The Southern African Institute of Government Auditors

Qualifying Examination for Registered Government Auditors

Paper 2: Accounting

November 2017

INSTRUCTIONS TO CANDIDATES

1 Maximum marks: **160**.
2 Total time available: **four hours**.
3 Q1=80 marks, Q2 80 marks
4 The marks allocated to each question are an indication of the expected length and required depth of the answer.
5 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.
6 Present your arguments clearly, using well structured, clear and precise language and appropriate professional terms.
7 No books or notes are allowed in the examination room.
8 All working papers must be handed in together with all paper provided for the examination (including unused answer sheets).
9 Answers written in pencil will not be marked.
10 Total number of pages for this question paper is 8
11 You are reminded that this examination will be held under the rules as set out in the document "RGA-QE Examination Matters & Examination Policy 2017".

SAIGA
ADVANCING AUDITING AND ACCOUNTABILITY

Question 1 **80 MARKS**

The function of the Department of Coordination is to develop national policies and legislation relating to the relations between the spheres of government. It needs to support provincial and local government, improve regulatory compliance and work with partners and stakeholders outside of government to strengthen intergovernmental relations.
After an investigation it was established that the department neglected to record information regarding its unauthorised expenditure, and fruitless and wasteful expenditure. They are unsure how this will affect the trial balance for the year ending 31 March 2017 and have phoned you, as a consultant, to adjust the trial balance and assist with the compilation of its annual financial statements.
The following information was made available to you:

1. Aid assistance was received for the funding of seminars, arranged by the department, intended to foster relations with external stakeholders to government. Fifty percent of unspent donor funding is repayable to the RDP fund and the other fifty percent can be carried over the next financial year.

2. Unauthorised expenditure information for the 2016/17 financial year consisted of R86 325 (Advertising) that was approved with funding and R55 000 (consulting services) that was approved without funding. Unauthorised expenditure of R29 500 due to spending on Communication that was not in accordance with the purpose of the Vote was confirmed in 2016/17. Unauthorised expenditure of R30 000 was not approved and should be transferred to receivables for recovery.

3. Fruitless and Wasteful expenditure of R15 000 that occurred in 2013 and was recorded in 2015 was recovered in the 2016/17 financial year. Apart from this Fruitless and Wasteful expenditure all other debtors are less than 12 months old.

4. The trial balance for the year ending 31 March 2017 without the unauthorised expenditure, and fruitless and wasteful expenditure information **(Attachment A)**.

Required: (No comparative figures are needed)

a) Present the general journal entries pertaining to the unauthorised expenditure information. **(12)**

b) Compile a Statement of Financial Performance for the department for the year ending 31 March 2017. **(15)**

c) Compile a Statement of Financial Position for the department on 31 March 2017. **(10)**

d) Compile a Cash flow statement for the department on 31 March 2017 **(15)**

e) Compile the following notes to the financial statements:

   i Unauthorised expenditure **(5)**

   ii Voted funds to be surrendered to the Revenue Fund **(5)**

   iii Departmental revenue to be surrendered to the Revenue Fund **(3)**

   iv Net cash flow available from operating activities **(9)**

f) Use the information from the trial balance after the adjustments have been taken into account to present the year opening and closing transactions for the annual appropriation, funds requisition (summarised for the year) and expenditure against voted funds in **ledger account format. Show only the Exchequer Grant Account.** **(6)**

/80/

Attachment A:

Trial Balance for the Department of Coordination on 31 March 2017

Description	2016/17	2015/16
	R	R
General Account of the Vote	(86,000,000)	(80,000,000)
Traditional authority license fee (current)	(497,126)	(451,278)
Sale of capital equipment	(5,137,824)	(1,601,934)
Interest received	(47,174)	(31,758)
Authorised losses recovered	(89,569)	-
Aid assistance received	(13,000,000)	(10,000,000)
Administrative fees	571,570	601,708
Advertising	901,748	824,712
Advertisements	301,794	338,648
Bursaries (employees)	83,750	70,258
Communication	1,915,262	1,707,388
Minor assets	3,792,842	2,865,396
Rent on land	913,974	738,250
Interest paid	139,482	123,930
Machinery and equipment (Capital)	473,096	379,308
Application software (Capital)	170,472	-
Computer services	71,396	30,824
Consultants, business and advisory services	242,974	239,128
Authorised losses	81,174	58,942
General Account of Revenue	5,500,000	2,000,000
Current transfer payment - NGO municipal liaison	519,708	393,082
Bursaries (community members)	196,200	-
Basic salaries	38,700,000	36,000,000
Medical aid contribution	3,870,000	3,600,000
Pension fund contribution	5,805,000	5,400,000
Housing subsidy	774,000	720,000
Aid assistance expenditure	12,500,000	10,000,000
Exchequer Grant Account	1,200,000	-
Paymaster General Account	18,642,179	19,226,534
Deposit account	379,048	2,305,790
Petty Cash account	280,000	280,000
Debtors (Receivables) Account	877,784	455,790
Subsistence and Travel Advances Account	4,370,934	2,330,854
Salary Advances Account	1,570,248	1,316,878
Unauthorised Expenditure	237,940	237,940
Cheques Payable Account	(77,904)	(3,794)
Unallocated Receipt Control Account	(17,930)	(7,304)
Bank Adjustment Account	974	(942)
Electronic Fund Transfer (EFT) Payable Account	(33,974)	(31,794)
Salary Deductions Control Account	(150,248)	(84,756)
Recoverable Revenue Account	(31,800)	(31,800)
	-	-

Question 2 **(80 MARKS)**

You are in the employ of the AGSA Head Office based in GP. Recently you have been promoted to the post of Senior Manager within ARD (technical division) of the AGSA. Your area of expertise, amongst other fields, is practical application of the various accounting reporting frameworks applicable to the SA public sector, especially GRAP and IFRS.

Various audit teams across SA send you technical queries pertaining to challenging accounting queries that they come across during their audits. These pertain to PFMA and MFMA entities.

There are few unresolved GRAP and IFRS matters that audit teams are now asking your technical accounting perspective and opinion on, which you are considering now during the month of November 2017.

These technical queries and **issues** are summarised below and you are busy formulating answers and plans to address these:

TECHNICAL QUERY NUMBER ONE **(35 marks)**

An audit team based in Limpopo has commenced with primary audit planning before the financial year end of one of their clients, a TVET College. TVET Colleges have a 31 December financial year end. Whilst attending a planning meeting during November 2017 with the College's Management team, the CFO of the College mentioned to the Audit Manager on the audit team that they have entered into a rental agreement during the year for the rental of a new administrative office building for the College. The CFO has concluded that this rental agreement is a finance lease and has accounted for it as such at the commencement of the rental, being 1 January 2017, year to date (i.e. until November 2017). The CFO plans on affecting all of the finance lease presentation and disclosure in the AFS for 31 December 2017. This is one of many lease agreements already accounted for by the College, some dating back from previous years. The rental agreement between the lessor and the College includes the following pertinent details:

- ☐ The rental agreement commences on 1 January 2017 and is for a three year period for the commercial rental of an office building XXFL from a commercial property investor. In terms of the agreement, the College will have the right to occupy building XXFL for the rental period, thereafter it will have to vacate the building, unless the rental agreement is renewed by both parties within 6 months prior to the lease expiry.
- ☐ The rental payment is R10, 000 per month, with an escalation of 10% per year.
- ☐ The agreement states that ownership remains with the lessor and at no time will ownership pass to the lessee. At the end of the lease the College does not have the option to purchase the building.
- ☐ If College cancels the agreement during the term, it has to immediately pay all outstanding payments for the remainder of the rental period to the lessor.
- ☐ The market value of the building at 1 January 2017 is R1, 500,000. The incremental borrowing rate is 11%.

Even though not included in the rental agreement, both the property investor and the CFO of the College are of the professional opinion that the economic life of the building is considered to be 70 years.

YOU ARE REQUIRED TO ANSWER THE FOLLOWING:

(a) If the College as lessee applied the finance lease indicators as stated in GRAP 13 to the terms in the lease agreement to determine whether the lease should have been classified as an operating or a finance lease, how should they have classified it at 1 January 2017? Please state your detailed reasons why it should be classified as a finance lease or as an operating lease by applying the relevant finance lease indicators found in GRAP 13.

(10 marks)

(b) If you are of the opinion that the TVET College incorrectly classified the rental agreement as a finance lease and should have classified it as an operating lease in terms of GRAP 13 *Leases,* please explain briefly what corrective accounting is required by the College during the 2017 financial year. I.e., state whether you believe this correction should be accounted for in terms of GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors* as the correction of a prior period error, a change in accounting estimate, a change in accounting policy or none of these accounting treatments as per GRAP 3 (if none of these explain why briefly). Also state what financial statement line items should be removed/ not have an effect on the 31 December 2017 AFS, specifically the Statement of Financial Position and Statement of Financial Performance.

(8 marks)

(c) Based on the classification of the lease arrangement in a) above, show the journal entries for all 3 years of the lease arrangement which the College should account for. You need not show the journal entries for each month of the three years but only the total lease expenditure for each of the 3 years needs to be journalised. **Journal narrations are** required and you must show your detailed calculations.

(17 marks)

TECHNICAL QUERY NUMBER TWO **(19 marks)**

An Audit Manager of an audit team based in Gauteng has sent you an email during August 2017 regarding their biggest Provincial Government Business Enterprise (GBE) client, namely Development Enterprises (DE). This GBE has a 31 March financial year end. The audit team concluded successfully the 2016/17 AFS audit of the DE and issued their audit report before the legislated deadline of 31 July 2017. However, in the email to you the Audit Manager states that she has come across an AFS working paper of the DE dated 2 June 2017 that detailed the following: DE has entered into and embarked on a research and development project that started during April 2017 and which was concluded before the end of May 2017. This project entailed the research and development of a **textile brand** called Epic Shirts, i.e. a clothing brand.

The expenditure incurred during the period of 1 April to 31 May 2017 was as follows

(Please note that below amounts are in Million):

Period from	*Expenditure type*	R
1 April 2017 – 20 April 2017	Research as to the extent of the market	3
21 April 2017 – 30 April 2017	Prototype clothing and goods design	4
1 May 2017 – 9 May 2017	Employee costs in refinement of design	2
10 May 2017 – 19 May 2017	Development work undertaken to finalise design	5
20 May 2017 – 31 May 2017	Production and launch of products	
		20

The costs of the production and launch of the products include the cost of upgrading/ improvement of the existing machinery amounting to R3 000 000, market research costs of R2 000 000 and staff training costs of R1 000 000.

The AFS working paper discovered by the Audit Manager states that Development Enterprises accumulated costs amounting to R20 000 000 as an intangible asset and that DE is already reporting internally that it has developed an intangible asset of R20 000 000 regarding the above.

YOU ARE REQUIRED TO ANSWER THE FOLLOWING:

a) Does the above-mentioned expenditure incurred by DE have an effect on the financial year ending 31 March 2017, which has already been audited by the GP audit team? Should DE have reported any of the information relating to these expenses in their 31 March 2017 AFS? Explain your answer please in sufficient detail by applying the relevant IFRS's. (8marks) Assuming that the DE is now accounting for the R&D and other costs relating this clothing brand development project, explain how the DE should account for it terms of IFRS/ IAS. If you believe there is an intangible asset that has been developed, please explain if DE is correct in stating that such an intangible asset amounts to R20m by explaining which costs should be included (i.e. capitalised) as development costs relating to an internally generated intangible asset in terms of IAS 38 *Intangible assets.* Also explain what should happen to costs that are not capitalised as part of this intangible asset.

(11 marks)

TECHNICAL QUERY NUMBER THREE (26 marks)

The Great Shark Municipality situated in KZN is being audited by one of the KZN audit teams. This team is already underway with their 2016/17 AFS audit and is busy wrapping up the final technical audit queries that are still unresolved. The assistant manager of this audit team is currently acting as manager on this audit due to the fact that the audit manager is currently on maternity leave and no other audit manager of the KZN audit BU can stand in as manager for this audit of the 2016/17 AFS.
The assistant manager has communicated to you as the National Technical Expert on accounting the below-mentioned transactions which has not been accounted for by the management of the municipality. The municipality acquired land and buildings at the beginning of the financial year and incurred certain expenditures relating to these properties during the year. An extract from the financial records of the Great Shark Municipality, contains the following information:

Property:	**RAND**
1. Land – Erf 160 Durban (acquired 1 July 2016)	1 500 000
Building thereon (Construction completed on 31 Dec 2016)	2 400 000
(The property is used to house staff of the Corporate Services Unit of the municipality)	
2. Land - Erf 132 Durban (acquired 1 July 2016)	1 600 000
Building thereon (Acquired along with the land)	4 200 000
Improvements to the building to extend rented floor capacity (Improvements effected at beginning of financial year)	800 000
Repairs and maintenance to investment property for entire year	100 000

Approximately 6 % of the floor space of the building situated on Erf 132 is also used to house staff from the Finance Office of the municipality. The remainder of this building is leased out under an operating lease for commercial rentals. The municipality provides the lessee with security services which entails a full time guard at the entrance of this building and one additional guard that patrols the land on which the building is situated after hours.

For subsequent measurement the municipality values investment property using the fair value model and owner-occupied property is valued at cost less accumulated depreciation and accumulated impairment losses. Owner occupied buildings are depreciated according to the straight line method over a period of 40 years. On 30 June 2017, Mr AP Praiser, a sworn appraiser, valued property Erf 132 (based on market evidence) at the following fair values:

	RAND
Property 2 (Erf 132)	
Land	2 000 000
Buildings	5 200 000

Property 1 and 2 can only be sold as two complete units. Towards the end of the financial year end, damage to the foundation of the building situated on Erf 160 was discovered during a routine inspection of the building. The management of Great Shark Municipality determined that the recoverable service amount of this building has declined to R2 100 000 at 30 June 2017. The Municipality received rental for Property 2 amounting to R320 000.

YOU ARE REQUIRED TO ANSWER THE FOLLOWING:

a) Discuss the accounting treatment in terms of the Standards of GRAP of the land and buildings situated on property even 160 and 132. Please give reasons for the classification of these properties. **(7 marks)**

<u>END OF PAPER</u>