ACCOUNTING

ANALYSIS AND INTERPRETATION OF FINANCIAL INFORMATION

GRADE 12

basic education

Department:
Basic Education
REPUBLIC OF SOUTH AFRICA

Read to Lead

A Reading Nation is a Leading Nation

2030 NDP

Foreword

In order to improve learning outcomes the Department of Basic Education conducted research to determine the specific areas that learners struggle with in Grade 12 examinations. The research included a trend analysis by subject experts of learner performance over a period of five years as well as learner examination scripts in order to diagnose deficiencies or misconceptions in particular content areas. In addition, expert teachers were interviewed to determine the best practicesto ensure mastery of thetopic by learners and improve outcomes in terms of quality and quantity.

The results of the research formed the foundation and guiding principles for the development of the booklets. In each identified subject, key content areas were identified for the development of material that will significantly improve learner's conceptual understanding whilst leading to improved performance in the subject.

The booklets are developed as part of a series of booklets, with each bookletfocussing onlyon one specific challenging topic. The selected content is explained in detail and include relevant concepts from Grades 10 - 12 to ensure conceptual understanding.

The main purpose of these booklets is to assist learners to master the content starting from a basic conceptual level of understanding to the more advanced level. The content in each booklets is presented in an easy to understand manner including the use of mind maps, summaries and exercises to support understanding and conceptual progression. These booklets should ideally be used as part of a focussed revision or enrichment program by learners after the topics have been taught in class. The booklets encourage learners to take ownership of their own learning and focus on developing and mastery critical content and skills such as reading and higher order thinking skills.

Teachers are also encouraged to infuse the content into existing lesson preparation to ensure in-depth curriculum coverage of a particular topic. Due to the nature of the booklets covering only one topic, teachers are encouraged to ensure learners access to the booklets in either print or digital form if a particular topic is taught.

TABLE OF CONTENTS

1. How to use this booklet

The main intention of this study guide is to address challenges with specific areas of subject content that was poorly answered in past NSC papers. This is informed by the detailed analysis done on each question and the findings that were provided in the Diagnostic Report. The material presented in this booklet focuses on the progression and content overlapacross the FET phase, as illustrated in the table below.

Field	Grade 12	Grade 10 & 11
Financial	**Companies** • Concepts and bookkeeping • Financial Statements • Cash Flow, Ratios (analysis and interpretation) • Reconciliations analysis • Bank, Debtors and Creditors • VAT	**Bookkeeping (sole trader)** • Adjustments • Financial Statements • Ratios/ Interpretation • Reconciliations prepare • VAT concepts and calculations
Managerial	**Manufacturing concerns** • Production Cost Statement • Unit cost calculations and break-even analysis **Budgeting (analysis)** • Projected Income Statement • Cash Budget	**Manufacturing** • Concepts and ledger accounts • Break-even analysis **Budgeting (prepare)** • Concepts and preparation • Basic calculations
Managing Resources	• **Stock valuation** FIFO, weighted average and specific identification • **Fixed asset management (analysis)** • **Auditing, internal controls and ethics**	• **Stock (clubs)** Perpetual and periodic • **Fixed assets (prepare)** Depreciation, disposal • **Auditing, internal controls and ethics**

It is important to first address prior knowledge (concepts, calculations), before moving to the more challenging mattersof analysing, interpreting and commenting. The next logical step is to tackle examination type questions with the knowledge that all questions will cater for the different cognitive levels.

This study guide provides:
- Notes on simple definitions, explanations, formulae and short-cuts (handy hints).
- Focus-activities to test specific skills.
- Application activities in the form of examination-type questions.
- Adapted questions from past examination papers.

Plan of action:
- Master the basic skills by using this manual, together with all other resources, if more practice is needed.
- Test your knowledge by attempting to do some examination questions.
- Make a note of your shortcomings and start the process over again until you get the activity right.

STUDY AND EXAMINATION TIPS

KNOW THE PAPER: GENERAL STRUCTURE AND LAYOUT.

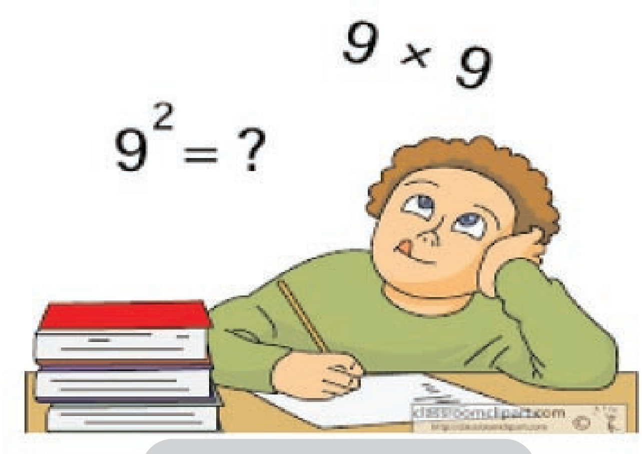
- One 3-hour paper for 300 marks;
- The paper consists of 6 compulsory questions; the marks per question range from 30 to 80 marks. Each question will comprise a number of sub-questions that are set at different cognitive levels.
- The content covered must conform to the requirements of CAPS, as follows:

Financial Accounting	50% - 60%	150 - 180 marks
Managerial Accounting	20% - 25%	60 - 75 marks
Managing Resources	20% - 25%	60 - 75 marks

- **PAST TREND:**
  - Question 1, 2 and 6 are generally shorter questions (30 - 45 marks).
  - Question 3 and 4 are generally longer questions, comprising Financial Statements and the Cash Flow Statement.
  - The question paper comes with a specially prepared ANSWER BOOK, which means you can answer the questions in any order.
- **STRATEGY:**
  - **Analysis and interpretation of financial information** cuts across all three fields of Accounting and constitutes a sizable portion of the marks in the examination paper.
  - Past trends show that the topicis normally asked in all questions, but it is concentrated on more inquestions3to 6. The questions require calculations as well as analysis and interpretation.
  - Examiners always set this topic and you must be well prepared on all sections of the work. Detailed explanations on this topic are provided in Section 5 of this document.
  - The calculations require strong mathematical ability, which is developed over a period of time, starting inGrade 7.
  - These skills must include calculating percentages, increases, decreases or specific amounts, using equations.
  - Interpretation and analysis requires good comprehension ability. Be mindful of the language of the paper, and practice using many past papers.

3. OVERVIEW OF ANALYSIS AND INTERPRETATION

USE OF FINANCIAL INFORMATION

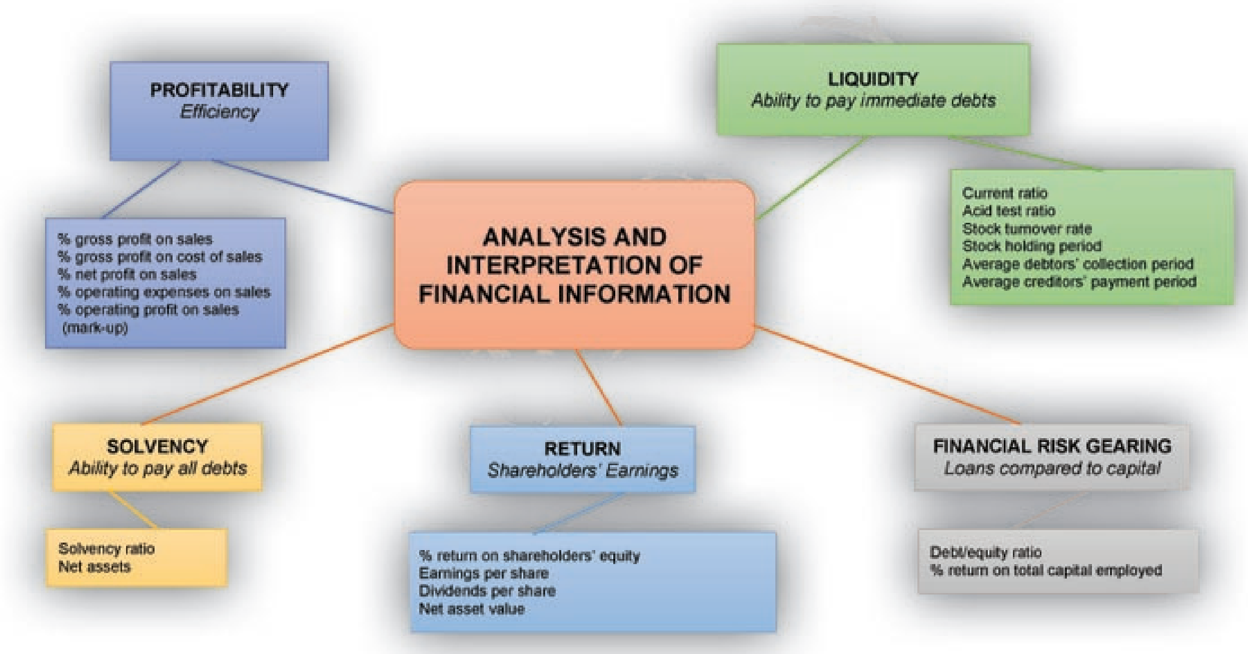


WHAT TO DO

- Identify the relevant financial indicators to comment on specific questions.
- Extract the appropriate information from the financial information given, to calculate financial indicators.
- Understand the requirements of the question, such as comment, give advice, provide the trend, justify his action, etc.
- Be knowledgeable, so that it is easy to work backwards using the given information.
- Don't rely on rote learning or mindless memorising without insight.
- Assess the length of the answer expected by the question.

PLEASE PAY MORE ATTENTION FROM NOW ON.

OVERVIEW OF ANALYSIS AND INTERPRETATION



OVERVIEW OF ANALYSIS AND INTERPRETATION

FINANCIAL STATEMENTS

FINANCIAL INDICATOR

FORMULAR

CALCULATIONS

ANSWER/RESULT

TREND/PATTERN

COMMENT

DECISION/RECOMMENDATION/ ADVICE

5. FINANCIAL ANALYSIS AND INTERPRETATION

5.1 CONCEPTS AND RELATED INFORMATION

Q: What is analysis and interpretation?
A:A process that extracts relevant information from a company's Financial Statements, which are interpreted to meet a particular need at a particular point in time.

Q: Why it is done?
A: Financial analysis and interpretation is done to provide information that is useful for the purpose of **decision making**.

Q: Who uses it?

A:

Users	**Reasons**
Shareholders	Current and future profitability.
Financial institutions (suppliers of short-term credit)	Will business be able to pay its debt?
Financial institutions (suppliers of long-term credit)	Will business be able to pay a long-term loan and interest?
South African Revenue Services	To know whether the correct tax is paid.
Management	To evaluate their performance.
Customers	To establish the staying power of a business.
Auditors	Does the financial statements fairly present the results of the business?
Employees or unions	Long-term growth prospects to ensure continued employment.

Q: How is it done?

A:Use the information from the Financial Statementsto calculate the required ratio.

After calculating, interpret the result by comparing it to:

- Financial indicators of the same business in previous years (meaningful)
- Competitors
- Generally accepted norms and standards

FINANCIAL INDICATORS

AREA OF ANALYSIS	DESCRIPTION	RELATED FINANCIAL INDICATORS
Profitability	How efficient is the company in its normal operating activities?	% gross profit on sales % gross profit on cost of sales % net profit on sales % operating expenses on sales % operating profit on sales (mark-up)
Liquidity	The ability of a company to pay off its immediate (short-term) debts.	Current ratio Acid test ratio Stock turnover rate Stock holding period Average debtors' collection period Average creditors' payment period
Solvency	The ability of a company to pay off all its debts.	Solvency ratio Net assets
Return	Are the shareholders earning a fair amount on their investment?	% return on shareholders' equity Earnings per share Dividends per share Net asset value
Financial risk gearing	To what extent is the company financed by loans (borrowed money) compared to its own capital?	Debt/equity ratio % return on total capital employed
Share price and market prospects	To determine whether the business is in a sound economic/financial position and if it is viewed as an investment opportunity.	Net asset value (NAV) Issue price Share price Average share price Market price (Securities Exchange)

INFORMATION FOR PRACTICE EXERCISES

ZAMA LTD
FOR THE FINANCIAL YEAR ENDED 28 FEBRUARY 2018.

INFORMATION:

A. **Share Capital**

The business has an authorised share capital of 750 000 ordinary shares.
The total issued share capital on 28 February 2018 was 400 000 ordinary shares.
50 000 ordinary shares were issued on 2 March 2017.

B. **Extract from the Income Statement on 28 February 2018:**

Sales	5 152 000
Cost of sales	3 220 000
Gross profit	1 932 000
Operating income	257 600
Operating expenses	1 004 640
Operating profit	1 184 960
Interest expense	133 960
Net profit before income tax	1 051 000
Income tax	315 300
Net profit after income tax	735 700

C. **Information from the Balance Sheet on 28 February**

	28/02/2018	28/2/2017
Non-current assets	**6 947 700**	**6 377 400**
Fixed assets	6 747 700	6 177 400
Financial assets	200 000	200 000
Current assets	**973 200**	**1 058 700**
Inventories	418 000	321 700
Trade debtors	550 000	475 000
Cash and cash equivalents	5 200	262 000
Shareholders' equity	**6 224 000**	**5 058 300**
Ordinary share capital	5 827 500	4 960 000
Retained income	396 500	98 300
Non-current liabilities	**1 000 000**	**1 600 000**
Current liabilities	**696 900**	**777 800**
Trade creditors	411 200	621 600
Shareholders for dividends	220 000	120 000
Bank overdraft	52 200	0

D. An interim dividend of R180 000 was paid and a final dividend was declared.

E. Credit sales amount to 30% of total sales.
Credit purchases amounted to R2 415 000.

5.2 PROFITABILITY

5.2.1 Gross profit on sales (gross margin)

$$\frac{\textit{(Gross Profit)}}{\text{Sales}} \times \frac{100}{1} = \%$$

It indicates the percentage by which the total selling price is greater than the cost price.
Decrease in this ratio indicates:

- Pressure on Selling Price as a result of competition.
- Upward pressure on costs as a result of inflation or other cost factors.
- Reduced SP to sell products.

5.2.2 Gross profit on cost of sales (gross mark-up)

$$\frac{\textit{Gross Profit}}{\text{Cost of Sales}} \times \frac{100}{1} = \%$$

Mark-up on Cost Price should equal this %;if not, it could be the result of:

- Shrinkage
- Products not correctly marked
- Theft
- Discounts

5.2.3 Net profit on sales (net margin)

$$\frac{\textit{Net Profit}}{\text{Sales}} \times \frac{100}{1} = \%$$

- If the ratio is 10%, this means that for every R1 of sales, 10 cents is profit.
- The faster the turnover, the greater the accumulation of 10 cents and the larger the ultimate net profit.

5.2.4 Operating expenses on sales

$$\frac{\textit{Operating Expenses}}{\text{Sales}} \times \frac{100}{1} = \%$$

- This indicates how much of the sales price is used to cover running expenses.
- The trend is favourable if this is dropping or at least consistent.

5.2.5 Operating profit on sales

$$\frac{\textit{Operating Profit}}{\text{Sales}} \times \frac{100}{1} = \%$$

- Indicates how much of the sales price ends up as profit.
- The trend is favourable if profit is increasing or at least consistent.

LET'S PRACTICE PROFITABILITY RATIOS

Use the practice information on page 7 to calculate the following ratios. Round off your answers to one decimal point.

a. Gross profit percentage on sales
b. Operating expenses on sales
c. Operating income on sales
d. Net profit after tax on sales
e. Gross profit percentage

a. Gross profit percentage on sales

$$\frac{1932\ 000}{5152\ 000} \times 100 = 37{,}5\ \%$$

b. Operating expenses on sales

$$\frac{1004\ 640}{5152\ 000} \times 100 = 19{,}5\ \%$$

c. Operating income on sales

$$\frac{1004\ 640}{5152\ 000} \times 100 = 19{,}5\ \%$$

d. Net profit after tax on sales

$$\frac{735\ 700}{5152\ 000} \times 100 = 14{,}3\ \%$$

e. Gross profit percentage

$$\frac{1932\ 700}{3220\ 000} \times 100 = 14{,}3\ \%$$

5.3 LIQUIDITY RATIOS

5.3.1 Current Ratio

Current Assets: Current Liabilities

- This indicates whether or not the business can meet its short-term obligations.
- It should not be too high, as that means that funds are tied up, instead of being used more effectively.

5.3.2 Acid Test Ratio

Current Assets - Inventory: Current Liabilities

- If this is too low, the business will not be able to meet its short-term obligations.
- It should not be too high, as that will mean that funds are tied up, instead of being used more effectively.

5.3.3 Stock turnover rate

$$\frac{\text{Cost of Sales}}{\text{Average Inventories}} = \_\_\_\_\_\_\_\_ \text{ times per year}$$

- Stock is turned over a number of times per year.
- This also depends on the type of goods being sold.
- The business needs to look at ways to increase its sales, in order to create a higher rate of stock turnover.

5.3.4 Stock holding period

$$\frac{\text{Average Inventories}}{\text{Cost of Sales}} \times \frac{365}{1} = \_\_\_\_\_ \text{ days}$$

- The faster the sales occur, the fewer number of days stock is kept.
- This is also influenced by the type of goods being sold .

5.3.5 Average debtors' collection period

$$\frac{\text{Debtors}}{\text{Credit Sales}} \times \frac{365}{1} = \_\_\_\_\_ \text{ days}$$

This indicates how long debtors will take to settle their accounts. It is informed by the credit terms of the business. A generally accepted period is 30 days. It is the final test of liquidity.

5.3.6 Average creditors' payment period

$$\frac{\text{Creditors}}{\text{Credit Purchases}} \times \frac{365}{1} = \_\_\_\_\_ \text{ days}$$

This indicates how long the business takes to pay its creditors. It is informed by the credit terms of the supplier. A generally accepted period is 90 days.

LET'S PRACTICE LIQUIDITY RATIOS

Use the practice information on page 7 to calculate the following ratios. Round off your answers to one decimal point.

i. Current ratio
ii. Acid test ratio
iii. Stock turnover rate
iv. Average stock holding period
v. Average debtors' collection period
vi. Average creditors' payment period

i.	**Current ratio** 973 200 : 696 900 1,4 : 1
ii.	**Acid test ratio** 555 200 (973 200 – 418 000) : 696 900 Or 555 200 (550 000 + 5 200) : 696 900 = 0,8 : 1
iii.	**Stock turnover rate** $\frac{3\ 220\ 000}{½\ (321\ 700 + 418\ 000)}$ = 41,9 times
iv.	**Average stock holding period** $\frac{½\ (321\ 700 + 418\ 000)}{3\ 220\ 000}$ X 365 = 41,9 times Or 365/8,7
v.	**Average debtors' collection period** 512 500 $\frac{½\ (475\ 000 + 550\ 000)}{30\%\ 5\ 15200}$ X 365 = 121 days 1 545 600
vi.	**Average creditors' payment period** 516 400 $\frac{½\ (621\ 600 + 411\ 200)}{2\ 415\ 000}$ X 365 = 78 days

5.4 SOLVENCY

5.4.1 Solvency ratio = Total Assets : Total Liabilities

- It indicates whether or not the business can meet (pay) its liabilities.
- A business is solvent if its assets exceed its liabilities.

5.4.2 Net Asset = Total Assets - Total Liabilities

LET'S PRACTICE SOLVENCY RATIOS

Use the practice information on page 7 to calculate the following ratios. Round off your answers to one decimal point.

1. Solvency ratio
2. Solvency

1. **Solvency ratio**

$$\underbrace{(6\,947\,700 + 973\,200)}_{7\,920\,900} : \underbrace{(1\,000\,000 + 696\,900)}_{1\,696\,900} = 4{,}7 : 1$$

2. **Solvency**

7 920 900 - 1 696 900 = 6 224 000

5.5 RETURN

5.5.1 Return on Shareholders' Equity

$$\frac{\text{Net Profit}}{\text{Average Owner's Equity}} \times \frac{100}{1} = \_\_\_\_\_ \%$$

- It indicates the return the owners' have received on their investment in the business.
- Should the owners rather have invested elsewhere?
- Compare it to returns achieved at financial institutions.

5.5.2 Earnings per share

$$\frac{\text{Net Profit}}{\text{Number of Shares issued}} \times \frac{100}{1} = \_\_\_\_\_ \text{ cents}$$

- Establish if purchasing the shares was worthwhile and whether or not the company has long-term sustainability and growth potential.

5.5.3 Dividends per share

$$\frac{\text{Ordinary Share Dividends}}{\text{Number of Shares issued}} \times \frac{100}{1} = \_\_\_\_\_ \text{ cents}$$

- Earnings are distributed to shareholders as dividends, but some earnings are retained to ensure future growth.

5.5.4 Net Asset value per share

$$\frac{\text{Ordinary Shareholder's Equity}}{\text{Number of Shares issued}} \times \frac{100}{1} = \_\_\_\_\_ \text{ cents}$$

This represents the intrinsic value of the share, i.e. a more realistic value, based on the performance of the undertaking over the years and the growth of the business, including acquisition of assets and additional shares being issued.

LET'S PRACTICE RETURN RATIOS

Use the practice information on page 7 to calculate the following ratios. Round off your answers to one decimal point.

a. Return on shareholders' equity
b. Earnings per share (EPS)
c. Dividends per share (DPS)
d. Net asset value per share (NAV)

a.	**Return on shareholders' equity** $\frac{735\ 700}{½\ (6\ 224\ 000 + 5\ 058\ 300)}$ X 100 = 13% 5 641 150
b.	Earnings per share (EPS) $\frac{735\ 700}{450\ 000}$ X 100 = 163,5 cents
c.	Dividends per share (DPS) $\frac{180\ 000 + 220\ 000}{450\ 000}$ X 100 = 89 cents
d.	Net asset value per share (NAV) $\frac{6224\ 000}{450\ 000}$ X 100 = 1383 cents

5.4 FINANCIAL RISK/GEARING

5.6.1 Debt-equity ratio (gearing)

Non-Current Liabilities: Shareholders' Equity

- It provides insight into the **capital structure** of the business.
- A ratio of 0,52:1 indicates that for every R1 of capital invested by the shareholders, 52c was raised through long-term loans.
- It also indicates the ability of the business to raise additional capital throughlong-term loans.
- A lower ratio indicates that the business has a higher creditworthinessand that it should therefore be able to obtain additional financing easily.
- It is favourable for the business to make use of borrowed capital when interest ratesare lower than the return that can be earned by the businessin using those funds.

5.6.2 Return on total capital employed

$$\frac{\text{Net Profit Before Tax}}{\text{Average Shareholders + Avarage Loans}} \times \frac{100}{1} = \_\_\_\_\_ \%$$

- Compare the figure to last year and indicate whether it has improved or deteriorated.
- Is it above or below the interest rate on loans?
- If it is above, it indicates positive gearing; therefore, it is favourable to use loans.
- If it is below, it indicates negative gearing; therefore, it is unfavourable to use loans and the business should consider paying loans off quickly.

LET'S PRACTICE FINANCIAL RISK/GEARING RATIOS

Use the practice information on page 7 to calculate the following ratios. Round off your answers to one decimal point.

i. Debt/equity ratio
ii. Return on average capital employed (ROTCE)

i.	**Debt/equity ratio** 1 000 000 : 6 224 000 = 0,2 : 1 (0,16 : 1)
ii.	**Return on average capital employed (ROTCE)** $\frac{1\ 051\ 000 + 133\ 960}{(6\ 224\ 000 + 1\ 000\ 000 + 5\ 058\ 300 + 1\ 600\ 000} \times 100 = 17{,}1\%$

5.7 COMMENTING ON FINANCIAL INDICATORS

Steps to follow when you are required to comment on financial indicators:

- Consider what the question is asking you to analyse (e.g. liquidity). Decide on the relevant financial indicator(s).
- Name the financial indicator(s), giving figures or ratios or percentages.
- Compare the current year's indicator(s) with that of the previous year. Say whether it has increased or decreased.
- *If possible, provide a general comment.

Hint: Use short sentences and point form when commenting.

EXAMPLE 1

Financial indicator	**2016**	**2017**
Current ratio	1,6 : 1	2,3 :1
Acid test ratio	0,7 : 1	1,5 : 1

- Current ratio has improved from 1,6 : 1 to 2,3 : 1
- Acid test ratio has improved from 0,7 : 1 to 1,5 : 1
- This company is in a good liquidity position and should be able to pay its short-term debt easily.

EXAMPLE 2

Financial indicator	**2016**	**2017**
Earnings per share (EPS)	85c per share	55c per share
Dividends per share (DPS)	75c per share	60c per share

- EPS has declined from 85c to 55c per share.
- DPS has declined from 75c to 60c per share.
- In 2016, the EPS was 85c, while the DPS was 75c per share. This means that the company retained 10c per share for future growth.
- In 2017, the company earned 55c per share, but gave the shareholders 60c per share; therefore none of this year's profits were retained.

5.8 ACTIVITIES

ANALYSIS AND INTERPRETATION ACTIVITIES

ACTIVITY 1

CONCEPTS

Required:

Complete the following sentences using the words in the list below. Write only the word next to the question number. **(5)**

liquid; profitable; solvent; return; risk/gearing
a) A company with total assets exceeding total liabilities is.......... b) A company thatrelies heavily on loans will have high……....... c) A company thatcontrols its income and expenses properly will be……... d) The percentage net income on equity indicates the ...... earned by shareholders. e) A company thatis able to settle its immediate debts is..............

ACTIVITY 2

(Modified from Nov 2014 DBE QP) **(32 Marks; 19 Minutes)**

REQUIRED

SMITH TRADERS

2.1 Calculate the following financial indicators for the financial year ended 28 February 2014:

2.1.1Solvency ratio (4)

2.1.2Net asset value per share (3)

2.1.3Debt-equity ratio (3)

2.2 Comment on the liquidity position of the company. Quote THREE relevant financial indicators (actual figures/ratios/percentages) and their trends. (9)

2.3 The directors decided to increase the loan during the current financial year. Quote TWO financial indicators (actual figures/ratios/percentages) that are relevant to their decision. Explain why this was a good decision, or not. (8)

2.4 The Bakker family owns 740 000 shares in this company.

Explain the effect that the repurchase of shares on 31 December 2013 hadon their control of the company.

Give a calculation to support your answer. (5)

INFORMATION:

A. Extract from the Income Statement for the year ended 28 February 2014:

Interest on loan (all capitalised)	88 500
Net profit before tax	1 575 000
Income tax	441 000

B. Extract from the Balance Sheet as at:

	28 Feb. 2014	28 Feb. 2013
Current assets	**3 337 300**	**4 641 000**
Inventories	818 200	641 000
Trade debtors	2 377 600	1 512 000
SARS: Income tax	128 000	-
Cash and cash equivalents	13 500	2 488 000
Shareholders' equity	**8 839 000**	**7 400 000**
Ordinary share capital	8 700 000	6 600 000
Retained income	139 000	800 000
Mortgage loan: Excel Bank (interest rate: 12,5% p.a.)	**908 000**	**508 000**
Current liabilities	**2 063 700**	**1 302 000**
Trade creditors	678 700	700 000
Shareholders'for dividends	870 000	480 000
Bank overdraft	515 000	-
SARS: Income tax	-	122 000

C. Shareholders' register:

DATE	DETAILS
1 March 2013	1 200 000 shares in issue.
31 March 2013	300 000 shares issued at R8 each.
31 December 2013	The company bought back 50 000 shares from a dissatisfied shareholder, S Smit, at R9,50 each. The average price of all shares issued to date was R6 per share.
28 February 2014	1 450 000 shares in issue.

D. Dividends for the financial year ending 28 February 2014:

Interim dividends paid on 31 August 2013	R750 000
Final dividends declared on 28 February 2014	R870 000

E. Financial indicators:

	28 Feb. 2014	28 Feb. 2013
Debt-equity ratio	?	0,1 : 1
Net asset value per share (NAV)	?	617 cents
Current ratio	1,6 : 1	3,6 : 1
Acid-test ratio	1,2 : 1	3,1 : 1
Stock turnover rate	6,8 times p.a.	5,1 times p.a.
Debtors' collection period	40 days	35 days
% return on average capital employed	18,8%	16,4%

ACTIVITY 3

(Modified from Nov 2015 DBE QP) **(38 Marks; 23Minutes)**
REQUIRED

3.1 CONCEPTS

Give ONE term for each of thedescriptions below.Choose a term from the list below. Write only the term next to the question number.

directors' report; Balance Sheet; shareholder; director; internal auditor; Cash Flow Statement; independent auditor

3.1.1 A person employed by a company to check and advise management on the financial control systems. (1)

3.1.2 A person appointed by the shareholders who expresses an unbiased opinion on the financial statements of a company. (1)

3.1.3 A person appointed to manage a company and make decisions to ensure it runs smoothly. (1)

3.1.4 The financial statement that shows the financial position of a business on a certain date. (1)

3.2 CEBO LTD

The information below relates to CEBO Ltd.
REQUIRED:

3.2.1 Calculate the following for the financial year ended 28 February 2015.

- Acid-test ratio (4)
- Return on shareholders' equity (ROSHE)
  (Use average equity in your calculation.) (5)
- Net asset value (NAV) per share. (3)

INFORMATION:

A. Figures from the Balance Sheet and notes:

	28 FEBRUARY 2015	28 FEBRUARY 2014
Fixed assets (carrying value)	R4 137 700	R2 598 300
Financial assets (fixed deposit)	350 000	600 000
Current assets	**662 300**	**575 500**
Inventory	322 000	345 000
Trade and other receivables	245 000	228 000
SARS: Income tax	6 400	–
Cash and cash equivalents	88 900	2 500
Shareholders' equity	**3 439 500**	**2 718 000**
Ordinary share capital	2 967 000	2 520 000
Retained income	472 500	198 000
Non-current liabilities	**1 200 000**	**500 000**
Current liabilities	**510 500**	**555 800**
Trade and other payables	323 000	285 000
Shareholders' dividend	187 500	108 000
SARS: Income tax	–	9 800
Bank overdraft	–	153 000

B. Extract from the Income Statement for the year ended 28 February 2015:

Gross profit	R2 040 000
Depreciation	215 100
Operating profit	1 300 000
Interest expense	132 000
Net profit before tax	1 175 000
Net profit after tax	846 000

C. Share capital:

- Authorised share capital consists of 800 000 ordinary shares.
- 150 000 new ordinary shares were issued on 1 October 2014.
- 60 000 ordinary shares were repurchased on 1 January 2015 at 90 cents above the average issue price of R4,30.
- On 28 February 2015, the share register reflected that a total of 690 000 shares had been issued to date.

D. Fixed assets:

- Additional property was purchased for R2 100 000. No other fixed assets were purchased.
- Equipment was sold at carrying value.

3.3 DON LTD AND LAKA LTD

You have R50 000 to invest in a listed company.

You choose to focus on two companies in the same industry.

NOTE: When answering the questions below, compare the information given and quote the relevant financial indicators of both companies (percentages, ratios and/or amounts).

REQUIRED:

3.3.1 Comment on the value of the shares of the two companies listed on the Johannesburg Securities Exchange (JSE). Explain how this will influence your choice of company. (6)

3.3.2 Compare and comment on the dividend pay-out policies of the two companies. (6)

3.3.3 Comment on the degree of risk and gearing. Explain how this will influence your choice of company. (6)

3.3.4 Apart from the points mentioned above, what other factors would you consider before deciding in which company you are going to invest? Explain TWO points. (4)

INFORMATION:

	DON LTD	LAKA LTD
Current ratio	4,3 : 1	1,5 : 1
Acid-test ratio	2,8 : 1	0,8 : 1
Stock turnover rate	4 times	6 times
Stock-holding period	90 days	62 days
Average debtors' collection period	54 days	26 days
Average creditors' payment period	59 days	62 days
Debt-equity ratio	0,3 : 1	1,6 : 1
Return on total capital employed (ROTCE)	15,6%	10,2%
Return on shareholders' equity (ROSHE)	17,2%	9,1%
Earnings per share (EPS)	420 cents	980 cents
Dividend per share (DPS)	360 cents	490 cents
Net asset value per share (NAV)	310 cents	750 cents
Market price of shares on JSE	400 cents	645 cents
Interest rate on loans	11,5%	11,5%

ACTIVITY 4

(Modified from Feb 2016 DBE QP) **(28 Marks; 17Minutes)**

PILLAY LTD

You are provided with information for the financial year ended 28 February 2016, taken from the books of Pillay Ltd. It is a listed public company.

4.1 Calculate the following financial indicators for the financial year ended 28 February 2016. (Round off your calculation to ONE decimal point or the nearest cent, where applicable.)

4.1.1 Net asset value per share (3)

4.1.2 Return on average shareholders' equity (5)

4.1.3 Debt-equity ratio (3)

4.2 Refer to Information E.

4.2.1 The directors are not satisfied with the liquidity position.
Quote and explain THREE relevant financial indicators
(with figures) to support this statement. (6)

4.2.2 The directors decided to increase the loan during the current financial year.
Explain why this was a good decision.
Quote and explain TWO financial indicators
(with figures) in your answer. (8)

4.2.3 The directors were pleased with the price that the
company paid to buy back the 40 000 shares.
Give a suitable reason why the directors felt that way.
Quote relevant financial indicators (with figures) to
support your answer. (3)

INFORMATION:

A. **Extract from the Income Statement for the year ended 28 February 2016:**

Sales	R2 800 000
Net profit before tax	1 240 000
Income tax	**?**
Net profit after tax	892 800

B. **Extract from the Balance Sheet on 28 February 2016:**

	2016	**2015**
Fixed assets (carrying value)	?	?
Fixed deposit: FS Bank	**1 450 000**	**1 200 000**
Current assets	**1 944 280**	**1 010 000**
Inventory	975 700	345 000
Debtors and other receivables	419 000	629 600
SARS (Income tax)	0	17 400
Cash and cash equivalents	549 580	18 000
Shareholders' equity	**5 950 800**	**4 345 000**
Share capital	5 402 000	4 200 000
Retained income	548 800	145 000
Mortgage loan: TKO Bank	**1 950 000**	**400 000**
Current liabilities	**587 200**	**555 000**
Creditors and other payables	437 800	165 000
Accrued expenses	8 700	5 000
SARS (Income tax)	35 700	0
Shareholders' dividend	105 000	275 000
Bank overdraft	0	110 000

C. **Share Capital**

- Authorised share capital is 3 000 000 ordinary shares.
- In 2012, 1 200 000 ordinary shares had been issued at R3,50 per share.
- On 1 November 2015, 300 000 ordinary shares were issued at R4,50 each.
- On 28 February 2016, 40 000 shares were repurchased at R0,60 more than the average price per share.

D. **Dividends**

The directors declared a final dividend of 7 cents per share.
The shares bought back on 28 February 2016 also qualify for the final dividend.

E. **Financial indicators on 28 February:**

	2016	**2015**
Net profit after tax on sales	31,9%	24,5%
Current ratio	3,3 : 1	1,8 : 1
Debtors' collection period	36 days	28 days
Creditors' payment period	45 days	80 days
Acid-test ratio	1,7 : 1	1,2 : 1
Rate of stock turnover	3 times	5 times
Return on shareholders' equity	?	17,5%
Return on total capital employed	24,2%	21,2%
Debt-equity ratio	?	0,09 : 1
Interest rate on loans	10,5%	10,5%
Net asset value per share	?	362 cents
Market value per share	505 cents	480 cents

ACTIVITY 5

(Modified Nov 2016 DBE QP)(49 Marks; 29 Minutes)

REQUIRED

5.1 Choose a term from COLUMN B that matches the description in COLUMN A. Write only the letter (A–D) next to the question number (5.1.1– 5.1.4).

COLUMN A		COLUMN B	
5.1.1	Ability of the business to pay off all its debts.	A	gearing
5.1.2	Ability of the business to pay off its short-term debts.	B	return on equity
5.1.3	The benefit that shareholders receive for investing in the company.	C	solvency
5.1.4	The extent to which a company is financed by loans.	D	liquidity

(4 x 1)

5.2 **REID LTD**

You are provided with information relating to Reid Ltd for the financial year ended 30 June 2016.

Where financial indicators are required to support your answer, name the financial indicator, the actual figure/ratio/percentage and the trend.

REQUIRED:

5.2.1 Calculate the following financial indicators on 30 June 2016:

- Acid-test ratio (4)
- Debt-equity ratio (3)
- % return on average shareholder's equity (ROSHE) (5)
- Net asset value per share (NAV) (3)

5.2.2 The liquidity of the company has improved.
Quote THREE financial indicators to support this statement. (6)

5.2.3 Dividend policy:

- Provide calculations to show the change in the dividend pay-out policy. (4)
- Explain why the directors decided to change the policy.
State ONE point with figures. (2)

5.2.4 Mary is the CEO of the company. Her shareholding is as follows:

NUMBER OF SHARES	DATE PURCHASED	% SHAREHOLDING
420 000	10 January 2015	46,7%

(a) Calculate Mary's % shareholding on
1 October 2015, after the repurchase of shares. (4)

(b) Explain how Mary has benefitted from the decision
to repurchase the shares. (2)

(c) The independent auditor discovered that Mary had made
the decision to repurchase the shares without informing the
board of directors. Why should the independent auditor be
concerned about this? (2)

5.2.5 The Financial Statements reflected fixed assets purchased in the amount of R4,5 million.

- Name TWO major sources of funding for these fixed assets and provide thefigures (over R1 000 000 each). (4)

- State for EACH source whether it was a good or bad decision. Explain your choice. Quote relevant financial indicators/figures to support your opinion. (6)

INFORMATION:

A. Share capital and dividends:

- 900 000 shares were in issue on 1 July 2015.
- 75 000 ordinary shares were repurchased from the estate of a deceased shareholder at R10,70 per share on 1 October 2015.
- The company issued 125 000 ordinary shares at R10,80 per share on 1 April 2016.
- The 2016 Cash Flow Statement reflected dividends paid of R434 250.

B. **Extract from Income Statement for the year ended 30 June 2016:**

	R
Sales	5 220 000
Cost of sales	3 600 000
Operating profit	1 295 000
Income tax	190 500
Net profit after tax	444 500

C. **Extract from Balance Sheet on 30 June:**

	2016	2015
	R	R
Fixed assets (carrying value)	17 420 950	14 683 300
Fixed deposit: Ken Bank	250 000	380 000
Current assets	**1 015 000**	**456 000**
Inventories (only trading stock)	564 000	281 500
Trade and other receivables (debtors)	246 000	167 000
Cash and cash equivalents	205 000	7 500
Shareholders' equity	**10 050 750**	**9 540 000**
Ordinary share capital	?	9 180 000
Retained income	?	360 000
Loan: Barbie Bank	**8 000 000**	**4 500 000**
Current liabilities	**635 200**	**1 479 300**
Trade and other payables	420 000	683 400
Shareholders' dividend	209 000	162 000
SARS: Income tax	6 200	23 400
Bank overdraft	-	610 500

D. **The following financial indicators were calculated on 30 June:**

	2016	2015
Current ratio	1,6 : 1	0,3 : 1
Acid-test ratio	**?**	0,1 : 1
Stock turnover rate	8,5 times	10 times
Debtors' collection period	36 days	43 days
Creditors' payment period	63 days	63 days
Solvency ratio	2,2 : 1	2,6 : 1
Debt-equity ratio	**?**	0,5 : 1
Return on total capital employed (ROTCE)	8,2%	9,5%
Return on shareholders' equity (ROSHE)	**?**	6,2%
Earnings per share (EPS)	51 cents	58 cents
Dividends per share (DPS)	55 cents	35 cents
Net asset value per share (NAV)	**?**	1 060 cents
Market price	1 000 cents	1 030 cents
Interest rate on loans	12%	12%

ACTIVITY 6

(Modified Nov 2017 DBE QP) **(50 Marks; 30Minutes)**

REQUIRED

6.1 Choose a term to complete each of the following statements.
Write only the term next to the question number (6.1.1– 6.1.4).

shareholder(s); external auditor(s); director(s); internal auditor(s)

6.1.1 …… are appointed by the shareholders to manage the company.
6.1.2 The ……. is employed by the company to set up functional internal control processes.
6.1.3 A …… is a person who invests in a company by buying shares.
6.1.4 ……. are appointed by shareholders to give an unbiased opinion on the financial statements. (4 x 1) (4)

6.2 **FINE LTD**
The given information relates to Fine Ltd for the financial year ended 31 August 2017.

REQUIRED:

6.2.1 Calculate the following financial indicators on 31 August 2017:
- Percentage operating profit on sales (3)
- Debt-equity ratio (4)

6.2.2 Calculate the dividends per share (DPS) of a shareholder who owned the same number of shares for the entire financial period. (4)

INFORMATION:

A. Information from the Income Statement for the financial year ended 31 August 2017:

	R
Sales	8 652 000
Operating expenses	1 760 000
Depreciation	320 000
Interest expense	86 100
Operating profit	697 000
Income tax	187 770
Net profit after income tax	438 130

B. **Information from the Balance Sheet on 31 August:**

	2017 (R)	2016 (R)
Fixed assets (carrying value)	6 177 000	4 975 000
Fixed deposits	220 000	300 000
Loan: Dolphin Bank	985 000	450 000
Current assets	619 600	663 300
Current liabilities	490 000	614 300
Shareholders' equity	?	?
Ordinary share capital	5 292 000	?
Retained income	?	147 370
Cash and cash equivalents	23 400	2 500
Bank overdraft	-	65 100
Shareholders' dividend	168 000	120 000
SARS: Income tax	11 800 (Cr)	2 400 (Dr)

C. **Share capital and dividends**

- The authorised share capital comprises 1 200 000 ordinary shares.
- 900 000 ordinary shares were in issue on 1 September 2016.
- The company issued 150 000 ordinary shares at R6,30 per share on 1 May 2017.
- 70 000 ordinary shares were repurchased from shareholders on 30 August 2017. A cheque for R437 500 was issued for these shares. These shareholders qualify for a final dividend.
- An interim dividend of 12 cents per share was paid on 1 February 2017.
- A final dividend was declared on 30 August 2017.

6.3 CASTRO LTD AND PETER LTD

You are provided with information relating to two companies.

BACKGROUND INFORMATION:

- Henry Harries owns 300 000 shares in each company.
- **Castro Ltd** issued 200 000 new shares to existing shareholders at the average issue price (R9,10). These funds were used to establish a new branch. No new loans were raised.
- **Peter Ltd** paid R4 800 000 to repurchase 320 000 shares.

REQUIRED:

NOTE: Where comments or explanations are required, quote financial indicators and figures to support your answer.

CASTRO LTD

6.3.1 Comment on the price of R9,10 charged by Castro Ltd for the new shares issued. (3)

6.3.2 Explain how the issue of new shares has affected the financial gearing and risk of Castro Ltd. Quote TWO financial indicators. (6)

6.3.3 Henry had the option to buy some of the new shares issued by Castro Ltd. He had saved sufficient funds (interest rate 5% p.a.) for this purpose.

- If Henry wanted to retain his 60% shareholding in the company, how many shares would he have had to buy and how much would he have had to pay? (5)

- Henry decided NOT to buy these shares. Apart from the % shareholding, explain TWO reasons why he has made a mistake by not taking up this option. (6)

PETER LTD

6.3.4 Comment on the liquidity of Peter Ltd. Quote TWO financial indicators. (6)

6.3.5 Comment on the price paid by Peter Ltd for the repurchase (buy-back) of shares. (3)

6.3.6 Explain THREE ways in which Henry has benefited from the repurchase of shares by Peter Ltd. (6)

ADDITIONAL INFORMATION:
Financial indicators and additional information from annual reports:

	CASTRO LTD		PETER LTD	
	2017	**2016**	**2017**	**2016**
Debt-equity ratio	0,5 : 1	0,8 : 1		
Current ratio			1,9 : 1	3,5 : 1
Acid-test ratio			1,1 : 1	1,7 : 1
Stock-holding period			54 days	54 days
Number of shares in issue	700 000	500 000	580 000	900 000
Average share issue price	R9,10		R10,20	
Price paid for share repurchase			R15,00	
Price of share on JSE	R12,00		R15,00	
Net asset value per share	R10,73	R11,38	R13,30	R13,22
% return on shareholders' equity	23%	17%	16%	13%
% return on total capital employed	20%	15%		
Earnings per share	140 cents	196 cents	266 cents	171 cents
Total dividends	R357 000	R325 000	R928 000	R928 000
Dividends per share	51 cents	65 cents	160cents	103 cents

6. CHECK YOUR ANSWERS

SOLUTION FOR ACTIVITY 1

(a) solvent ✓ (b) risk/gearing ✓ (c) profitable✓ (d) return ✓ (e) liquid ✓**(5)**

SOLUTION FOR ACTIVITY 2

2.1 2.1.1 Calculate the solvency ratio for 2014.

8 839 000 + 908 000 + 2 063 700 : 908 000 + 2 063 700

11 810 700✓✓ : 2 971 700✓

3.97 : 1 or 4 : 1☑one part correct

2.1.2 Calculate the net asset value per share for 2014.

$\frac{8\ 839\ 000 ✓}{1\ 450\ 000 ✓} \times \frac{100}{1}$

= 610 cents ☑one part correct; R or c or 609,6 cents or R6,10

3

2.1.3 Calculate the debt-equity ratio for 2014.

908 000 ✓: 8 839 000 ✓

= 0,1 : 1 ☑one part correct; must be x:1

3

2.2 Comment on the liquidity position of the company. Quote THREE relevant financial indicators (actual figures/ratios/percentages) and their trends.

Any THREE valid financial indicators:

Name of financial indicator ✓✓✓

Figure and trend: ✓✓✓

- Current ratio: 3,6 : 1 → 1,6 : 1 / decreased to 1,6 : 1
- Acid test ratio: 3,1 : 1 → 1,2 : 1 / decreased to 1,2 : 1
- Stock turnover rate: 5,1 → 6,8 times p.a./ increased to 6,8 times
- Debtors' collection period: 35 → 40 days / increased to 40 days

9

2.3 The directors decided to increase the loan during the current financial year. Quote TWO financial indicators (actual figures/ ratios/percentages) that are relevant to their decision. Explain why this was a good decision, or not.

ROTCE ✓

- This is 18,8% ✓

DEBT/EQUITY RATIO ✓

- This is 0,1 : 1 (see 4.4.2)☑

Explanation:

- It is positively geared as ROTCE is higher than interest rate ✓✓
- There is a low financial risk / It is not making much use of loans, as it relies more on funds from internal sources.✓✓

8

2.4

The Bakker family owns 740 000 shares in this company. Explain the effect that the repurchase of shares on 31 December 2013 had on their control of the company. Give a calculation to support your answer.

Before the repurchase, the family's shareholding was:

$$\frac{740\,000 \checkmark}{1\,500\,000} \times \frac{100}{1} = 49{,}3\% \checkmark$$

After the repurchase, the family's shareholding is:

$$\frac{740\,000 \checkmark}{1\,450\,000} \times \frac{100}{1} = 51{,}0\% \checkmark$$

The family is now the majority shareholder. ✓

5

SOLUTION FOR ACTIVITY 3

3.1

3.1.1	Internal Auditor	✓
3.1.2	Independent Auditor	✓
3.1.3	Director	✓
3.1.4	Balance Sheet	✓

4

3.2

Calculate the acid-test ratio for 2015.

340 300
(662 300 ✓ – 322 000 ✓) : 510 500 ✓
OR 245 000 + 6 400 + 88 900
2 marks

= 0,7 : 1 ☑one part correct in the form x : 1OR 0,67:1 **OR** 0,66:1 **NOT** 0,6:1

4

Calculate the return on shareholders' equity (ROSHE) for 2015. (Use average equity in your calculation.)

$$\frac{846\ 000\ ✓}{½ ✓(2\ 718\ 000\ ✓ + 3\ 439\ 500\ ✓)} \times \frac{100}{1}$$

3 078 750 (3 marks)

= 27,5% ☑one part correct
OR 27,47% OR 27,48%

5

Calculate the net asset value per share (NAV).

3 439 500 ✓ ÷ 690 000 ✓ x 100 = 498,5 cents ☑OR R4,99 one part correct
OR 499 centsOR 498,47 cents OR 498,48 cents

3

3.3 DON LTD AND LAKAY LTD

3.3.1 **Comment on the value of the shares of the two companies on the Johannesburg Securities Exchange (JSE). Explain how this will influence your choice of company.**

Financial indicators or explanations thereof; with figures		✓✓
Don Ltd	✓✓ JSE price 400c > NAV 310c	I would invest in Don Ltd, as the shares seem to be in good demand. **OR** I would not invest in Don Ltd, as the shares might be over-priced. **OR**
Lakay Ltd	✓✓ JSE price 645c < NAV 750c	I would invest in Lakay Ltd, as the shares seem to be under-valued. **OR** I would not invest in Lakay Ltd, as the shares might be in low demand.

6

3.3.2 **Compare and comment on the dividend pay-out policies of the two companies.**

Financial indicators or explanations thereof; with figures		Comparison and comment ✓✓
Don Ltd	DPS 360 cents ✓ EPS 420 cents ✓ **OR** Distributes 86% of earnings 2 marks	Don Ltd is distributing a higher percentage of income earned.Lakay Ltd has decided to retain half of EPS. **OR** Don Ltd appears to keep shareholders satisfied by giving them good dividends.Lakay Ltd appears to have plans for growth (better long-term benefits) / equalisation of dividends over time.
Lakay Ltd	DPS 490 cents ✓ EPS 980 cents ✓ **OR** Distributes 50% of earnings2 marks	

6

3.3.3 **Comment on the degree of risk and gearing. Explain how this will influence your choice of company.**

Financial indicators or explanations thereof with figures		Comparison, must involve a choice ✓✓
Don Ltd	D/E ratio 0,3 : 1 ✓ ROTCE 15,6% ✓ **OR** ROTCE >11,5%	I choose Don Ltd, as the financial risk is lowand gearing is positive (ROTCE exceeds interest). **OR** I choose Don Ltd for its positive gearing (ROTCE exceeds interest) but they are not making effective use of loans. **OR** I do not choose Lakay Ltd, as there is high financial risk and negative gearing / Too much money was borrowed and it is not able to use the funds effectively. **OR** **I** choose Lakay Ltd, as there is high use of loans and, if they can improve efficiency (ROTCE), profit would improve significantly.
Lakay Ltd	D/E ratio 1,6 : 1 ✓ ROTCE 10,2% ✓ **OR** ROTCE < 11,5%	

6

3.3.4 **Apart from the points mentioned above, what other factors would you consider before deciding in which company you are going to invest? Explain TWO points.**

Any two valid factors with explanation/ figures as explanation.✓✓✓✓

- **ROSHE**: Don Ltd's return (17,2%)is much higher than that of Lakay Ltd (9,1%).
- **Liquidity**: Lakay Ltd has a better current ratio (1,5:1) / acid-test ratio (0,8:1).
- **Stock turnover**: Lakay Ltd is managing stock more efficiently (62 days).
- **Debtors' collection**: Lakay Ltd's collection period is good (26 days).
- **Corporate social responsibility**: This indicates the good reputation of company (King Code).
- **Directors**: Good professionalism will benefit the company and shareholders.
- **Audit report**: It indicates whetherthe auditors have detected any problems or not.

4

SOLUTION FOR ACTIVITY 4

4.1.1 **Calculate the net asset value per share.**

5 950 800✓ x 100 = 396,7 cents ☑One part correct
1 500 000✓ 1

OR5 950 800 x 100 = 407,6 cents
1 460 000 1

3

4.1.2 **Calculate the return on average shareholders' equity.**

892 800 ✓ x 100 = 17,3%☑One part correct
½ ✓(5 950 800✓ + 4 345 000)✓ 1
5 147 9003 marks

5

4.1.3 **Calculate the debt-equity ratio.**

1 950 000 ✓: 5 950 800 ✓
0,3: 1 ☑One part correct

3

4.2.1 **The directors are not satisfied with the liquidity position. Quote and explain THREE relevant financial indicators (with figures) to support this statement.**

Ratio ✓✓✓Trend and figures ✓✓✓

- Current ratio increased from 1,8 : 1 in 2015 to 3,3 : 1 in 2016.
- Acid test ratio increased from 1,2 : 1 in 2015 to 1,6 : 1in 2016.
- The stock turnover rate declined from 5 times in 2015 to3 times in 2016.

Debtors' Collection and Creditors' Payment Period not accepted.

6

4.2.2 **The directors decided to increase the loan during the current financial year. Explain why this was a good decision. Quote and explain TWO financial indicators (with figures) in your answer.**

Ratio ✓✓
Figures and trend ✓✓
Comment beyond trend ✓✓✓✓

ROTCE

- This has increased from 21,2% to 24,2%.
- Positively geared, as ROTCE is higher than the interest rate (10,5%).

DEBT-EQUITY RATIO

- This has increased from 0,09 : 1 to 0,33 : 1 see 5.5.3.
- There is low financial risk./ It is not making much use of loans. It relies more on own funds.

8

4.2.3 **The directors were pleased with the price that the company paid to buy back the 40 000 shares. Give a suitable reason why the directors felt that way. Quote relevant financial indicators(with figures) to support your answer.**

Reason ✓✓ Relevant figure ✓

The company paid R4,30 per share to buy back shares. This is lower than the market value per share (2015 – 480 cents; 2016 – 505 cents).

(Not a big difference compared to the NAV – 362 cents and 408 cents.)

Average issue price was R3,70.

The shares were purchased at a lower price than the issue price of the additional shares, i.e. (R4,50).

3

SOLUTION FOR ACTIVITY 5

5.1

5.1.1	C	✓	Solvency
5.1.2	D	✓	Liquidity
5.1.3	B	✓	Return on equity
5.1.4	A	✓	Gearing

4

5.2.1

Calculate the acid-test ratio on 30 June 2016.

1 015 000 one mark – 564 000 one mark
451 000 two marks

(246 000 ✓ + 205 000 ✓) : 635 200 ✓ = 0,7 : 1 ☑One part correct; must be y:1

4

Calculate the debt-equity ratio on 30 June 2016.

8 000 000 ✓ : 10 050 750 ✓ = 0,8 : 1 ☑One part correct; must be y:1Accept 0,79 : 1.

3

Calculate the % return on average shareholders' equity (ROSHE) for the year ended 30 June 2016.

$$\frac{444\,500✓}{½ ✓ (10\,050\,750✓ + 9\,540\,000✓)} \times \frac{100}{1}$$

9 795 375three marks

= 4,5% ☑One part correct; % sign not essential; cannot be Rands, cents, units, etc.

5

Calculate the net asset value per share (NAV) on 30 June 2016.

$$\frac{10\,050\,750 ✓}{950\,000 ☑} \times 100 = 1058 \text{ cents} ☑$$

One part correct**OR** R10,58 **OR** 1057,9 cents.

See 4.2.1

3

5.2.2

The liquidity of the company has improved. Quote THREE financial indicators to support this statement. Provide figures and trends.

THREE valid indicators ✓✓✓Figures and trends ✓✓✓

Current ratio – 0,3 : 1 to 1,6 : 1
Acid-test ratio – 0,1 : 1 to 0,7 : 1see 4.2.4
Debtors' collection period – 43 days to 36 days.

6

5.2.3

Provide calculations to show the change in the dividend pay-out policy.

Comparison of DPS to EPS for 2015 ✓ Calculation / implied calculation ✓
Comparison of DPS to EPS for 2016 ✓ Calculation / implied calculation ✓
Possible calculations for two marks each:

- 2015: 35/58 = 60,3% **OR** 0,6:1 **OR**It paid out most of its earnings/more than 50%.
- 2016: 55/51 = 107,8% **OR** 1,1:1 **OR**It paid out more than its earnings.

Possible responses for one mark each:

- 2015: It paid out 35c of 58c earnings. / It retained 23c of 58c earnings.
- 2016: it paid out 55c of 51c earnings. / It paid out 4c from previous earnings.

4

Explain why the directors decided to change the policy. State ONE point and include figures. Any ONE valid explanation ✓ Relevant figures ✓ Responses for two marks: To satisfy shareholders, as: • ROSHE decreased (from 6,2%) to 4,5%. see 4.2.4 • Market price decreased (from 1030 cents) to 1000 cents. • EPS decreased (from 58 cents) to 51 cents.	2

5.2.4

(a) Calculate Mary's % shareholding on 1 October 2015 after the repurchase of the shares. $\frac{420\ 000✓}{(900\ 000✓ - 75000✓)}$ x 100 = 50,9% ☑One part correct 825 000 two marks	4
(b) Explain how Mary has benefitted from the decision to repurchase the shares. Explanation ✓✓ Mary became the majority shareholder.	2
(c) The independent auditor discovered that Mary had made the decision to repurchase the shares without informing the board of directors. Why should the independent auditor be concerned about this? Responses for two marks:✓✓Part-mark for unclear / incomplete answer • This is not good corporate governance. / This is not in accordance with the King Code. • The CEO cannot make these decisions without getting board approval. • This is considered to be insider trading. / This is an abuse of position for personal benefit. • Unethical. / Not transparent.	2

5.2.5

The Cash Flow Statement reflected fixed assets purchased in the amount of R4,5 million. Source and decision must match source. Explanation must be relevant to the source.

Major sources of funding with figures (over R1 000 000 each)	Good/Bad decision	Explanation with financial indicators/figure Explanation ✓ ✓ Figures ✓ ✓
Source 1: Increase in loan - R3 500 000 Source ✓ Figures✓	Bad ✓	The company is negatively geared. ROTCE (8,2%) is lower than the interest rate on loans (12%). **OR** Financial risk increased. The debt-equity ratio increased from 0,5 : 1 to 0,8 : 1. (See 4.2.4)
Source 2: Issue of shares - R1 350 000 Source ✓ Figures ✓	Good ✓	Shares were sold for R10,80 per share, which is greater than the market price of R10,30 (2015) or R10,00 (2016) or NAV of R10,60. **OR** If this amount were borrowed, interest of 12% would be payable. / It has reduced the risk, as the D/E ratio would have been higher than 0,8:1. **OR** Mary is no longer the majority shareholder. She owns 44% of the shares.

10

SOLUTION FOR ACTIVITY 6

6.1

6.1.1	Directors	✓
6.1.2	Internal auditor	✓
6.1.3	Shareholder	✓
6.1.4	External auditors	✓

4

6.2.1 **Calculate the percentage operating profit on sales.**

$\frac{697\ 000 ✓}{8\ 652\ 000 ✓}$ x 100 = 8,1% ☑one part correct

3

Calculate the debt-equity ratio.

5 542 000 two marksSee 4.2.1

985 000 ✓ : (5 292 000 ✓ + 250 000 ☑) = 0,2 : 1☑one part correct

4

6.2.2 **Calculate the dividends per share (DPS) of a shareholder who owned the same number of shares for the entire financial period.**

900 000 + 150 000

(168 000✓/1 050 000 ✓x 100) + 12 cents ✓ = 28 cents ☑one part correct

16 cents two marks

4

6.3 **CASTRO LTD**

6.3.1 **Comment on the price of R9,10 charged by Castro Ltd for the new shares issued.**

Compare issue price to market price or NAV✓✓
Figures R12,00 or R10,73 ✓

Expected responses:

- The shares were issued at the average share issue price.
  The existing shareholders are being rewarded, as the price is lower than the R12,00 charged on the JSE and the NAV of R10,73.
- The shares could have been issued at the market price of R12,00 or the NAV of R10,73. (They have diluted the value of the shares.)

3

6.3.2 **Explain how the issue of new shares has affected the financial gearing and risk of Castro Ltd. Quote TWO financial indicators.**

Explanation ✓✓Financial indicators ✓✓ Figures ✓✓

Expected responses:

one mark

- Gearing has improved – less risk (as there was an issue of new shares)
  one markone mark
  Debt-equity ratio decreased from 0,8 : 1 to 0,5 : 1 (by 0,3 : 1)

  one markone mark
- ROTCE improved(due to increased efficiency / profits on new branch)
  one mark
  from 15 % to 20 % (by 5% or 33,3%)
  May also compare ROTCE to their estimate of current interest rate.

6

6.3.3

If Henry wanted to retain his 60% shareholding in the company, how many shares would he have had to buy? ✓✓☑one part correct (700 000 x 60%) – (500 000 x 60%) = 120 000 420 000 300 000 ORtwo marksone method mark (if x 60%) 200 000 x 60% = 120 000	3
How much would he have had to pay? ☑☑one part correct 120 000 shares at R9,10 each = R1 092 000	2
Henry decided NOT to buy these shares. Apart from the % shareholding, explain TWO reasons why he has made a mistake by not taking up this option. Explanation ✓✓✓✓ Figures✓✓ **Expected responses:** • His dividends would have increased by R61 200 (51c x 120 000 shares). This is more than the interest he earned on the savings account, i.e. R54 600 (1 092 000 see above x 5%). • He could have bought the shares for capital growth: he could have bought the shares for R9,10 and then sold them on the JSE for R12,00. / Total profit would have been R348 000. / It would have been a good buy, as R12,00 exceeds NAV R10,73. • He would have earned more dividends on the bigger investment (51c/910c = 5,6%). • ROSHE would be 23% on a bigger investment. • He would lose 120 000 votes at the AGM.	6

PETER LTD

6.3.4

Comment on the liquidity of Peter Ltd. Quote TWO financial indicators. Explanation: ✓✓ The liquidity situation has improved./ It is able to meet its current debts. / Liquidity ratios have decreased. / Liquidity ratios are more efficient. Financial indicators any two✓✓Figures ✓✓ • Current ratio has improved/decreased (from 3,5 : 1) to 1,9 : 1. • The acid-test ratio has improved/decreased (from 1,7 : 1) to 1,1 : 1. • The stock-holding period appears to be efficient at 54 days (less than 2 months).	6

6.3.5

Comment on the price paid by Peter Ltd for the repurchase (buy-back) of shares.

Expected response: ✓✓

The company is paying a premium above the average share price in order to entice shareholders to give up their shares. / They wanted to increase returns by decreasing equity. / This is a fair value – it is the same as the price on the JSE.

Compare price paid (R15,00) to — Any one figure✓

- market value R15,00
- net asset value R13,30
- average issue price of shares R10,20

3

6.3.6

Explain THREE ways in which Henry has benefited from the repurchase of the shares by Peter Ltd.

Explanation ✓✓✓ Figures ✓✓✓

Expected responses: Three different responses

- He has now become a majority shareholder. His 300 000 shares are 51,7% of the total shares (33,3% before the share buy-back).
- Due to the reduced number of shares, his return has improved, i.e. EPS has increased by 95c / from 171c to 266c / ROSHE increased from 13% to 16%.**(NOTE:** EPS and ROSHE reinforce the same point).
- The reduced number of shares could have contributed to an increase in the DPS by 57c / by 55,3% / from 103c to 160c, (The directors may have maintained the dividend pay-out policy).

6

7. Message to Grade 12 learners from the writers

"Begin with the end in mind."

Stephen Covey

At the end of your journey in the GET phase, you were required to choose a subject set that willshape your career path. Hopefully, your choice was based on your aptitude, ambition and desire to become a successful individual, with a comfortable standard of living.

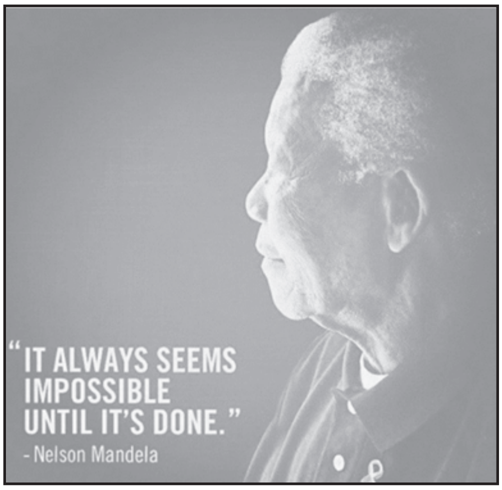
Let's be frank! Accounting is not for the faint-hearted. There are NO short-cuts. Success in Accounting demands hard work and dedication, but the rewards are satisfying.

The questions and topics covered in the examination papers are very predictable. You need to just extract the NSC papers for the last three years from the internet and compare the questions. If you do this, you will become familiar with the commonly asked questions and the style and format of the paper. You will also gain insight into the different ways in which questions can be asked.

Practice every day, do not be afraid to ask questions, engage in group studies and attend the many intervention programmes organized by your school and your Department of Education.

Effective planning ensures that you:

Know the rules of the game, and play it better than others.



8. Thank you

This Accounting module on the Analysis and Interpretation of financial information was developed by Mr P Govender, Mr A Leeuw, Mr M.P Shabalala, Mr Dorian Olifant and Ms ZJM Mampana (Subject Specialists, PED)

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Look out for more modules that deal with other topics of the Grade 12 syllabus.

ACCOUNTING

ANALYSIS AND INTERPRETATION OF FINANCIAL INFORMATION

GRADE 12

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