



The Southern African Institute of Government Auditors

Qualifying Re-examination for Registered Government Auditors

Paper 2: Accounting

March 2009

INSTRUCTIONS TO CANDIDATES

- 1 Maximum marks: **160**.
- 2 Total time available **four hours**.
- 3 The marks allocated to each question are an indication of the expected length and required depth of the answer.
- 4 Ensure proper planning and avoid exceeding the time you have allocated for each question as suggested by the number of marks allocated to the question.
- 5 Present your arguments in a clear, well structured manner, using precise language and professional terms, where appropriate.
- 6 No books or notes are allowed in the examination room.
- 7 All working papers must be handed in together with all paper provided for the examination (including unused answer sheets).
- 8 Answers written in pencil will not be marked.
- 9 You are reminded that this examination will be held under the rules as set out in the document "RGA-QE Examination Matters & Examination Policy 2008".
- 10 You are required to observe all Examination Instructions on the separate sheet of paper handed to you before commencement of this examination.

QUESTION 1**(80 marks)****Part A****(70 marks)****Trial balance for the Department of Agricultural Development on 31 March 2008**

	2007/08		2006/07	
	Dr	Cr	Dr	Cr
Recoverable revenue		400		200
Salary deductions to be transferred		580		810
Receipt control account		315		465
Travelling and subsistence claims		67		150
PMG - Cheques payable		148		85
PMG - Electronic fund transfers		235		190
Exchequer grant account	3 700			
Unauthorised expenditure	1 000		1 000	
Fruitless and wasteful expenditure	200		200	
Petty cash advance	40		40	
Paymaster general account	11 118		261	
PMG - Deposit account	32		46	
Paymaster general adjustments account		17		14
Travelling and subsistence advance	135		130	
Staff parking receivable	46		37	
Staff bursaries recoverable	400		200	
General account of the vote		54 100		39 014
Foreign aid assistance received		7 000		6 000
Permits issued		1 240		890
Sale of capital equipment		2 000		1 320
Basic salaries	3 500		3 200	
Employee housing allowances	350		300	
Employee pension fund contributions	467		420	
Employee medical aid contributions	440		410	
Travel and subsistence - local	150		90	
Communication	45		48	
Advertising	31		29	
Stationary and printing	55		57	
Equipment under R5 000	3 564		7 950	
Audit fees - regularity	210		190	
Foreign aid assistance - current	2 579		2 500	
Foreign aid assistance - capital	3 670		3 500	
Transport equipment	9 000		7 000	
Buildings	12 000		10 000	
Land	10 000		9 000	
General account of revenue	3 000		2 210	
Community bursaries	370		320	
	66 102	66 102	49 138	49 138

Additional information:

- 1 The following programme information was made available after the adjusted appropriation:

	2007/08	2006/07
Programme 1: Administration		
Adjusted appropriation	10 820	7 803
Current payments	6 492	4 682
Capital payments	4 328	3 121
Shift funds from current payments to capital payments within Programme 1	200	
Shift funds from current payments Programme 1 to current Payments Programme 2	500	
Actual expenditure	8 036	7 803
Current payments	4 822	4 682
Capital payments	3 215	3 121
Funds requested from revenue fund	10 080	7 803
Programme 2: Farmer support		
Adjusted appropriation	24 345	17 556
Current payments	14 385	10 342
Transfers and subsidies	370	320
Capital payments	9 590	6 895
Shift funds from capital payments Programme 2 to capital payments Programme 3	150	
Actual expenditure	18 082	17 556
Current payments	10 627	10 342
Transfers and subsidies	370	320
Capital payments	7 085	6 895
Funds requested from revenue fund	22 680	17 556
Programme 3: Agricultural planning		
Adjusted appropriation	18 935	13 655
Current payments	11 361	8 193
Capital payments	7 574	5 462
Actual expenditure	14 064	13 655
Current payments	8 438	8 193
Capital payments	5 625	5 462
Funds requested from revenue fund	17 640	13 655

- 2 Unused foreign aid may be rolled over to the next financial year.
- 3 Unauthorised expenditure of R1 000 together with fruitless and wasteful expenditure of R200 was identified in 2005/06. Expenditure on staff bursaries was deemed collectable in 2005/06.
- 4 Salary deductions to be transferred and the receipts that need to be cleared all stem from the month of March 2008.

REQUIRED:
(No comparative figures are needed)

As the Financial Accountant of the Department of Agricultural Development, it is expected of you to compile the Annual Financial Statements for the Department for the financial year ending 31 March 2008.

- 1 Compile an Appropriation Statement for the Department of Agricultural Development for the year ending 31 March 2008. (22)
- 2 Compile a Statement of Financial Performance for the Department of Agricultural Development for the year ending 31 March 2008. (15)
- 3 Compile a Statement of Financial Position for the Department of Agricultural Development on 31 March 2008. (11)
- 4 Show the following notes to the financial statements:
 - 4.1 Annual appropriation.
 - 4.2 Local and foreign aid assistance.
 - 4.3 Cash and cash equivalent.
 - 4.4 Voted funds to be surrendered to the revenue fund.
 - 4.5 Departmental revenue to be surrendered to the revenue fund.
 - 4.6 Payables.
 - 4.7 Net cash flow available from operating activities. (22)

Part B

(10 marks)

In the light of the future application of Generally Recognised Accounting Practice (GRAP) Standards on the recognition and measurement of financial information in the South African public service, explain to your subordinates the requirements of the successful implementation of accrual based accounting in the South African public service. (10)

QUESTION 2

(40 marks)

ASAGU LIMITED, a company (Schedule 2 public entity) listed on the JSE Securities Exchange, was incorporated on 1 April 20X2 and has a 31 March year end. The following information of Asagu Limited for the year ended 31 March 20X7 is provided to you:

- 1 Revenue for the year ended 31 March 20X7 amounted to R45 350 000.
- On 25 March 20X7, a customer bought products to the value of R25 000 (cost of R17 857 to Asagu Limited). The customer paid the full amount in cash immediately and received a trade (volume) discount of R1 000 as well as a 5% cash discount on the full sales value before any discounts and rebates. The items were on hand and ready for delivery. The customer, however, requested that the goods only be delivered at his premises on 5 April 20X7. The items were clearly marked and stored separately and delivery took place on 5 April 20X7, as requested.

This sales transaction was not recognised for the year ended 31 March 20X7, as goods were still on hand.

- On 1 February 20X7, a customer bought goods on lay away for R18 000. Forty percent (40%) of the amount has been received by 31 March 20X7 and this amount is included in the revenue of R45 350 000. From previous experience it has been determined that most such sales are consummated if 60% of the sales value has been received. The cost of sales on this transaction has not been recognised yet, as the items are still on hand and included in inventories at year end. The time value of money is immaterial and can be ignored.
- Invoices for credit sales of R43 500 were only recorded on 2 April 20X6, although the sales transactions had taken place before 31 March 20X6. This was only discovered after the annual financial statements for the year ended 31 March 20X6 were already issued.

Cut-off tests were performed for the year ended 31 March 20X7 to ensure that this does not happen again.

The cost of sales of these transactions amounted to R31 071 (refer no. 2 below).

- One of Asagu Limited's main debtors, with an outstanding balance of R98 000 on 31 March 20X7, was liquidated on 15 May 20X7. Asagu Limited had not been aware of the financial problems that the debtor had been experiencing for many months. According to the lawyers, Asagu Limited will receive R0,20 of every R1 owed to them.
- 2 Cost of sales for the year ended 31 March 20X7 (including the R31 071 above), amounted to R32 393 000.

3 Other income for the year ended 31 March 20X7 amounts to R48 446, before taking the following into account:

3.1 Asagu Limited leases a few offices (an insignificant portion) in its own office block to a company in terms of a non-cancellable operating lease agreement, which commenced on 1 April 20X5.

The lease payments are receivable monthly in arrears and the lease term is for five years. The lease payments increase annually by 6%. During the first year of the lease term, the lease payments amounted to R10 000 per month.

Asagu Limited also receives 0,5% of the profit of the lessor company on 31 March of each year. During the year ended 31 March 20X7, the profit on which the 0,5% is calculated, amounted to R3 000 000.

3.2 Asagu Limited received a government grant on 1 March 20X5 of R500 000 to subsidise certain salaries for a period of five years. The government grant is treated as deferred income and recognised in other income, when applicable.

4 Other expenses for the year ended 31 March 20X7 amount to R942 000 before taking the following items into account:

4.1 Asagu Limited leases equipment in terms of a non-cancellable finance lease agreement. The lease term is for five years and commenced on 1 July 20X5. The fair value of the machine was R1 275 000 and payments of R380 352 are made annually in arrears on 30 June. There is no guaranteed or unguaranteed residual value and there were no initial direct costs. The interest rate implicit in the lease is 15%.

The following amortisation table is provided to you and you must assume that it is correct:

Date	Payment	Capital	Interest	Balance
30/06/X6	380 352	189 102	191 250	1 085 898
30/06/X7	380 352	217 468	162 884	868 430
30/06/X8	380 352	250 088	130 264	618 342
30/06/X9	380 352	287 601	92 751	330 741
30/06/X10	380 352	330 741	49 611	-

It is the accounting policy of Asagu Limited to depreciate equipment on the straight-line method over the estimated useful life of seven years. At the inception of the lease it was not certain whether ownership of the machine would transfer to Asagu Limited at the end of the lease term of five years.

4.2 The land and office building of Asagu Limited (also refer 3.1) is revalued as necessary. The previous revaluation was done on 1 April 20X4 and resulted in a revaluation surplus of R65 000. This was the first revaluation and the second revaluation was done on 1 April 20X6.

The land and office building were acquired in 1 April 20X2 and were immediately ready for use as intended by management. The following information regarding the land and office building are provided to you:

		Land	Office Building
1/04/X2	Cost	500 000	3 800 000
1/04/X4	Net replacement value	515 000	3 470 000
1/04/X6	Net replacement value	495 000	3 000 000

On revaluation, the accumulated depreciation is set-off against the gross carrying amount. The revaluation reserve is realised as the asset is used.

It is the accounting policy of Asagu Limited to depreciate the office building on the straight-line method over its estimated useful life of 20 years, in terms of the cost model in IAS 16 (AC 123), *Property, Plant and Equipment*. The current residual value at initial recognition was estimated at Rnil. The depreciation method, useful life and residual value have been reviewed annually and remained unchanged since acquisition.

- 4.3 Vehicles with a carrying amount of R195 000 on 31 March 20X7 (after correctly accounting for depreciation for the year ended 31 March 20X7) were impaired due to an accident on 31 March 20X7. If the vehicles were repaired (at a cost of R52 000), they could be used again for the remaining useful life of three years and a total net value-in-use of R158 000 is estimated then. If the vehicles are not repaired, they will have no value-in-use and can only be sold for scrap for R35 000. On 30 April 20X7 a contract was signed for the repair of the vehicles.
- 5 The financial statements for the year ended 31 March 20X7 were authorised for issue on 31 July 20X7.

REQUIRED:

- 1 Present the statement of comprehensive income of Asagu Limited for the year ended 31 March 20X7, in accordance with Statements of Generally Accepted Accounting Practice. (30)

Note:

- Round all final calculated amounts to the nearest R1.
- Assume all amounts are material.
- Ignore any taxation implications.
- Comparative amounts are not required.

- 2 Prepare the journal entries (cash transactions included) in the general journal of Asagu Limited for the period 1 July 20X5 to 30 June 20X6 in respect of the finance lease agreement (refer 4.1), in accordance with Statements of Generally Accepted Accounting Practice. (10)

Note:

- Round all final calculated amounts to the nearest R1.
- Assume all amounts are material.
- Ignore any taxation implications.
- Journal narrations are not required.
- Journals must be dated.

QUESTION 3**(40 marks)****PART A****(11 marks)**

The Big City Municipality had been facing shortages of water in its municipal area and approached the Government for assistance. Government decided to give the Big City Municipality a grant to construct additional reservoirs and thus improve its capacity to render a water service to its communities.

The cost of constructing the reservoirs was estimated to be R2 000 000 when the discussions with Government took place. Due to budgetary constraints, Government signed a written agreement that it would make the grant payment to Big City in the form of two payments; one on 1 April 2007 and the second one on 1 April 2008. These grants were received by Big City Municipality on the same dates that they were disbursed by Government.

The condition of the grant is that it must be used solely to construct the reservoirs.

The Municipality commenced construction of the reservoirs on 3 July 2007. The project ended on 31 August 2008. During the course of construction, the following payments were made by the Municipality:

Date	Transaction	Amount R
3 July 2007	Ground-breaking party hosted by the Mayor to celebrate the commencement of construction.	10 000
17 July 2007	Design of the reservoirs paid to ABC Engineers.	50 000
3 August 2007 to 31 March 2008	Payment to RRR Construction Company – Progress Invoices 1 – 8. The payment excluded retentions withheld by Big City Municipality amounting to R150 000.	1 100 000
31 March 2008	The Mayor was delighted with the progress being made with the construction, and with the consent of the Municipal Council, paid the Municipal Manager a performance bonus.	75 000
1 April 2008 – 30 June 2008	Payment to RRR Construction Company – Progress Invoices 9 – 14. The payment excluded retentions withheld by Big City Municipality amounting to R200 000.	1 250 000
31 August 2008	Payment to RRR Construction Company – Progress Invoices 15 – 16. No retention was withheld.	200 000
30 September 2008	Payment of retention on certificates 1 – 14.	350 000

REQUIRED:

- 1 Calculate what revenue should be disclosed in the annual financial statements for the years ended 30 June 2007 and 30 June 2008. You must also prepare the reconciliation of the grant that is disclosed in the annual financial statements. (6)
- 2 Calculate what the value of the reservoirs is as at 30 September 2008 in accordance with GAMAP/GRAP 17. (1)
- 3 Advise the Chief Financial Officer on whether the incomplete reservoirs should be included in the fixed asset register as at 30 June 2007 and 30 June 2008. What advice will you give the Chief Financial Officer? (1)
- 4 Indicate on what date the reservoirs can be used for their intended purpose. (1)
- 5 The Mayor is disappointed with the under-funding by Government. He approaches the Minister of Finance for additional funding. The Minister says he will look into the matter and will officially respond to the Mayor in writing when he has discussed the matter with the National Treasury officials. When preparing annual financial statements for the year ended 30 June 2008, the Mayor suggests to you that the under-funding be included in the accounting records as revenue and a debtor.

Indicate what your response to the Mayor will be (using the principles contained in the GAMAP/GRAP accounting standards). (2)

PART B

(10 marks)

Assume that due to new legislation, a municipality has to set aside 5% of its revenue in a reserve to insure its workforce against work-related injuries and diseases. The amount contributed to the reserve can only be used to pay claims, approved by an occupational specialist, to workers. The reserve must be ring-fenced in the books of municipalities.

Small City Municipality is implementing the new legislation and has opened a separate general ledger account where the following transactions were processed:

Date	Transaction	Amount R
1 July 2007	Contribution of 5% of revenue to the reserve	100 000
17 July 2007	Payment of claims approved by an occupational specialist	(50 000)
30 June 2008	Interest earned on unspent balance of the reserve	10 000
30 June 2008	Balance on the reserve	60 000

REQUIRED:

- 1 Set out whether this account should be shown as either an accrual, provision or reserve in the annual financial statements of Small City Municipality according to accounting standards. Substantiate your answer. (4)
- 2 Assume that the account is a reserve. Record each of the transactions in the annual financial statements. The Statement of Financial Performance, Statement of Financial Position and the Statement of Changes in Net Assets should be disclosed. (6)

PART C**(10 marks)****REQUIRED:**

Answer each question below. Substantiate your answer wherever possible.

- 1 Why is it incorrect for a municipality to show a motor vehicle at a Rnil carrying value in the accounting records whilst the Municipality is still using the motor vehicle for its intended purpose? (2)
- 2 Explain briefly what you understand an impairment of an item of property, plant and equipment to be? (2)
- 3 Where should a computer application system (for example the General Ledger system) be disclosed in the annual financial statements? (1)
- 4 What is the major difference between a provision and a contingent liability? (5)

PART D**(9 marks)**

The Municipality purchases a piece of land that it intends to develop for economic development purposes. The intention is to install services in the property so that buyers can build factories. The municipality incurs the following costs in the year ended 30 June 2008:

Transaction	Amount R
Purchase of the land	100 000
Costs to sub-divide the land into five equal sized parcels of land	500
Constructing a road network to link all the properties to an existing road (the roads will not be transferred to the buyers of the property)	20 000
Construction of water, electricity and sewerage connector services. The intention is that these services are recovered from the buyers of the property as it has increased the value of the land	50 000
Costs not yet incurred	
Anticipated selling costs	10 000

REQUIRED:

- 1 Calculate the value of each property as at 30 June 2008. (3)
- 2 Where will you disclose these properties in the annual financial statements? (1)
- 3 Assuming that a property is sold for R45 000 on 31 July 2008, calculate what the gross profit or loss will be on the date of the sale. (1)
- 4 Prepare the journal entry for the sale referred to in 3 above, assuming that the buyer has paid cash for the property. (3)
- 5 What is the increase in the property, plant and equipment arising from these transactions? (1)