. (4)

QUESTION 3 **(40 marks)**

Cell A Limited is a company in the mobile communications sector operating in Southern Africa.

During the previous financial year the directors decided to expand their business to include data communication and property investments.

Under the heading Property, Plant and Equipment (*at cost*) the following was presented in the Statement of Financial Position as at 31 December 2011:

	R
Data communication centre *under* construction	600 000
Computer equipment	190 000
Delivery vehicles	555 000
Voice communication centre	470 000

The following information for the year ended 31 December 2012 is available:

1 Expenses incurred during the year relating to the data communication centre in Mpumalanga are as follows:

	R
31 January 2012	180 000
28 February 2012	210 000
30 April 2012	280 000
31 May 2012	30 000

The data communication centre was materially completed on 31 May 2012 and available for use as intended by management on 31 July 2012.

2 Depreciation on Property, Plant and Equipment, and on investment property, is calculated as follows:

Data communication centre	10% per year	Straight-line
Buildings	5% per year	Straight-line
Computer equipment	20% per year	Reducing-balance
Delivery vehicles	4 years (Original)	Straight-line
Voice communication centre	20% per year	Straight-line
Land	None	

3 Accumulated depreciation on 31 December 2011 on Property, Plant and Equipment is as follows: (assume correct)

	R
Computer equipment	80 400
Voice communication centre	282 000
Delivery vehicles	277 500

4 Computer equipment was purchased on 30 September 2012 for R84 321 cash and leased to Vodakom Limited under a finance lease agreement on 30 September 2012 at a sales price of R90 668 (fair value).

Details of the agreement are as follows:

- ☐ Lease payments of R35 500 are received annually in arrears.
- ☐ Ownership will transfer to the lessee at the end of the lease term.
- ☐ The lease term is three years.
- ☐ The interest rate implicit to the lease is 8.5%.

5 Cell A Limited revalued its voice communication centre for the first time during the year ended 31 December 2012. The gross replacement value of the voice communication centre was determined by an independent sworn appraiser, with reference to an active market for voice communication centres in the same condition and location. The voice communication centre is 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 latest revalued amount. The revaluation reserve will be transferred to equity when used. On revaluation, the accumulated depreciation of the voice communication centre is offset against the gross carrying amount.

On 1 January 2012, the gross replacement value of the voice communication centre amounted to R710 000.

6 On 1 June 2010 an apartment building was purchased for R14 850 000 and was available for use as intended by management on 1 June 2010. All of the apartments were rented out to tenants. The apartment building consists of 20 two-bedroom flats, 15 three-bedroom flats and one penthouse.

For the year ended 31 December 2012 rental for a two-bedroom flat is R4 000 per month, for a three-bedroom flat it is R5 950 per month and R9 250 per month for the penthouse. All the flats were fully let for 2012.

Repairs and maintenance amounted to R87 000 in total for 2012, and security costs for the year ended 31 December 2012 was R12 500 per month. These costs were paid in cash by Cell A Limited.

The fair value of the apartment building, as determined by an independent appraiser, was R15 480 000 on 1 January 2012, and R15 850 000 on 31 December 2012.

7 On 10 April 2012 Cell A Limited purchased three pieces of land (stands 145, 146 and 147) for R750 000 each, in cash. Cell A Limited immediately started with the construction of three separate, but identical, office buildings.

The first office building on stand 145 was completed and available for use as intended by management on 31 August 2012, at a cost of R2 680 000, and the directors decided to use this office building to accommodate Cell A Limited's own administration function. The other two office buildings, on stands 146 and 147, were completed and available for use as intended by management on 30 September 2012, at a cost of R2 980 000 each, and was paid for in cash.

At this time the directors of Cell A Limited decided that the first office building was sufficient for accommodating their administration function, and they then started renting out the other two office buildings on stands 146 and 147. The directors stated that they had no intention of selling the office buildings.

Rental was received for the two office buildings (on stands 146 and 147), from 30 September 2012, and amounted to R18 000 per month for the building on stand 146, and R19 200 per month for the building on stand 147.

The fair value of each of the three stands, together with their office building improvements, as determined by an independent appraiser, to be R4 110 000 each, as of 31 December 2012.

8 Cell A Limited received a grant of R450 000 from government on 1 May 2012 for the construction of the data communication centre. The provision of the grant was subject to the condition that Cell A Limited constructed a communication centre in a rural area, so as to gain the additional benefit of local job creation. Cell A Limited has now complied with all the conditions contained in the grant agreement. It is the accounting policy of Cell A Limited to account for a grant relating to an asset, as deferred income.

General

9 The data communication centre has a residual value of R180 000.

10 Cell A Limited altered the depreciation rate for their delivery vehicles from four years to five years for the year ended 31 December 2012. The remaining useful life of the delivery vehicles, as on 1 January 2012, was determined to be three years.

11 There has been no indication of impairment at the end of any of the financial years since acquisition of any of the assets.

12 The methods used to calculate estimates of depreciation, useful life, and residual value for the assets have been reviewed annually, and have remained unchanged for all of the assets, unless otherwise stated.

13 Owner-occupied property and investment property is accounted for in accordance with the cost model of IAS16 and IAS40.

14 Ignore any VAT or tax implications.

REQUIRED:

(a) Prepare the journal entries relating **only** to the finance lease agreement and the government grant received for the year ended 31 December 2012, in accordance with International Financial Reporting Standards. (14)

(b) Prepare the following **notes** to the financial statements of Cell A Limited for the year ended 31 December 2012, in accordance with International Financial Reporting Standards:

- ☐ Profit before taxation (16)
- ☐ Property, Plant and Equipment (10)
  (Only the columns for the data communication and voice communication centres are required.)

Round all final amounts to the nearest R1.
No accounting policy notes are required.
No comparative figures are required.
Total columns are not required.