GRADE 12

Accounting

SELF STUDY GUIDE

ANALYSIS AND INTERPRETATION OF INFORMATION

PAPER 1 AND 2

basic education
Department:
Basic Education
REPUBLIC OF SOUTH AFRICA

Second Chance Matric Support Programme

2030 NDP

NATIONAL EDUCATION COLLABORATION TRUST

ETDP•SETA

WOZA MATRICS 2021 CATCH UP

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1. INTRODUCTION

The declaration of COVID-19 as a global pandemic by the World Health Organisation led to the disruption of effective teaching and learning in many schools in South Africa. The majority of learners in various grades spent less time in class due to the phased-in approach and rotational/ alternate attendance system that was implemented by various provinces. Consequently, the majority of schools were not able to complete all the relevant content designed for specific grades in accordance with the Curriculum and Assessment Policy Statements in most subjects.

As part of mitigating against the impact of COVID-19 on the current Grade 12, the Department of Basic Education (DBE) worked in collaboration with subject specialists from various Provincial Education Departments (PEDs) developed this Self-Study Guide. The Study Guide covers those topics, skills and concepts that are located in Grade 12, that are critical to lay the foundation for Grade 12. The main aim is to close the pre-existing content gaps in order to strengthen the mastery of subject knowledge in Grade 12. More importantly, the Study Guide will engender the attitudes in the learners to learning independently while mastering the core cross-cutting concepts.

2. HOW TO USE THIS SELF STUDY GUIDE

This manual addresses content and offer strategies to develop the skill of Analysing and Interpreting financial information, in a piecemeal approach, with consolidation activities to conclude.

The explanations and activities are intended to supplement the work you may have covered in class or have gained from textbooks.

They proceed from the short, simple focused examples to more complex calculations necessary for analysis and interpretation of information.

It is important to allocate sufficient time to:
Carefully read the explanations provided; underline / highlight key concepts, difficult vocabulary, important dates and relevant amounts.
Interrogate the worked example to gain an understanding of the message being conveyed or the sequence of events being illustrated.

Attempt the activities on you own; make constant reference to the explanatory notes, but avoid referring to the suggested answers before completing an activity.

Compare your answers to the suggested answers and do your corrections in a different colour ink pen/pencil. Note that you will learn more by discovering your weaknesses (when you get things wrong), and making an effort to understand why your thinking was out of line.

The activities provided may not be sufficient to perfect your skills. Always refer to similar questions from past examination papers for this purpose.

Become familiar with the use of the Answer Book and prepared writing material as this is the trend with all Accounting examinations.

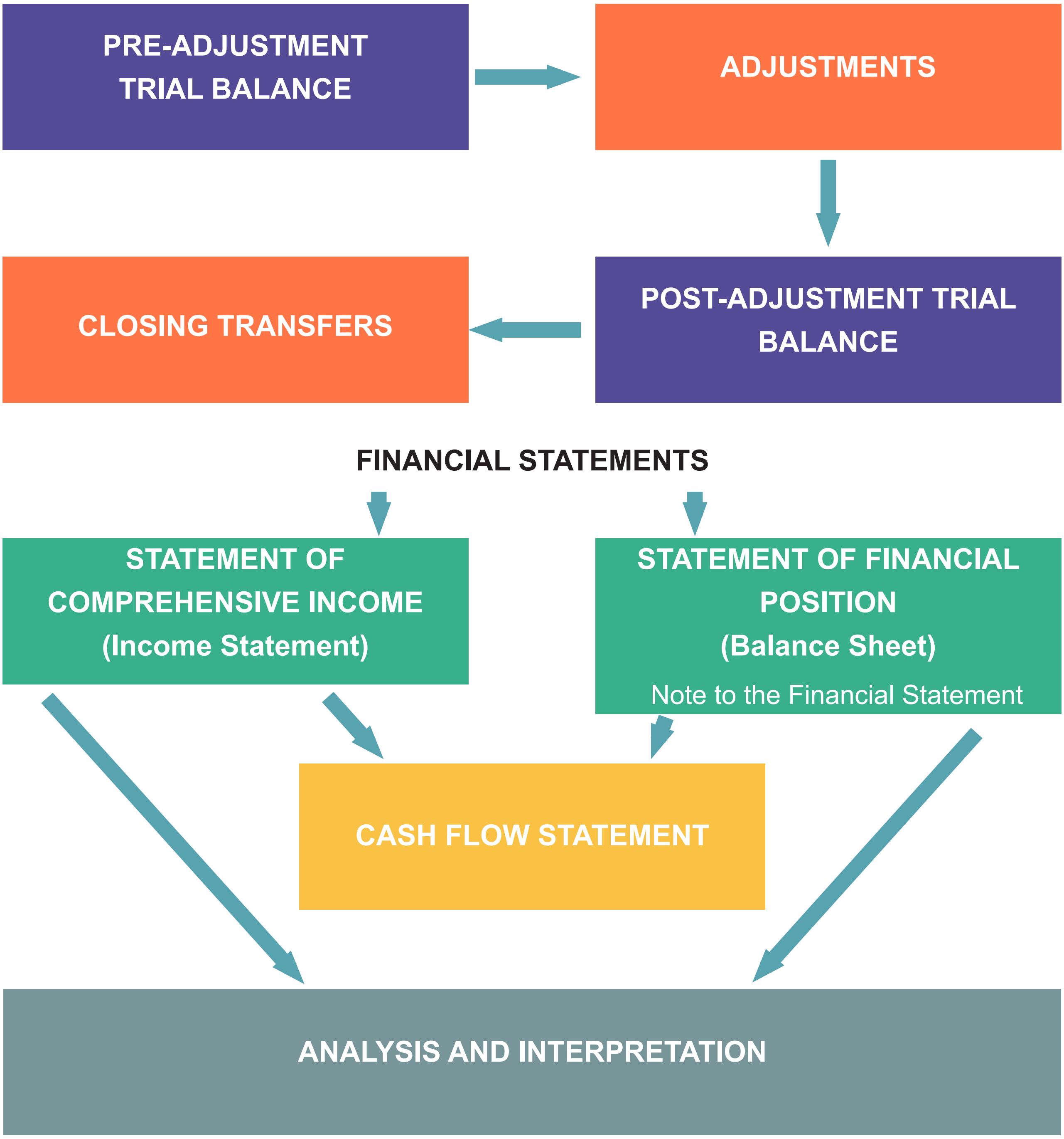
PRE-AMBLE:

Analysis and interpretation is covered in Term 1, under Companies and is integrated in other topics across the curriculum e.g. Inventory Valuation.
It features mainly in the Accounting P1 (Financial Reporting and Evaluation) and in certain topics of P2 (Managerial accounting and internal controls).
Recent trends on this topic show a spread of questioning techniques that rely on a clear understanding, insight and analytical thinking using financial and non-financial information, including all financial statements.

PRIOR KNOWLEDGE (Content you would have covered in previous Grades)

- Basic Analysis and Interpretation of the Financial Statements of a Sole Trader as introduced in Grade 10;
- Analysis and Interpretation of Partnership's Financial Statements done in Grade 11.
- Analysis and Interpretation of information from different topics of the curriculum covered in Grade 10 and 11.

A REFLECTION OF THE YEAR-END CYCLE OF ACTIVITIES



3. ANALYSIS AND INTERPRETATION OF FINANCIAL/NON-FINANCIAL INFORMATION

3.1 Concepts and notes

Analysis and interpretation	
A process that extracts relevant information from company's Financial Statements which are interpreted to meet a particular need at a particular point in time.	
Analysis and interpretation is done to provide information that is useful for the purpose of decision making.	
Users and the reasons for it	
Users	Reasons
Shareholders	Will the business be profitability now and in future?
Financial institutions (suppliers of short term credit)	Will the business be able to pay its debt?
Financial institutions (suppliers of long term credit)	Will business be able to pay long term loan and interest?
South African Revenue Services	Is the business paying correct tax?
Management (Directors)	Is the business performing as expected?
Customers	Is the business going to be around in future?
Auditors	Does the financial statements fairly present the results of the business?
Employees or Unions	Does the business have a long term growth prospects to ensure continued employment?
Information from the Financial Statements is used to calculate the required financial indicators and analysis/interpretation is then done	
After calculating, interpret the results by comparing results to: Financial indicators of the same business in previous years (meaningful) Competitors Markets in the same industry	

Area of analysis	Description
Profitability	Indicate if a company is generating a profit and an adequate return on assets and equity. Indicates how efficiently assets are being used and how effectively operations are being managed.
Liquidity	Focuses on the company's ability to pay short-term obligations (e.g. creditors, short-term loans, shareholders for dividends and SARS).
Solvency	The ability of a company to pay off all its debts
Return	Shows shareholder's fair/unfair earnings on amount invested.
Risk and gearing	Indicate how a company is financed, if they will be able to meet long-term obligations, and the risk factor.
Share price and market prospect	Used to see how a company is performing compared to others in the same industry and to compare the company's performance from one year to the next.

Financial Indicators are calculated using information extracted from the Financial Statements.			
Financial Statement	Direction	Items extracted	Financial indicators
Statement of Comprehensive Income	Profitability	Sales Cost of sales Operating expenses Operating profit Net profit after tax	% gross profit on sales % gross profit on cost of sales % net profit on sales % operating expenses on sales % operating profit on sales
	Return indicators	Net profit before tax Net profit after tax Interest expense	Earnings per share Dividends pay-out rate % Return on shareholders' equity % Return on Capital Employed
Statement of Financial Position And Notes to the Statement: Ordinary share capital Retained income Trade and other receivables Trade and other payables	Liquidity	Current assets Current liabilities	Current ratio Acid test ratio Stock turnover rate (Average) Stock holding period Average debtors' collection period Average creditors' payment period
	Solvency	Total assets Total liabilities Net assets (Shareholders Equity)	Solvency ratio Net assets = Assets – Liabilities
	Risk and Gearing	Non-current liabilities Shareholders' equity	Debt/equity ratio % return on total Capital Employed Interest rate on loans*
	Return	Shareholders' equity Non-current liabilities Total Capital Employed Share dividends	% return on shareholders' equity Dividends per share Interest rate on investments*
	Share price	Share capital Number of shares Shareholders' equity	Net asset value (NAV) Issue price/Share price Average share price Market price (Securities Exchange)*

* external financial indicators which are given in the Question

Financial Indicators are calculated using information extracted from the Financial Statements to get a specific answer.

Classification	Financial Indicators	Formulae	Answer	Integration
Profitability	% Gross profit on sales	$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$	%	Income Statement
	% Gross profit on cost of sales (mark-up %)	$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$	%	
	% Operating profit on sales	$\frac{\text{Operating profit}}{\text{Sales}} \times \frac{100}{1}$	%	
	% Operating expenses on sales	$\frac{\text{Operating expenses}}{\text{Sales}} \times \frac{100}{1}$	%	
	% Net profit on sales	$\frac{\text{Net profit}}{\text{Sales}} \times \frac{100}{1}$	%	
Solvency	Solvency ratio	Total assets : Total liabilities	Ratio = : 1	BS
Liquidity	Current ratio	Current assets : Current liabilities	Ratio = : 1	BS
	Acid test ratio	Current assets - inventories : Current liabilities	Ratio= : 1	BS
	Stock turnover rate	$\frac{\text{Cost of sales}}{\text{Average Stock}}$	Times	IS/BS
	(Average) Stock holding period	$\frac{\text{Average Stock}}{\text{Cost of sales}} \times \frac{365}{1}$ OR 12	Days / months	IS/BS
	Average debtors collection period	$\frac{\text{Average Debtors}}{\text{Credit Sales}} \times \frac{365}{1}$ OR 12	Days / months	IS/BS
	Average creditors payment period	$\frac{\text{Average Creditors}}{\text{Credit Purchases}} \times \frac{365}{1}$ OR 12	Days / months	IS/BS
Return	% Return on Shareholders' Equity (ROSHE)	$\frac{\text{Net profit after tax}}{\text{Average Shareholders' Equity}} \times \frac{100}{1}$	%	IS/BS

	% Return on Capital Employed (ROTCE)	$\frac{\text{Net profit before tax + interest on loan}}{\text{Average Capital Employed}} \times \frac{100}{1}$ Capital Employed is: Aver Shareholders Equity + Average Loans	%	IS/BS
	Earnings Per Share	$\frac{\text{Net profit after tax}}{\text{Number of issued shares}} \times \frac{100}{1}$	Cents	IS
Return	Dividends Per Share	$\frac{\text{Interim + Final dividends}}{\text{Number of issued shares}} \times \frac{100}{1}$	Cents	Note 8,RI
	Net Asset value per share	$\frac{\text{Shareholders' Equity}}{\text{Number of issued shares}} \times \frac{100}{1}$	Cents	B/S, Note 7 and 8
	Dividend pay-out rate	$\frac{\text{Dividends for the year}}{\text{Net profit after tax}} \times \frac{100}{1}$	%	I/S, Note 7 and 8
		$\frac{\text{Dividends per share}}{\text{Earnings per share}} \times 100$		
Financial risk/ Gearing	Debt -equity ratio (gearing)	Non-current liabilities : Shareholders' equity	Ratio = : 1	BS
Key:				
BS =Balance sheet	I/S = Income statement	RI = Retained Income		

BASELINE ACTIVITY
The formula sheet used in the assessment/examination is given below. REQUIRED: Give the name of every formula listed in this formula sheet (Number 1 – 25).
GRADE 12 ACCOUNTING FINANCIAL INDICATOR FORMULA SHEET

1.	$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$	15.	$\frac{\text{Gross profit}}{\text{Cost of sales}} \times \frac{100}{1}$
2.	$\frac{\text{Net profit before tax}}{\text{Sales}} \times \frac{100}{1}$	16.	$\frac{\text{Net profit after tax}}{\text{Sales}} \times \frac{100}{1}$
3.	$\frac{\text{Operating expenses}}{\text{Sales}} \times \frac{100}{1}$	17.	$\frac{\text{Operating profit}}{\text{Sales}} \times \frac{100}{1}$
4.	Total assets : Total liabilities	18.	Current assets : Current liabilities
5.	(Current assets – Inventories) : Current liabilities	19.	Non-current liabilities : Shareholders' equity
6.	(Trade and other receivables + Cash and cash equivalents) : Current liabilities		
7.	$\frac{\text{Average trading stock}}{\text{Cost of sales}} \times \frac{365}{1}$	20.	$\frac{\text{Cost of sales}}{\text{Average trading stock}}$
8.	$\frac{\text{Average debtors}}{\text{Credit sales}} \times \frac{365}{1}$	21.	$\frac{\text{Average creditors}}{\text{Cost of sales/Credit Purchases}} \times \frac{365}{1}$
9.	$\frac{\text{Net income after tax}}{\text{Average shareholders' equity}} \times \frac{100}{1}$	22.	$\frac{\text{Net profit after tax}}{\text{Number of issued shares}} \times \frac{100}{1}$
10.	$\frac{\text{Net income after tax + Interest on loans}}{\text{Average Shareholders' equity + Average non-current liabilities}} \times \frac{100}{1}$		
11.	$\frac{\text{Shareholders' equity}}{\text{Number of issued shares}} \times \frac{100}{1}$	23.	$\frac{\text{Dividends for the year}}{\text{Number of issued shares}} \times \frac{100}{1}$
12.	$\frac{\text{Interim dividends}}{\text{Number of issued shares}} \times \frac{100}{1}$	24.	$\frac{\text{Final dividends}}{\text{Number of issued shares}} \times \frac{100}{1}$
13.	$\frac{\text{Dividends per share}}{\text{Earnings per share}} \times \frac{100}{1}$	25.	$\frac{\text{Dividends for the year}}{\text{Net income after tax}} \times \frac{100}{1}$
14.	$\frac{\text{Total fixed costs}}{\text{Selling price per unit – Variable costs per unit}}$		

BASELINE ACTIVITY ANSWER				
1.	2.	3.	4.	5.
6.	7.	8.	9.	10.
11.	12.	13.	14.	15.
16.	17.	18.	19.	20
21.	22.	24.	24.	25.
CHECK YOUR ANSWERS AGAINST THE NOTES BELOW				

FINANCIAL INDICATORS, FORMULA, EXPLANATIONS AND WORKED EXAMPLES

3.2 PROFITABILITY

3.2.1 Gross profit on sales (gross margin)

$$\times \frac{100}{1} = \quad \%$$

Indicates the percentage by which the total selling price is greater than the cost price. Decrease in this financial indicator:

- Pressure on Selling Price possible due to competition or low demand.
- Upward pressure on costs as result of inflation or other cost factors

3.2.2 Gross profit on cost of sales (Gross mark-up)

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

Mark-up on CP should equal to this %, if not, it can be as a result of:

- Shrinkage
- Products not correctly marked
- Discounts

3.2.3 Net profit on Sales (net margin)

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

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

3.2.4 Operating expenses on Sales

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

- Indicates how much of the sales is used to cover running expenses.
- Trends are favourable if this is dropping or at least consistent.

3.2.5 Operating profit on Sales

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

- Indicates how much of the Sales end up as profit
- Trends are favourable if profit is increasing or at least consistent

WORKED EXAMPLES
FINANCIAL INFORMATION

KHOZA LTD.

The financial year ended on 28 February 2021.

INFORMATION:

A. Share Capital

The business has an authorised share capital of 1 125 000 ordinary shares.

The total issued share capital on 28 February 2020 was 600 000 ordinary shares.

75 000 ordinary shares were issued on 1 March 2020.

B. Extract from the Income Statement on 28 February 2021:

Sales	7 728 000
Cost of sales	(4 830 000)
Gross profit	2 898 000
Operating income	
Operating expenses	(1 506 960)
Operating profit	1 777 440
Interest expense	(200 940)
Net profit before income tax	1 576 500
Income tax	(472 950)
Net profit after income tax	1 103 550

C. Information from the Balance Sheet on 28 February

	28/02/2021	28/2/2020
Non-current assets	10 421 550	9 566 100
Fixed assets	10 121 550	9 266 100
Financial assets	300 000	300 000
Current assets	1 459 800	1 588 050
Inventories	627 000	482 550
Trade debtors	825 000	712 500
Cash and cash equivalents	7 800	393 000
Shareholders' equity	9 336 000	7 641 750
Ordinary share capital	8 741 250	7 440 000
Retained income	594 750	201 750
Non-current liabilities	1 500 000	2 400 000
Current liabilities	1 045 350	1 112 400
Trade creditors	616 800	932 400
Shareholders for dividends	330 000	180 000
Bank overdraft	98 550	0

D. An interim dividend of R270 000 was paid and a final dividend was declared.

E. Credit sales amount to 30% of the total sales.
Credit purchases amounted to R3 622 500.

WORKED EXAMPLE 1
PROFITABILITY FINANCIAL INDICATORS

Use information on PAGE 14 to calculate the following financial indicators. Round off your answers to one decimal point

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

a.	% Gross profit percentage on sales
	$\frac{2\,898\,000}{7\,728\,000}$ x 100 = 37,5%
b.	% Operating expenses on sales
	$\frac{1\,506\,960}{7\,728\,000}$ x 100 = 19,50%
c.	% gross operating income on sales
	$\frac{386\,400}{7\,728\,000}$ x 100 = 5%
d.	% Net profit after tax on sales
	$\frac{1\,103\,550}{7\,728\,000}$ x 100 = 60%
e.	% Gross profit on cost of sales (mark-up %)
	$\frac{2\,898\,000}{4\,830\,000}$ x 100 = 60%

3.3 LIQUIDITY

3.3.1 Current Ratio

Current Assets: Current Liabilities

- Indicates whether the business can meet its short-term obligations or not.
- Should not be too high – this means funds are tied up in stock which could be more effectively used

3.3.2 Acid Test Ratio

Current Assets – Inventory: Current Liabilities
OR
Trade and other receivables + Cash and Cash Equivalents : Current Liabilities

- If too low the business will not be able to meet its short-term obligations.
- Should not be too high – this means funds are not effectively used, or should be invested to generate more income.

3.3.3 Stock turnover rate

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

- If stock turnover is too high, the business may run out of stock.
- If stock turnover is too low, stock may become obsolete.
- This is also dependent on the type of goods being sold.
- The business needs to look at ways to increase its sales to create a higher rate of stock turnover.

3.3.4 Average Stock holding period

$$\frac{\text{Average Inventories}}{\text{Cost of Sales}} \times \frac{361}{1} = \_\_\_\_\text{days}$$

Stock holding period (Use final stock not average)

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

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

3.3.5 Average debtors' collections period

$$\frac{\text{Average Debtors}}{\text{Credit Sales}} \times \frac{361}{1} = \_\_\_\_\_\_\text{days}$$

- Indicates how long debtors take to settle their accounts.
- It is compared to the credit terms of the business, to assess effective control.
- A generally accepted period is 30 days. Indicates final test of liquidity.

3.3.6 Average creditors' payment period

$$\frac{\text{Average Creditors}}{\text{Cost of Sales /Credit Purchases}} \times \frac{361}{1} = \_\_\_\_\text{days}$$

Indicates how long the business takes to pay its creditors. It is compared to the credit terms of the supplier. A generally accepted period is 90 days.

WORKED EXAMPLE 2
LIQUIDITY FINANCIAL INDICATORS'

Use information on PAGE 14 to calculate the following financial indicators. 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
	1 459 800 : 1 045 350 = 1,4 : 1
ii.	Acid test ratio
	$\overset{832\,800}{(1\,459\,800 - 627\,000)} : 1\,045\,350$ Or $\overset{832\,800}{(825\,000 + 7\,800)} : 1\,045\,350$ = 0,8 : 1
iii.	Stock turnover rate
	$\frac{4\,830\,000}{\substack{\frac{1}{2}\ (482\,550 + 627\,000) \\ 554\,775}}$ = 8,7 times
iv.	Average stock holding period (in days)
	$\frac{\frac{1}{2}\ (482\,550 + 627\,000)}{4\,830\,000}$ x 365 = 41,9 days Or 365 / 8,7
v.	Average debtors collection period
	$\frac{\substack{774\,600 \\ \frac{1}{2}\ (932\,400 + 616\,800)}}{\substack{30\% \text{ x } 7\,728\,00 \\ 2\,318\,400}}$ x 365 = 121 days
vi.	Average creditors payment period
	$\frac{774\,600}{\substack{\frac{1}{2}\ (932\,400 + 616\,800) \\ 4\,830\,000}}$ x 365 = 58,5 days

3.4	SOLVENCY
3.4.1	Solvency ratio Total Assets : Total Liabilities
	• Indicates whether the business can meet (pay) its liabilities (Non-Current Liabilities and Current Liabilities). • A business is solvent if its total assets exceeds its total liabilities
3.4.2	Net Asset = Total Assets – Total Liabilities

WORKED EXAMPLE 3
SOLVENCY FINANCIAL INDICATORS

Use information on PAGE 14 to calculate the following financial indicators. Round off your answers to one decimal point.

1. Solvency ratio
2. Net Assets (solvency)

1.	Solvency ratio 11 881 350 2 545 350 (10 421 550 + 1 459 800) : (1 500 000 + 1 045 350) = 4,7 : 1
2.	Net Assets (solvency) 11 881 350 – 2 545 350 = 9 336 000

3.5 RETURN

3.5.1 % Return on Shareholders' Equity

$$\frac{\text{Net Profit after tax}}{\text{Average Owner's Equity}} \times \frac{100}{1} = \underline{\qquad}\%$$

- Indicates the % return owners' have received for investing in the business
- It answers the question of whether the owners should have invested elsewhere
- Compare to % returns that could be achieved at financial institutions (alternative investment)

3.5.2 Earnings per share (EPS)

$$\frac{\text{Net Profit after tax}}{\text{Number of Shares Issued}} \times \frac{100}{1} = \underline{\qquad}\text{cents}$$

- Establish whether purchasing shares were worthwhile and whether the company has long term sustainability and growth potential.

3.5.3 Dividends per share (DPS)

$$\frac{\text{Ordinary Share Dividends}}{\text{Number of Shares Issued}} \times \frac{100}{1} = \underline{\qquad}\text{cents}$$

- Earnings are distributed to shareholders as dividends but some are retained for future growth.

3.5.4 Net Asset value per share (NAV)

$$\frac{\text{Ordinary Shareholders Equity}}{\text{Number of Shares Issued}} \times \frac{100}{1} = \underline{\qquad}\text{cents}$$

- It represents the intrinsic value of the share i.e. a more realistic value based on the performance of the undertaking over the years and growth within the business, including acquisition of assets and issue of additional shares.

WORKED EXAMPLE 4
RETURN FINANCIAL INDICATORS

Use information on PAGE 14 to calculate the following financial indicators. 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 $\frac{1\ 103\ 550}{\frac{1}{2}\ (9336000 + 7\ 587\ 450)} \times 100 = 13\%$ 8 3461 725
b.	Earnings per share (EPS) $\frac{1\ 103\ 550}{675\ 000} \times 100 = 163{,}5$ cents or 164 cents
c.	Dividends per share (DPS) $\frac{270\ 000 + 330\ 000}{675\ 000} \times 100 = 89$ cents (88,9 %)
d.	Net asset value per share (NAV) $\frac{9\ 336\ 000}{675\ 000} \times 100 = 1383{,}1$ cents

3.6 FINANCIAL RISK/GEARING

3.6.1 Debt-equity ratio (gearing)

Non-Current Liabilities: Shareholders Equity

- Provides insight into capital structure of the business.
- A ratio of 0,55:1 indicates that for every R1 capital invested by shareholders, 55c was raised through long-term loans.
- It also indicates the business ability to raise additional capital through Long-term loans.
- A lower ratio indicates that the business has a higher creditworthiness and should therefore be able to obtain additional financing easier

3.6.2 % Return on total capital employed

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

- Compare to last year and indicate whether it improved or deteriorated
- Is it above or below the interest rate on loans?
- Above indicates positive gearing – therefore favourable to use loans
- Below indicates negative gearing – unfavourable to use loans – may pay loans off quickly
- It’s favourable to make use of borrowed capital when interest rates are lower than the return that can be earned by the business in using those funds.

WORKED EXAMPLE 5
RISK/GEARING FINANCIAL INDICATORS

Use information on PAGE 14 to calculate the following financial indicators. Round off your answers to one decimal point.

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

i.	Debt/equity ratio
	1 500 000 : 9 336 000 = 0,2 : 1 (0,16 : 1)
ii.	Return on average capital employed (ROTCE)
	$\dfrac{\overset{1\,777\,440}{1\,576\,500 + 200\,940}}{\underset{10411725}{\tfrac{1}{2}\ (9336000+1\,500\,000 + 7\,587\,450 + 2400\,000)}} \times 100 = 17{,}1\%$

WORKED EXAMPLE 6
COMMENTING ON FINANCIAL INDICATORS

INFORMATION

The following information appeared in the accounting records of Blom Ltd for the financial year ended 28 February 2021

	2021	2020
Current ratio	3,6:1	2,8:1
Acid test ratio	0,5:1	0,7:1
Rate of stock turnover	3,7 times	5 times
Average debtors collection period	28 days	35 days
Return on shareholders' equity	16%	18%
Earnings per share	45 cents	54 cents
Dividends per share	22 cents	44 cents
Gross profit on cost of sales	70%	65%
Gross profit on sales	28%	32%
Net profit after tax on sales	12%	15%
Operating profit on sales	16%	21%
Return on total capital employed	12%	14%
Debt-equity ratio	0,6:1	0,3:1
Interest rate on long-term loans	13%	12%
Interest on fixed deposit	8%	8%
Net asset value per share	335 cents	346 cents
Market price per share	347 cents	340 cents

REQUIRED:

1. Comment on the profitability of the business. Quote TWO financial indicators (with figures).
2. Directors feel that the business will experience difficulty in meeting its short term debts in the next financial year. Explain why you either agree or disagree with them. Quote THREE financial indicators with figures to support your opinion.
3. Although shareholders are satisfied with their % returns, they are concerned about the change in dividend pay-out policy. Explain why they are satisfied with their % returns. Provide TWO possible reason for the change in the dividend pay-out rate.
4. The directors took the decision to increase the loan during the year. Explain why this was a poor decision. Quote relevant financial indicators in your explanation.
5. The company paid R3,50 per share to repurchase 50 000 shares during April 2020. This was R0,75 above the average share price. Explain whether the shareholder received a fair price for his shares. Quote TWO financial indicators with figures.

SOLUTION WORKED EXAMPLE 6
COMMENTING ON FINANCIAL INDICATORS

1. Comment on the profitability of the business. Quote and explain TWO relevant financial indicators (with figures). • An increase in the mark-up % (gross profit on cost of sales) has caused a decrease in the % GP on sales (32% to 28%); • NP after tax also decreased from 15% to 12% (by 3% points); operating profit dropped from 21% to 16%.
2. Directors feel that the business will experience difficulty in meeting its short term debts in the next financial year. Explain why you either agree or disagree with them. Quote THREE financial indicators with figures to support your opinion. • Current ratio increased (2,8:1 to 3,6:1); • Acid test ratio dropped (0,7 : 1 to 0,5 : 1); • a clear indication on stock not moving (stock piling) ; also reflected by the decrease in the STR from 5 times to 3,7 times.
3. Although shareholders are satisfied with their % returns, they are concerned about the change in dividend pay-out policy. Explain why they are satisfied with their returns. Provide TWO possible reason for the change in the dividend pay-out rate. • ROSHE: Although it decreased (from 18% to 16%) it is still better than any alternative investments such as a fixed deposit which fluctuates around 8%. • Last year the company distributed 81,5% of the EPS as DPS. • This year it was only 49%. An indication that the company has decided to retain a greater portion of the earnings. • They wanted to use the resources for future expansions of the business. They plan to address cash flow issues. Equalization of dividends, over the long term.
4. The directors took the decision to increase the loan during the year. Explain why this was a poor decision. Quote relevant financial indicators in your explanation. (8) • An increase in the financial risk. Debt/Equity increased from 0,3 : 1 to 0,6 : 1. • The ROTCE dropped from 14% to 12%. It is now less than the interest on loan (13%). • Meaning that the company is negatively geared.
5. The company paid R3,50 per share to repurchase 50 000 shares during April 2020. This was R0,75 above the average share price. Explain whether the shareholder received a fair price for his shares. Quote TWO financial indicators with figures. • He received more than the NAV which is now 335 cents. • It is also higher than the NAV at the beginning of the year (346 cents). • It is also close to the market price at the end of the year (347 cents; 340 cents last year). • Looking at trends, although the NAV is declining, the MP is increasing; an indicator of investor confidence.

3.7 INTERPRETATION BEYOND FINANCIAL INDICATORS

In addition to using financial indicators as a basis for interpretation, candidates' understanding and insight is extended into critically analysing the actual amounts and trends of specific sections of the different financial statements.

3.7.1 THE DIVIDEND PAY-OUT POLICY:

- A comparison of the percentage of Earnings (per share) distributed as Dividends (per share) is required (DPS/EPS x 100).
- The difference would reflect the percentage of earnings that the directors want to retain (as part of equity).
- At times, they may also decide to declare dividends that exceeds the earnings of the current financial year (> 100% of EPS).
- Possible questions would generally require:
  - A calculation and comparison of this pay-out rate (as a %);
  - Possible reasons for directors making this adjustment.
  - Possible consequences of these decisions on the shareholders or the business

3.7.2 % SHAREHOLDING AND MAJORITY SHAREHOLDING

- This refers to a shareholder owning more than 50% of the issued shares in a company.
- The number of shares is used in the calculation (shares are issued at different prices over time, so the amount may not be meaningful).
- A change in the number of shares (increase/decrease) will affect this percentage.
- It must be noted that a single shareholder may not necessarily own more than 50% of the shares, which means that a group of shareholders can decide to influence decisions by voting together.
- Possible questions will include:
  - Calculate this shareholder's % shareholding before / after any changes in the share capital (number of shares)
  - The effect of the change in issued shares on his/her % shareholding
  - If he/she is not the majority shareholder, how many shares must he/she buy from any new issue of shares, to become the majority shareholder.
  - More than 50% is: 50% + 1 share Or 50% + 100 shares (if assumed share issued in batches of 100 shares) Or 51% of issued shares.
  - The motivation to become the majority shareholder (Reasons)
  - Ethical issues (manipulating changes to the share capital).

WORKED EXAMPLE 7
PAY-OUT POLICY AND MAJORITY SHAREHOLDING

INFORMATION

A. Details of share capital		
	2021	2020
Number of shares	1 275 000	975 000
Ordinary Share Capital	R 9 105 000	R 6 825 000
B. Velile a senior director on the Board, owns 525 000 shares on 1 March 2020. Additional shares were issued on 30 June 2020. Velile was on holiday and missed the opportunity to purchase any shares.		
Financial Indicators calculated		
	2021	2020
Earnings per share (EPS)	147 cents	168 cents
Dividends per share (DPS)	126 cents	87 cents
Interest rate on fixed deposits	6,5%	6%

1.Calculate Velile's percentage shareholding before and after the issue of additional shares on 30 June 2020.

2. Explain why Velile would be disappointed that he was not able to purchase any additional shares when these shares were issued.

3. Velile convinced the CEO to repurchase 240 000 shares from a close friend who was not interested in being a shareholder of the company on 1 March 2021.

3.1 Explain the effect of this re-purchase on Velile's % shareholding.

3.2 Explain why the other shareholders would be concerned about this transaction, after they received inside information about the share buyback.

4. Show the change on the dividend pay-out rate by doing a calculation.

5. Provide TWO possible reasons why the directors decided to change the trend of previous year.

6. Will the shareholders be satisfied with this change on policy? Provide TWO points.

SOLUTIONS: WORKED EXAMPLE 7

PAY-OUT POLICY AND MAJORITY SHAREHOLDING

<table>
<tr><td>Calculate Velile's percentage shareholding before and after the issue of additional shares on 30 June 2020.

• Before share issue: 525 000/975 000 = 53.8%
• After share issue : 525 000/1 275 000 = 41.2%</td></tr>
<tr><td>Explain why Velile would be disappointed that he was not able to purchase any additional shares when these shares were issued.

• He lost his status as a majority shareholder.
• As the majority shareholder, he was able to influence many decisions, including appointments of key directors.</td></tr>
<tr><td>Shareholding
Explain the effect of this re-purchase on Velile's % shareholding.

• The total number of shares would decrease from 1 275 000 – 240 000 to 1 035 000 shares.
• Velile's % shareholding: 525 000/1 035 000 = 50,7%. Velile regain his majority status.</td></tr>
<tr><td>Explain why the other shareholders would be concerned about this transaction, after they received inside information about the share buyback.

• Ethical issue – inside information used.
• He has used his position (senior director) to influence the re-purchase of shares
• He wants to regain his majority status.</td></tr>
<tr><td>Show the change on the dividend pay-out rate by doing a calculation.

2020: 87/168 = 51.8%   2021: 126/147 = 85.7%</td></tr>
</table>

Provide TWO possible reasons why the directors decided to change the trend of the previous year. • To satisfy shareholders, who may be concerned about the decrease in profitability. • They have no strategic plans for growth. • They are in the process of balancing the dividends distributed over the last 5 years.
Will the shareholders be satisfied with this change on policy? Provide TWO points. • Shareholders may be satisfied – they received a higher dividend (better returns than last year; they may be relieved that they are getting some money back before deciding to sell their shares. No confidence in the long term prospects of he business • They may be concerned that the company is paying a larger dividend when they are experiencing problems with profitability • They may be concerned that directors do not have plans for growth – addressing the profitability problem of the business

4. CONSOLIDATION ACTIVITIES

ACTIVITY 1 (Adapted from Nov 2018 DBE QP) (53 Marks; 42 Minutes)

You are provided with information about Vooma Limited for the past two financial years ended 30 June. The company is situated in KZN and trades in racing bikes.

REQUIRED:

NOTE: Provide figures or financial indicators (ratios or percentages) and comparisons with the previous year to support comments or explanations.

1.1 Calculate the following for 2018:

1.1.1 % operating expenses on sales (2)

1.1.2 Acid-test ratio (4)

1.1.3 % return on shareholders' equity (4)

1.2 Cash flow and financing activities:

1.2.1 Explain why the directors are satisfied with the improvement in cash and cash equivalents since 1 July 2016. (3)

1.2.2 Decisions and gearing in 2018:

Identify THREE decisions that the directors made to pay for land and buildings.

Explain how these decisions affected: (6)

- Capital employed
- Financial gearing (Quote TWO indicators.) (6)

1.2.3 From the Cash Flow Statement identify ONE decision made by the directors in 2017 that they did NOT make in 2018, besides the points mentioned above. Give a possible reason for the decision in 2017. (3)

1.3 Dividends, returns and shareholding for the 2018 financial year:

- On 1 July 2017 there were 800 000 shares in issue.
- On 31 December 2017 interim dividends were paid.
- On 1 January 2018, 200 000 shares were issued to existing shareholders.
- On 30 June 2018 final dividends of 75 cents per share were declared on all shares, but have not yet been paid.

1.3.1 Calculate: the total interim dividends paid in the 2018 financial year

Calculate: the interim dividends per share paid in the 2018 financial year.

1.3.2 Calculate total dividends earned by Dudu Mkhize for the 2018 financial year. Her shareholding is:

	SHARES PURCHASED	PURCHASE PRICE
31 August 2016	380 000 shares	R7,00
1 January 2018	110 000 shares	R20,00
TOTAL	490 000 shares	

(5)

1.3.3 On 1 January 2018 each shareholder was offered two shares for every five shares owned. Dudu did not buy enough shares to become the majority shareholder.
Calculate the minimum number of additional shares that Dudu should have bought.

(3)

1.4 The directors decided to buy land and buildings in two other provinces in 2018 to solve the problem of low sales that they had previously had in KZN.

1.4.1 Explain:

- Why it was necessary to purchase properties in other provinces instead of in KZN (2)
- Whether the decision to purchase these properties had the desired effect on sales (3)
- Another strategy they used to solve the problem of low sales (3)

1.4.2 The CEO, Ben Palo, wants to communicate other good news to the shareholders at the AGM. Give advice on what he should say about the following topics:

- Earnings per share (3)
- % return earned (3)
- Share price on the JSE (3)

INFORMATION FOR THE YEAR ENDED 30 JUNE:

A. FIGURES IDENTIFIED FROM INCOME STATEMENT:

	2018	2017
Sales	R13 182 000	R7 740 000
Number of bikes sold	1 750 bikes	900 bikes
Mark-up %	58%	72%
Cost of sales	8 330 000	4 500 000
Gross profit	4 852 000	3 240 000
Operating expenses	1 900 000	1 500 000
Depreciation	412 000	275 000
Income tax	819 000	444 000
Net profit after tax	1 911 000	1 036 000

B. EXTRACT FROM BALANCE SHEET ON 30 JUNE:

	2018	2017
Fixed assets (carrying value)	R12 154 000	R8 031 000
Investments	625 000	600 000
Current assets	2 427 000	2 090 000
Inventories	1 652 000	1 250 000
Trade and other receivables	365 000	820 000
SARS: Income tax	0	15 000
Cash and cash equivalents	410 000	5 000
Shareholders' equity	12 112 000	7 191 000
Non-current liabilities (Loan)	1 850 000	2 600 000
Current liabilities	1 244 000	930 000
Trade and other payables	420 000	515 000
Shareholders for dividends	750 000	280 000
SARS: Income tax	74 000	0
Bank overdraft	0	135 000

C. CASH FLOW STATEMENT:

		2018	2017
Cash flows from operating activities		R1 850 000	R1 046 000
Cash generated from operations		3 322 000	1 989 000
Interest paid		?	(260 000)
Dividends paid		(520 000)	(254 000)
Income tax paid		?	(429 000)
Cash flows from investing activities		(4 560 000)	(167 000)
Purchases of land and buildings		(4 840 000)	0
Sale of fixed assets		?	383 000
Change in investments		?	(550 000)
Cash flows from financing activities		3 250 000	(400 000)
Share capital issued		4 000 000	0
Shares repurchased		0	(1 000 000)
Change in non-current liabilities		(750 000)	600 000
Cash and cash equivalents:	Net change	540 000	479 000
	Opening balance	(130 000)	(609 000)
	Closing balance	410 000	(130 000)

D. FINANCIAL INDICATORS:

	2018	2017
Mark-up % achieved	58%	72%
Operating expenses on sales	?	19,4%
Debt-equity ratio	0,2 : 1	0,4 : 1
Acid-test ratio	?	0,9 : 1
Return on shareholders' equity	?	14,4%
Return on capital employed	20,8%	17,8%
Earnings per share	208 cents	130 cents
Dividends per share	?	70 cents
Dividend pay-out rate	50%	54%
Net asset value per share	1 211 cents	899 cents
Market price on stock exchange	2 800 cents	2 100 cents
Interest on loans	12%	12%

ACTIVITY 2

(Adapted from June 2019 DBE QP) 42 Marks; 34 Minutes)

2.1 Choose a term from the list below that answers the specific following questions. Write only the term next to the question numbers (2.1.1 to 2.1.4) in the ANSWER BOOK.

gearing; return on equity; solvency; liquidity; profitability

2.1.1 Is the business able to pay off all its debts?

2.1.2 Can the business pay off short-term debts in the next financial year?

2.1.3 Will shareholders be satisfied with the benefit that they receive for investing in the company?

2.1.4 To what extent is the company financed by loans or borrowed capital?

(4)

2.2 KULFI LTD

information for the financial year ended 28 February 2019 is provided.
Where financial indicators are required to support your answer, quote the financial indicator and actual figure/ratio/percentage and trends.

REQUIRED:

2.2.1 Calculate the following financial indicators on 28 February 2019:

- Acid-test ratio (4)
- Debt-equity ratio (4)
- % return on average shareholders' equity (ROSHE) (5)

2.2.2 The shareholders are satisfied with the improvement in the liquidity position.
Quote THREE financial indicators (with figures) to support this statement. (6)

2.2.3 The company increased the share capital by R840 000, and the loan by R550 000.

- Explain how this affected the gearing and risk of the company. Quote TWO financial indicators. (5)
- Provide TWO possible reasons why the business may need additional funds. (4)

2.2.4 The directors decided to decrease the dividend pay-out percentage.

- Provide calculations to show the change in the pay-out rate. (4)
- Give ONE reason why many shareholders were satisfied with the change in policy. Quote figures. (2)

2.2.5 On 1 March 2018 Martha owned 475 000 shares in the company. She did not purchase any shares from the shares issued on 1 May 2018.

- Explain how the repurchase of the shares benefited Martha's shareholding. Quote figures. (4)

INFORMATION:

A Share capital:

- There were 900 000 ordinary shares in issue on 1 March 2018.
- An additional 100 000 ordinary shares were issued on 1 May 2018.
- On 1 October 2018 the company repurchased 60 000 shares at R9,00 per share. The average share price at the time was R8,04.

B. Dividends

- Interim dividends of 25 cents per share were paid on 15 September 2018.
- Final dividends were declared on 28 February 2019.

C. Extract from Income Statement for the year ended 28 February 2019:

	R
Depreciation	123 600
Interest expense	143 000
Income tax (at 30% of the net profit)	293 100

D. Extract from Balance Sheet on 28 February 2019:

	2019	2018
	R	R
Fixed assets (carrying value)*	8 775 720	8 430 720
Fixed deposit: Flay Bank	150 000	100 000
Current assets	996 480	684 300
Inventories	448 000	281 000
Trade and other receivables (Note 1)	288 300	378 300
Cash and cash equivalents	260 180	25 000
Shareholders' equity	?	7 341 500
Ordinary share capital	7 557 600	7 200 000
Retained income	311 000	141 500
Loan: Home Bank	1 400 000	850 000
Current liabilities	553 600	923 520
Trade and other payables (Note 2)	553 600	781 000
Bank overdraft	0	142 520

* Old equipment was sold at carrying value, R111 800, for cash.

Note 1: Trade and other receivables:	2019	2018
Debtors' control	288 300	367 000
SARS: Income tax	0	11 300

Note 2: Trade and other payables:	2019	2018
Creditors' control	325 000	421 000
Shareholders for dividends	206 800	360 000
SARS: Income tax	21 800	0

E. The following financial indicators were calculated on 28 February:

	2019	2018
Current ratio	1,8 : 1	0,7 : 1
Acid-test ratio	?	0,4 : 1
Debtors' collection period	28 days	39 days
Creditors' payment period	60 days	60 days
Debt-equity ratio	?	0,1 : 1
Return on shareholders' equity (ROSHE)	?	10.2%
Return on total capital employed (ROTCE)	12,9%	14,4%
Earnings per share (EPS)	71 cents	83 cents
Dividends per share (DPS)	47 cents	80 cents
Net asset value per share (NAV)	837 cents	816 cents
Market value per share	840 cents	807 cents
Interest rate on loans	13,5%	13,5%

ACTIVITY 3

(Adapted from November 2019 DBE QP) (52 Marks; 42 Minutes)

3.1 SUNSET LTD

The financial year ended on 28 February 2019.

REQUIRED:

3.1.1 Calculate financial indicators for the year ended 28 February 2019:

- % operating profit on sales (4)
- Net asset value per share (4)
- Debt-equity ratio (4)

INFORMATION FOR SUNSET LTD:

A. Information from Income Statement on 28 February 2019:

Sales	R8 725 000
Gross profit	3 525 000
Depreciation	408 000
Operating profit	2 033 900
Interest expense	441 000
Income tax	477 900
Net profit after tax	1 138 000

B. Information from Balance Sheet on 28 February:

	2019	2018
Fixed assets (carrying value)*	R11 835 100	R10 658 000
SARS: Income tax	18 000 Cr	63 000 Dr
Shareholders' equity	8 625 000	10 065 000
Ordinary share capital	7 724 000	9 300 000
Loan: Funza Bank	3 500 000	2 800 000
Shareholders for dividends	372 000	195 000
*NOTE: Fixed assets were sold at carrying value, R490 000.		

C. Share capital and dividends:

SHARE CAPITAL		NUMBER OF SHARES	DETAILS OF SHARES
2018	1 March	1 500 000	In issue at R6,20 per share
	30 April	300 000	Repurchased at R6,90 per share
2019	1 January	40 000	New shares issued
	28 February	1 240 000	In issue

DIVIDENDS			DIVIDENDS PER SHARE
Final	2 March 2018	Paid	13 cents
Interim	31 August 2018	Paid	35 cents
Final	28 February 2019	Declared	30 cents

3.2 HORIZON LTD and OPTIMA LTD

Refer to Information D to F.
Mike Mbele owns shares and is a director in both these companies.
He recently invested another R420 000 in each company by buying shares on the JSE at market value as follows:

HORIZON LTD	OPTIMA LTD
R8,40	R4,00

REQUIRED:
NOTE: Provide figures, financial indicators or calculations in EACH case to support your comments and explanations.

3.2.1 Purchase of shares:

- Explain why directors should be interested in the price of their companies' shares on the JSE. (2)
- Calculate the number of additional shares in Horizon Ltd that Mike was able to buy on the JSE in 2019. (3)
- Comment on the price that Mike paid for these shares and give TWO reasons why he might have been satisfied to pay this price. (6)

3.2.2 Dividends and earnings:

- Explain your opinion on which company has the better dividend pay-out policy. (6)
- Compare and comment on the % return on equity earned by EACH company. (4)
- Mike feels that the earnings per share (EPS) of Optima Ltd is much better than that of Horizon Ltd. Explain why he feels this way. (5)

3.2.3 Refer to the Cash Flow Statements.
The poor economy has negatively affected Horizon Ltd more than Optima Ltd.

- Explain TWO decisions taken by the directors of Horizon Ltd in response to the state of the economy, and how these decisions will affect the company in future. (6)
- Explain TWO decisions taken by the directors of Optima Ltd that affect risk and gearing. Quote and comment on TWO financial indicators. (8)

D. Shareholding of Mike Mbele in two companies:

	HORIZON LTD	OPTIMA LTD
Number of shares bought in 2017	580 000 shares	1 430 000 shares
Total shares issued by each company	1 240 000 shares	2 600 000 shares
Additional shares bought by Mike	?	105 000 shares
Mike's % shareholding before buying additional shares	46,8%	55,0%

E. Financial indicators and additional information on 28 February 2019:

	HORIZON LTD	OPTIMA LTD
Earnings per share (EPS)	97 cents	83 cents
Dividends per share (DPS)	65 cents	80 cents
Debt-equity ratio	0,1 : 1	0,7 : 1
% return on average equity	6,2%	18,2%
% return on average capital employed	9,4%	15,1%
Net asset value (NAV)	750 cents	445 cents
Additional information:		
Interest rate on loans	12,0%	12,0%
Interest on investments	6,5%	6,5%

F. Extracts from Cash Flow Statements for year ended 28 February 2019:

	HORIZON LTD	OPTIMA LTD
Cash flows from investing activities	R2 700 000	(R2 730 000)
Purchase of fixed assets	0	(1 580 000)
Sale of fixed assets	1 800 000	0
Change in investments	900 000	(1 150 000)
Cash flows from financing activities	(2 670 000)	4 000 000
Proceeds of new shares issued	0	200 000
Shares repurchased	(1 070 000)	0
Cash effects of long-term loan	(1 600 000)	3 800 000

ACTIVITY 4

(Adapted from November 2020 DBE QP) (18 Marks; 14 Minutes)

USANDA LIMITED

The financial year ended on 28 February 2021.

REQUIRED:

Calculate the following financial indicators for the year ended 28 February 2021:

4.1 % operating profit on sales (2)
4.2 Acid-test ratio (4)
4.3 Debt- equity ratio (4)
4.4 Return on average shareholders' equity (ROSHE) (4)
4.5 Dividend pay-out rate (%) (4)

INFORMATION:

A: Extract: Statement of Comprehensive Income: on 28 February 2021:

Sales	R17 800 000
Operating profit	2 262 100
Interest on loan (capitalised)	270 000
Net profit before tax	1 777 000
Net profit after tax	1 243 900

Extract: Statement of Financial Position:

	28 February 2021	29 February 2020
Fixed assets (carrying value)	R13 650 600	R13 590 000
Current assets	659 500	1 067 500
Inventories	276 500	373 200
Trade and other receivables	262 300	539 600
Cash and cash equivalents	120 700	154 700
Shareholders' equity	9 891 400	11 985 000
Ordinary share capital	9 555 000	11 220 000
Retained income	336 400	765 000
Loan: VBC Bank (see E)	?	2 080 000
Current liabilities	611 900	592 500
Trade and other payables	252 100	185 700
Bank overdraft	0	90 000
SARS: Income tax	19 800	69 300
Shareholders for dividends	340 000	247 500

Share capital:

DATES	NUMBER OF SHARES	DETAILS OF SHARES
1 March 2020	1 650 000	In issue
30 October 2020	50 000	Additional shares issued
27 February 2021	335 000	Shares repurchased at R9,50 each
28 February 2021	1 365 000	In issue

D .Dividends and earnings:

- An interim dividend was paid on 31 August 2020.
- A final dividend of 20 cents per share was declared on 28 February 2021.
- Total dividends for the year amounted to R835 000.
- Earnings per share (EPS) on 28 February 2021 was 74 cents.

E. Loan: VBC Bank

- The balance on 1 March 2020 was R2 080 000.
- Monthly instalments of R35 000, including interest, were paid.
- Interest capitalised amounted to R270 000.

ACTIVITY 5

(Adapted from November 2020 DBE QP) 35 Marks; 28 Minutes)

5.1 Choose the question from COLUMN B that matches a category of financial indicators in COLUMN A. Write the letter (A–E) next to the numbers (5.1.1-5.1.4) in the ANSWER BOOK.

COLUMN A		COLUMN B	
5.1.1	Liquidity	A.	Is the business managing expenses effectively to increase profitability?
5.1.2	Risk and gearing	B.	Is the investment in the company better than investing in fixed deposit?
5.1.3	Return to shareholders	C.	Will the company be able to pay off its current debts?
5.1.4	Operating efficiency	D.	Will the company be able to pay off all its debts using existing assets?
		E.	How is the company managing loans or borrowed capital?

(4)

5.2 SCI-FI GEEKS LTD

The business trades in electronic equipment purchased from China. The information relates to the past two financial years, ended 31 March. The COVID-19 lockdown has negatively affected sales over the current financial year.

REQUIRED:

5.2.1 Liquidity:

The directors are satisfied with the improvement in the current ratio and the acid-test ratio. Explain why you would disagree with them. Quote TWO financial indicators in your response. (6)

5.2.2 Dividends:

- The directors changed the dividend policy for the current financial year. Comment on the dividend per share over the two years. Quote figures. (2)
- Explain the change in the dividend payout rate and give a reason for this change. Quote figures. (4)
- A shareholder felt that they should be satisfied with the dividends they received, as it is better than last year. Explain why you agree with him. Quote figures. (3)

5.2.3 Comment on the risk and gearing for both years.
Quote TWO financial indicators (with figures). (6)

5.2.4 Existing shareholders are dissatisfied that the new shares issued on 1 April 2020 were sold to the CEO, Ida Shark. Give TWO reasons why you consider their feelings to be justified. Quote figures. (6)

5.2.5 The Cash Flow Statement reflected a positive change of R980 000. Provide TWO points why this should still be a concern to directors. Quote figures. (4)

INFORMATION:

A. Financial indicators and additional information:

	2021	2020
Mark-up % achieved	60%	60%
% net profit before tax on sales	13,9%	20,3%
Current ratio	2,4 : 1	1,1 : 1
Acid-test ratio	1,0 : 1	0,4 : 1
Stockholding period	102 days	32 days
Average debtors' collection period	46 days	31 days
Average creditors' payment period	60 days	60 days
Earnings per share	58 cents	130 cents
Dividends per share	72 cents	90 cents
Dividend payout rate	136,5%	69%
Debt-equity ratio	0,4 : 1	0,3 : 1
Return on average shareholders' equity	17,7%	31,6%
Return on total capital employed	23,2%	39%
Net asset value per share	332 cents	409 cents
Market price of shares on stock exchange	410 cents	540 cents
Interest rate on loans	13,5%	13,5%
Interest rate on fixed deposits	6,8%	7,8%

B. Share capital:

- On 1 April 2020 the company issued an additional 250 000 shares.
- On 31 March 2021 there were 1 250 000 shares in issue.

C. Extract from the Cash Flow Statement on 31 March:

	2021	2020
Cash flows from operating activities	(148 080)	910 000
Cash generated from operations	1 281 620	
Interest paid	(232 000)	
Taxation paid	(272 700)	
Dividends paid	(925 000)	
Cash flows from investing activities	101 580	(300 000)
Cash flows from financing activities	1 026 500	(100 000)
Sale of shares	375 000	0
Change in loan	651 500	(100 000)
Cash and cash equivalents: Net change	980 000	510 000
Opening	(330 000)	(840 000)
Closing	650 000	(330 000)

5. ANSWER BOOK

ACTIVITY 1 ANSWER SHEET

1.1 CALCULATION OF FINANCIAL INDICATORS FOR 2018

1.1.1 Calculate: % operating expenses on sales

Workings	Answer

(2)

1.1.2 Calculate: Acid-test ratio

Workings	Answer

(4)

1.1.3 Calculate: % return on shareholders' equity

Workings	Answer

(4)

1.2 EXPLANATIONS ON CASH FLOW STATEMENT

1.2.1 Explain why the directors are satisfied with the improvement in cash and cash equivalents since 1 July 2016. Quote figures.

(3)

1.2.2 Identify THREE decisions that the directors made to pay for land and buildings.

Decision 1 (with figures)	
Decision 2 (with figures)	
Decision 3 (with figures)	

(6)

Explain how these decisions affected the capital employed in the 2018 financial year. Quote figures.

Explain how these decisions affected the financial gearing in the 2018 financial year. Quote TWO indicators and their figures.

(6)

1.2.3 From the Cash Flow Statement identify ONE decision made by the directors in 2017 that they did NOT make in 2018, besides the points mentioned above. Give a possible reason for the decision in 2017.

Decision (with figures)	Possible reason

(3)

1.3 DIVIDENDS, RETURNS AND SHAREHOLDING

1.3.1 Calculate: Total interim dividends paid for the 2018 financial year

Workings	Answer

(6)

Calculate: Interim dividends per share for the 2018 financial year

Workings	Answer

(6)

1.3.2 Calculate total dividends earned by Dudu Mkhize for the 2018 financial year.

Workings	Answer

1.3.3 Calculate the minimum number of additional shares that Dudu should have bought.

Workings	Answer

(3)

1.4.1 Explain why it was necessary to purchase properties in other provinces instead of in KZN.

(2)

Explain whether the decision to purchase these properties had the desired effect on sales. Quote figures.

(3)

Explain another strategy they used to solve the problem of low sales. Quote figures.

(3)

1.4.2 Give advice on what Ben Palo should say about the following topics:

Advice on what to say on earnings per share:

(3)

Advice on what to say on % return earned:

(3)

Advice on what to say on share price on the JSE:

(3)

ACTIVITY 2 ANSWER SHEET

2.1

2.1.1	
2.1.2	
2.1.3	
2.1.4	

(4)

2.2 KULFI LTD

2.2.1 Calculate: Acid-test ratio

Workings	Answer

(4)

Calculate: Debt-equity ratio

Workings	Answer

(4)

Calculate: % return on average shareholders' equity (ROSHE)

Workings	Answer

(6)

2.2.2 The shareholders are satisfied with the improvement in the liquidity position. Quote THREE financial indicators (with figures) to support this statement.

(6)

2.2.3 The company increased the share capital by R840 000, and the loan by R550 000. Explain how this affected the gearing and risk of the company. Quote TWO financial indicators.

(5)

Provide TWO possible reasons why the business may need additional funds.

(5)

2.2.4 Provide calculations to show the change in the pay-out rate.

(4)

Give ONE reason why many shareholders were satisfied with the change in policy. Quote figures.

(2)

2.2.5 Explain how the repurchase of the shares benefited Martha's shareholding. Quote figures.

(4)

ACTIVITY 3 ANSWER SHEET

3.1

SUNSET LTD

3.1.1

Calculate financial indicators for the year ended 28 February 2019:

% operating profit on sales

Workings	Answer

(4)

Net asset value per share

Workings	Answer

(4)

Debt-equity ratio

Workings	Answer

(4)

3.2 HORIZON LTD and OPTIMA LTD

3.2.1

Explain why directors should be interested in the price of their companies' shares on the JSE.	

(4)

Calculate the number of additional shares in Horizon Ltd that Mike was able to buy on the JSE in 2019.	
Workings	Answer

(4)

Comment on the price that Mike paid for these shares and provide TWO reasons why he might have been satisfied to pay this price.
Comment (with figures): Reason 1 : Reason 2:

(6)

3.2.2

Explain your opinion on which company has the better dividend pay-out policy. Quote figures.

(6)

Compare and comment on the % return on equity earned by EACH company. Quote figures.

(4)

Mike feels that the earnings per share (EPS) of Optima Ltd is much better than that of Horizon Ltd. Explain why he feels this way. Quote figures or calculations.

(5)

3.2.3	Explain TWO decisions taken by the directors of Horizon Ltd in response to the state of the economy, and how these decisions will affect the company in future.	
	Decision 1 (with figures): Decision 2 (with figures): Effect on Horizon Ltd in future:	(6)
	Explain TWO decisions taken by the directors of Optima Ltd that affect risk and gearing. Quote and comment on TWO financial indicators.	
	Decision 1 (with figures): Decision 2 (with figures): Quote and comment on TWO financial indicators that affect risk and gearing.	(8)

ACTIVITY 4 ANSWER SHEET

USANDA LIMITED

Calculate financial indicators for the year ended 28 February 2021:

4.1 % operating profit on sales	
Workings	Answer
4.2 Acid-test ratio	
Workings	Answer
4.3 Debt- Equity ratio	
Workings	Answer
4.4 % return on average shareholders' equity (ROSHE)	
Workings	Answer
4.5 Dividend pay-out rate (%)	
Workings	Answer

ACTIVITY 5 ANSWER SHEET

5.1

5.1.1	
5.1.2	
5.1.3	
5.1.4	

(4)

5.2 SCI-FI GEEKS LTD

5.2.1

The directors are satisfied with the improvement in the current ratio and the acid-test ratio. Explain why you would disagree with them. Quote TWO financial indicators in your response.

(6)

5.2.2

Comment on the dividend per share over the two years. Quote figures.

(2)

Comment on the dividend per share over the two years. Quote figures.

Give a reason for this change.

(4)

A shareholder felt that they should be satisfied with the dividends they received as it is better than last year. Explain why you agree with him. Quote figures.

(4)

5.2.3	Comment on the risk and gearing for both years. Quote TWO financial indicators (with figures).	
5.2.4	Existing shareholders are dissatisfied that the new shares issued on 1 April 2020 were sold to the CEO, Ida Shark. Give TWO reasons why you consider their feelings to be justified. Quote figures.	
		(6)
5.2.5	The Cash Flow Statement reflected a positive change in R980 000. Provide TWO points why this should still be a concern to directors. Quote figures.	
		(4)

6. SUGGESTED ANSWERS AND MARKING GUIDELINES
ACTIVITY 1
SUGGESTED ANSWERS AND MARKING GUIDELINES

1.1 CALCULATION OF FINANCIAL INDICATORS FOR 2018

1.1.1 Calculate: % operating expenses on sales

Workings	Answer
$\frac{1\ 900\ 000}{13\ 182\ 000} \times 100$	14,4% ✓✓

(2)

1.1.2 Calculate: Acid test ratio

Workings	Answer
775 000 two marks (2 427 000 ✓ – 1 652 000 ✓) : 1 244 000 ✓ Or: (410 000 + 365 000) : 1 244 000 one mark one mark one mark	0,6 : 1 ✓

(4)

1.1.3 Calculate: % return on shareholders' equity (use average equity)

Workings	Answer
$\frac{1\ 911\ 000 ✓}{9\ 651\ 500 ✓✓} \times 100$	19,8% ✓

(4)

1.2 EXPLANATIONS ON CASH FLOW STATEMENT

1.2.1 Explain why the directors are satisfied with the improvement in cash and cash equivalents since 1 July 2016. Quote figures.

ONE valid point ✓✓ relevant figure/s ✓

Response for three marks (i.e. comment on two financial years):

- Large negative balance of R609 000 (at end of 2016 financial year) improved to positive R410 000 (at end of 2018 financial year) / improved by R1 019 000. OR
- Large overdraft of R609 000 (at end of 2016) improved to R130 000 / by R479 000 by the end of the 2017 financial year.
- Improvement continued in 2018; the overdraft was eradicated, and C&CE were positive R410 000 at end of 2018 financial year.
- Response for two marks (i.e. comment on one financial year):
- In 2018 financial year, C&CE increased from R5 000 to R410 000 / by R405 000 OR:
- In 2017 financial year, overdraft of R609 000 decreased to R130 000 / by R479 000 OR:
- In 2018 financial year, overdraft of R130 000 was eliminated, C&CE improved to positive R410 000 / by R540 000.

(3)

1.2.2 Identify THREE decisions that the directors made to pay for land and buildings.

	Points (with figures)
Decision 1 (with figures)	✓Issued shares (rights issue): R4m✓
Decision 2 (with figures)	✓Sale of fixed assets R305 000✓
Decision 3 (with figures)	✓Cash generated from operations; part of R1,85m ✓ / increase of R804 000
Any other valid point e.g.	• Items that may influence cash generated from operations R3,32m • Increase in sales R5,4m / due to lower mark-up 72% to 58% • Tax not paid R74 000 • Better collection from debtors (820 000 – 365 000)

(6)

Explain how these decisions affected the capital employed in the 2018 financial year. Quote figures. Any ONE of: (with figures) ✓✓

- TCE increased by R4,171m / from R9,791m to R13,962m / by 29,9%
- OSHE increased by R4,921m / by 68,4% / OSC increased by R4m
- Loan decreased by R750 000

Explain how these decisions affected the financial gearing in the 2018 financial year. Quote TWO financial indicators and their figures.

TWO relevant financial indicators ✓ ✓ figures and trend ✓ ✓

- Debt/equity ratio improved (decreased) from 0,4: 1 to 0,2:1
- ROTCE improved/increased from 17,8% to 20,8% while interest rate is 12%

(6)

1.2.3 From the Cash Flow Statement identify ONE decision made by the directors in 2017 that they did NOT make in 2018, besides the points mentioned above. Give a possible reason for the decision in 2017.

Any one decision ✓ (with figures) ✓	Possible reason ✓
Repurchase of shares, R1m	Satisfy shareholders / improve certain financial indicators; EPS; DPS; NAV
Issued no shares (i.e. Nil)	Maintain ROSHE or EPS or DPS; economic climate not conducive to expansion in previous year
Increased the loan by R600 000	Because they did not issue shares

(3)

1.3 DIVIDENDS, RETURNS AND SHAREHOLDING

1.3.1 Calculate: Total interim dividends paid for the 2018 financial year

Workings	Answer
✓ ✓ 520 000 – 280 000	✓ R240 000

Calculate: Interim dividends per share for the 2018 financial year

Workings	Answer
$\frac{240\ 000\ ✓}{800\ 000\ ✓} \times 100$	30 cents ✓ one part correct accept 30 or R0,30

(6)

1.3.2 Calculate total dividends earned by Dudu Mkhize for the 2018 financial year.

Workings	Answer
✓ ✓ ✓ ✓ (380 000 x 0,3) + (490 000 x 0,75) 114 000 two marks 367 500 two marks	481 500 ✓

(5)

1.3.3 Calculate the minimum number of additional shares that Dudu should have bought.

Workings	Answer
✓ ✓ 500 000 – 490 000 +1 or +2 or + 100 or 51% 1 000 000 shares x 50% Dudu's shares OR: 500 001 – 490 000	10 001 or 10 002 OR 10 100 OR 20 000 ✓
OR: Accept all figures above in addition to the 110 000 already bought, 500 000 – 380 000 +1 or +2 or + 100 or 51% = 120 001 / 120 002 / 120 100 / 130 000	
Response for one mark: She could have bought 152 000 shares (i.e. 380 000 x 2/5)	

(3)

1.4.1 Explain why it was necessary to purchase properties in other provinces instead of in KZN.
Any valid explanation ✓✓

To increase their target market / to increase sales /
to ~~generate~~ new customers /
to expand to areas where there is lots of money /
because they exhausted the market in KZN /
too much competition in KZN / low profits in KZN /
to diversify their business operations (e.g. rental income) /
because of better value for money in other provinces

Explain whether the decision to purchase these properties had the desired effect on sales. Quote figures.
Identify positive effect ✓ Figures ✓✓

Sales increased by 850 bikes / from 900 to 1 750 / by 94,4%
OR by R5,442m / from R7,74m to R13,18m / by 70,3%

(3)

Explain another strategy they used to solve the problem of low sales. Quote figures.
Identify positive effect ✓ Figures ✓✓

Decrease in MU% from 72% to 58% / by 14% (led to increased sales)
OR Decreased selling prices reduced from R8 600 to R7 533 / by R1 067

(3)

1.4.2 Give advice on what Ben Palo should say about the following topics:
Advice on what to say on earnings per share:
Explanation/trend ✓ Figures ✓✓

EPS increased by 60% / from 130c to 208c / by 78c (compared to R28 or R12,11)

(3)

Advice on what to say on % return earned:
Explanation/trend ✓ Figures ✓✓

ROSHE (is above returns on alternative investments) increased from 14,4% to 19,8%

(3)

Advice on what to say on share price on the JSE:
Explanation/trend ✓ Figures ✓✓

Market price increased R21,00 → R28,00
Exceeds NAV R8,99 → R12,11

(3)

ACTIVITY 2
SUGGESTED ANSWERS AND MARKING GUIDELINES

2.1

2.1.1	Solvency ✓
2.1.2	Liquidity ✓
2.1.3	Return on equity ✓
2.1.4	Gearing ✓

(4)

2.2 KULFI LTD

2.2.1

Calculate: Acid test ratio

996 480 one mark – 448 000 one mark
548 480 two marks

(288 300 ✓ + 260 180 ✓) : 553 600 ✓ = 0,99: 1 or 1 : 1 ✓

(4)

Calculate: Debt-equity ratio

1 400 000 ✓ : (311 000 ✓ + 7557 600✓)
7 868 600

= 0,2 : 1 ✓ (0,17 : 1)

(4)

Calculate: % return on average shareholders' equity (ROSHE)

293 100 x 70/30

$$\frac{683\ 900\ ✓}{½\ ✓\ (7\ 341\ 500P + 7\ 968\ 600\ ✓)} \times \frac{100}{1}$$

7 655 050

= 8,9% ✓

(5)

2.2.2	The shareholders are satisfied with the improvement in the liquidity position. Quote THREE financial indicators (with figures) to support this statement.	
	THREE valid indicators (with trend) ✓✓ ✓✓ ✓✓ Current ratio increased from 0,7 : 1 to 1,8 : 1 Acid test ratio increased from 0,4 : 1 to 1 : 1 Debtors collection period improved from 39,5 days to 28,1 days	(6)
2.2.3	The company increased the share capital by R840 000, and the loan by R550 000. Explain how this affected the gearing and risk of the company. Quote TWO financial indicators.	
	TWO valid indicators ✓✓ ✓✓ Comment ✓ Debt/equity ratio moved from 0,1 : 1 to 0,2 : 1 ROTCE decreased from 14,4% to 12,9% The company is lowly geared (not making extensive use of loans) Increasing the loan has caused the company to be negatively geared as the interest rate is 13,5%. The business is not making effective use of the money borrowed to increase profitability.	(5)
	Provide TWO possible reasons why the business may need additional funds.	
	TWO points ✓✓ ✓✓ The business could invest in fixed assets to improve efficiency They could have done so the address any overdraft concerns Fund could be needed to address liquidity issues such as paying creditors or acquiring more stock to improve sales Need to pay more dividends to satisfy shareholders Possibly invest in fixed deposits (although interest would not be good)	(4)

2.2.4 Provide calculations to show the change in the pay-out rate.

	In 2018: 80/83 x 100 = 96,4% ✓✓ of EPS was distributed as dividends In 2019: 47/71 x 100 = 66,2% ✓✓ of EPS was distributed as dividends	(4)
	Give ONE reason why many shareholders were satisfied with the change in policy. Quote figures.	
	Any ONE valid explanation ✓ Relevant figures ✓ Cash earnings from dividends decreased by 33 cents per share because the company is retaining money for capital growth.	(2)
2.2.5	Explain how the repurchase of the shares benefited Martha's shareholding. Quote figures.	
	ONE point ✓✓ figure (calculation) ✓✓ After the issue of additional shares, she now owns 47,5% of the shares 475 000/1 000 000. After the repurchase, she once again became the majority shareholder. 475 000/940 000 = 50,5%	(4)

ACTIVITY 3
SUGGESTED ANSWERS AND MARKING GUIDELINES

3.1 SUNSET LTD

3.1.1 Calculate financial indicators for the year ended 28 February 2019:

% operating profit on sales

Workings	Answer
$\frac{2\,033\,900 ✓}{8\,725\,000 ✓} \times 100$	23,3% ✓✓

(4)

Net asset value per share

Workings	Answer
$\frac{8\,625\,000 ✓}{1\,240\,000 ✓} \times 100$	695,6 cents ✓✓

(4)

Debt-equity ratio

Workings	Answer
3 500 000 ✓ : 8 625 000 ✓	0,4 : 1 ✓✓

(4)

3.2 HORIZON LTD and OPTIMA LTD

3.2.1 Explain why directors should be interested in the price of their companies' shares on the JSE.

Any ONE valid comment ✓✓ one mark for partial or incomplete answer It shows public confidence in the company. Compare to other companies. Shareholders will want to have capital growth on their investment. Directors will be judged on the performance of the shares as this reflects the performance of the company.

(2)

Calculate the number of additional shares in Horizon Ltd that Mike was able to buy on the JSE in 2019.

Workings	Answer
R420 000 ✓ ÷ R8,40 ✓	50 000 shares ✓

(3)

Comment on the price that Mike paid for these shares and provide TWO reasons why he might have been satisfied to pay this price.

Compare price paid to NAV ✓✓ Reasons ✓✓ ✓✓ HORIZON: JSE Price exceeds NAV by 90 cents (R8,40 – R7,50) • Valid reasons for HORIZON: • He wants to be the majority shareholder • He can have more influence over decisions by board of directors • JSE price reflects public demand for the shares • He feels that there is potential for high returns OPTIMA: JSE Price is lower than NAV by 45 cents (R4,45 – R4,00) Valid reasons for OPTIMA Ltd: • The JSE price is a good deal compared to NAV • Optima is earning higher returns for him

(6)

3.2.2 Explain your opinion on which company has the better dividend pay-out policy. Quote figures.

Choice of company: Either Horizon Ltd OR Optima Ltd ✓ Reason: Either retaining funds OR rewarding shareholders ✓ Figures: Horizon Ltd pays out 67% (65c of 97c earned) ✓✓ While Optima Ltd pays out 96% (80c of 83c earned) ✓✓

(6)

Compare and comment on the % return on equity earned by EACH company. Quote figures.

Comment ✓ Figures ✓ Horizon Ltd is nor performing well: ROSHE 6,2% below interest rate (6,5%) Comment ✓ Figures ✓ Optima Ltd is performing well: ROSHE 18,2% above interest rate (6,5%)

(4)

Mike feels that the earnings per share (EPS) of Optima Ltd is much better than that of Horizon Ltd. Explain why he feels this way. Quote figures or calculations.
Quote

EPS of Horizon Ltd 97 cents ✓
Quote EPS of Optima Ltd 83 cents ✓

Compare EPS of both companies to:
Share value OR to number of shares owned OR % ROSHE OR: Net Profit ✓
Identify figures for any one comparison below ✓✓

Horizon Ltd	Optima Ltd
Cost of shares is high 750c or 840c (Earnings yield is 12,9% or 11,5%)	Cost of shares is low 445c or 400c (Earnings yield is 18,7% or 20,8%)
EPS is earned on 580 000 shares R562 600	EPS is earned on 1 430 000 shares R1 186 900
% ROSHE is 6,2%	% ROSHE is 18,2%
NP after tax is R1 202 800 (97c x 1 240 000 shares)	NP after tax is R2 158 000 (83c x 2 600 000 shares)

(5)

3.2.3 Explain TWO decisions taken by the directors of Horizon Ltd in response to the state of the economy, and how these decisions will affect the company in future.

Decisions: TWO valid decisions ✓✓ Figures ✓✓

Sold fixed assets R1 800 000 / No new assets were purchased, R0
Did not issue new shares, R0
Reduced investments R900 000
Loan repaid R1 600 000

Effect on Horizon Ltd in future: must relate to a decision above
Any one valid comment: ✓✓ one mark for partial or incomplete answer

The infrastructure / size of the company is decreasing which will affect future profit.
The reduced infrastructure / size of the company could lead to cost savings (or increased profit).
Saving on interest / less risk. (6)

Explain TWO decisions taken by the directors of Optima Ltd that affect risk and gearing.
Quote and comment on TWO financial indicators.

Decisions: Two valid decisions ✓✓ Figures✓✓ Increased loan R3 800 000 Sold shares R200 000 Shares repurchased R0 Quote and comment on TWO financial indicators that affect risk and gearing. Financial indicators with figures ✓✓ Comment on risk ✓ high / medium / low / increased risk low/high geared. Comment on gearing ✓ Positive gearing / ROTCE is higher than the interest rate of 12% Debt-equity ratio: 0,7 : 1 ROTCE 15,1% exceeds interest rate (12%) Valid comment: There is positive gearing and high/medium risk OR: This will increase risk and gearing but it is still positive OR: Gearing increases a lot, but still positive

(8)

ACTIVITY 4
SUGGESTED ANSWERS AND MARKING GUIDELINES

USANDA LIMITED

Calculate financial indicators for the year ended 28 February 2021:

4.1 % operating profit on sales

Workings	Answer	
$\frac{2\ 262\ 100}{17\ 800\ 000} \times \frac{100}{1}$	12,7%✓✓	(2)

4.2 Acid-test ratio

Workings	Answer	
(659 500 – 276 500) two marks or (262 300 + 120 700) two marks 383 000✓✓ : 611 900✓	0,6 :1✓	(4)

4.3 Debt- equity ratio

Workings	Answer	
✓ ✓ 1 930 000 : 9 891 400	0,19 : 1 Or 0,2 : 1	(4)

4.4 % return on average shareholders' equity (ROSHE)

Workings	Answer	
$\frac{1\ 243\ 900 ✓}{½\ (11\ 985\ 000 ✓ + 9\ 891\ 400 ✓)} \times 100$ 21 876 400 10 938 200 two marks	11,4%✓	(4)

4.5 Dividend pay-out rate (%)

Workings	Answer	
495 000/1 650 000 = 30 cents 30 cents + 20 cents; one mark each $\frac{50 \text{ cents} ✓✓}{74 \text{ cents} ✓} \times \frac{100}{1}$ OR $\frac{835\ 000}{1\ 243\ 900} \times \frac{100}{1}$ (2021 Total. div) (2021 NPATax)	67,6% ✓ or 67,1% Accept 67% / 68%	(4)

ACTIVITY 5
SUGGESTED ANSWERS AND MARKING GUIDELINES

5.1

5.1.1	C ✓
5.1.2	E ✓
5.1.3	B ✓
5.1.4	A ✓

(4)

5.2 SCI-FI GEEKS LTD

5.2.1 The directors are satisfied with the improvement in the current ratio and the acid-test ratio. Explain why you would disagree with them. Quote TWO financial indicators in your response.

Financial indicators ✓✓ Figures ✓✓ Explanation ✓✓

The stock holding period increased from 32 days to 102 days (or 70 days).
Average debtors' collection period increased from 31 days to 46 days (15 days)
The difference between current ratio (2,4 : 1) and acid test ratio (1,0 : 1) reflects that there is an over-investment in stock.

Any ONE valid explanation; part marks for incomplete /unclear explanation

Too much liquid assets (cash) tied up in stock; stock piling / Electronic equipment can easily become obsolete due to advancements in technology rendering the stock unsaleable.
The business has relaxed / neglected its collection policies and these impacts on the cash flow of the business.

(6)

5.2.2 Comment on the dividend per share over the two years. Quote figures.

ONE valid comment with figures ✓✓ The DPS dropped from 90 cents (in 2020) to 72 cents (in 2021) Shareholders received 18 cents less; or a 20% drop.

(2)

Explain the change in the dividend pay-out rate. Quote figures.

Explanation ✓✓ The dividend pay-out rate increased from 69% (90/130) to 136,5% or 72/58 (accept 124,1%) / or a 98,4% increase from the previous year /t Give a reason for this change. ONE valid point ✓✓ Directors attempted to please the shareholders for the low profitability Compensation for using funds retained in previous financial years. No plans for growth / expansions (to retain additional funds)

(4)

A shareholder felt that they should be satisfied with the dividends they received as it is better than last year. Explain why you agree with him. Quote figures.

Explanation ✓✓ figure ✓ EPS dropped from 130c to 58c (by 72 cents / 55%) but DPS dropped from 90c to 72c (by 18 cents / 20%) If the policy was maintained at 69% of EPS, they would have received 40 cents. The drop in the market price from 540 cents to 410 cents reflects a dividend yield (DPS/MP) of 17,7% this year compared to 16,7% last year.

(3)

5.2.3 Comment on the risk and gearing for both years. Quote TWO financial indicators (with figures).

Financial indicators with figures ✓✓ ✓✓ Explanation ✓✓ Debt/equity ratio increased from 0,3 : 1 to 0, 4: 1 (or by 0,1 : 1) ROTCE decreased from 39% to 23,2% Increased borrowing not effectively used to increase / improve profitability Although still positively geared (interest rate 13,5%), the drop in profitability / downward trend is a concern.

(6)

5.2.4 Existing shareholders are dissatisfied that the new shares issued on 1 April 2020 were sold to the CEO, Ida Shark. Give TWO reasons why you consider their feelings to be justified. Quote figures.

TWO reasons ✓✓ ✓✓ financial indicators and figures ✓✓ The CEO bought the shares at R1,50 each (375 000/250 000); exercising undue influence over the issue price; receiving preferential treatment; against the Companies Act which requires that shares be advertised; lack of transparency; The market price is 410 cents; NAV is 332 cents; Company lost out on potential additional funding as shares could have been sold at a price in that range, or on the stock exchange.

(6)

5.2.5 The Cash Flow Statement reflected a positive change in R980 000. Provide TWO points why this should still be a concern to directors. Quote figures.

TWO points (with figures) ✓✓ ✓✓ Cash flow from operating activities is (148 080) Large increase in loan, 651 500; high interest payment (232 000) contributed to negative cash flow from operation Very high payment for dividends (925 000) Cash from investing activities, 101 580 Additional shares issued, 375 000

(4)

7. EXAMINATION GUIDANCE

1. The Analysis and interpretation questions are tested across almost all topics in both papers where calculations / comment / decision / advice are required.
2. The Financial Indicators Formulae Sheet is attached to your question paper to help you in what you have learnt not to give you answers.
3. Do not rely on the formula sheet totally, as the names of the financial indicators are not provided. E.g. If the question requires you to calculate the current ratio, the formula sheet will show: Current Assets : Current Liabilities, and not mention current ratio.
4. You should read the sub-questions carefully and highlight the relevant information such as verbs (what are you expected to do) and key dates to ensure that you use the correct financial indicator in your calculations.
5. Identify the relevant financial indicators to comment on specific questions.
6. Extract the appropriate information from the financial information given, to calculate financial indicators.
7. Understand the requirements of the question, such as comment, give advice, provide the trend, justify his actions etc. and give an appropriate answer.
8. Do not comment on the negative – use positive.
9. Be knowledgeable so that it is easy to work backwards using the given information.
10. Don’t rely on rote learning or mindless memorising without insight.
11. The marks allocated in a question are an indication of the length of the expected answer.

8. GENERAL STUDY AND EXAMINATION TIPS

1. Note that Accounting content is now assessed/split into TWO papers;

• P1 Financial Reporting and Evaluation	150 marks	2 hours
• P2 Managerial accounting and internal controls	150 marks	2 hours

2. It is important to be familiar with the specific content for each paper so that you can plan effectively for examinations. Note that certain topics are relevant to both papers and some may be integrated within one paper and question.
3. Obtain the examination guidelines, exemplar papers and many past examination papers to form the basis of your study programme.
4. Prepare a functional study time table and focus on specific topics at different intervals. Align this to time management; exploring short-cuts for calculations, frequently asked predictable questions and recommended responses for interpretive questions.
5. Pay close attention to the language used in past papers such as key vocabulary and action verbs.
6. For calculations, always show all workings – they carry many part marks.
7. Familiarise yourself with the structure and layout of Questions. They follow the same pattern which is: Appetizer, Required, Information.
8. Note that the ANSWER BOOK is a vital part of the Question Paper, as many amounts and details will be included for most Questions. This is a time-saving device. Ensure that you include these amounts in your final answers, where relevant.
9. Always arrive at least 30 minutes before the commencement of the paper. You will then be able to easily take care of all the administration requirements and to make effective use of your 10 minutes reading time.
10. Use the reading time to get a global picture of the paper, and identify where you wish to start (according to your strengths). You already have the ANSWER BOOK to assist in this regard. Simply go to the relevant pages for that Question.
11. You can also answer the sub-questions in any order; always inserting what is given, working from the simple to the more challenging.
12. Write legibly and neatly; markers must be clear about your answers.
13. Keep your comments short and to-the-point. The mark allocation is your guide about the length of your response.
14. Have your own stationery and a good calculator (even a spare – just in case).

9. ACKNOWLEDGEMENTS

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