

**ACCOUNTING GRADE 12**

**LOCKDOWN LEARNER SUPPORT MATERIAL**

**NOTES AND WORKED ACTIVITIES**

**INTERPRETATION OF FINANCIAL INFORMATION**

It is important to note that interpretation is NOT a topic in isolation; it filters into almost all topics of the syllabus. This will also be relevant to Paper 1 and Paper 2 in 2020 (Gr 12).

Basically, interpretation will include:

* Using Financial Indicators to analyse and make meaningful comments;
* Factors beyond financial indicators, such as comparisons, decisions and problem-solving

 **Users of Financial Statement want Answers????**

**Can the business pay of its immediate debts in the short term?**

**To what extent is the business financed by borrowed capital?**

**Are investors interested in buying shares in this company?**

**Is the business controlling expenses effectively?**

**Is the business able to meet all their financial obligations with existing assets?**

**Are shareholders receiving a favourable benefit from this business?**

**STRATEGY TO ANSWERING INTERPRETATIVE QUESTIONS**

* **Identify the appropriate financial indicators necessary to answer the question.**

At times, the question will not give any indications of the financial indicators to be used. Example, Comment on the liquidity of the business… You may need to calculate the ratios (if they are not given on the table of indicators).

* **Quote the figures and show the trend. Do some comparison (increase/decrease):**

*Comparisons would include:*

* + - Information of the same business (previous financial year/s)
		- Other businesses in the same industry (competitors)
		- Targets set by the business (such as a mark-up percentage)
		- An alternative action (such as an investment in a fixed deposit)
		- External factors such as the inflation rate, interest rate and market price of shares.
* **Comment.**

Showing insight or understanding (focus on whether this is **good** or **bad** for the business). Provide short, concise statements. Be guided by the mark allocation as to how much information you need to provide.

**Financial Indicators** are calculated using information extracted from the **Income Statement** and the **Balance Sheet.**

|  |  |  |
| --- | --- | --- |
| **Income Statement** | **Profitability**  | % on sales / cost of salesNet profit after tax |
| Operating efficiency |
| **Return** indicators | Net profit (before/after tax)Interest expense |
| **Balance Sheet** | **Liquidity** | Current assets and Current liabilities |
| **Solvency** | Total assets and total liabilitiesNet assets (Shareholders Equity) |
| **Risk and Gearing** | Non-current liabilitiesShareholders’ equity |
| **Return**  | Shareholders’ equityNon-current liabilitiesTotal capital employedShare dividends (Retained income) |
| **Share price** | Share capital, Number of sharesShareholders’ equity |

**ACTIVITY 1: Interpreting Financial indicators**

**REQUIRED**:

|  |  |  |
| --- | --- | --- |
| 1.1 | Comment on the **profitability** (operating efficiency) of the business. Quote and explain TWO relevant financial indicators (with figures).  | (6) |
|  |  |  |
| 1.2 | 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.  | (9) |
|  |  |  |
| 1.3 | 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.
 | (6) |
|  |  |  |
| 1.4 | 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) |
|  |  |  |
| 1.5 | The company paid R4,00 per share to repurchase 50 000 shares during April 2018. This was R1,25 above the average share price. Explain whether the shareholder received a **fair price for his shares**. Quote TWO financial indicators with figures.  | (6) |

**INFORMATION**

|  |  |  |
| --- | --- | --- |
|   | **2017** | **2016** |
| 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 expenses on sales | 36% | 31% |
| 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% |
| Net asset value per share | 335 cents | 346 cents |
| Market price per share | 347 cents | 340 cents |

**INTERPRETATION BEYOND FINANCIAL INDICATORS**

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

**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).
* This 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.

**2. Majority shareholding**

* Essentially, this refers to a shareholder owning **more than 50%** of the issued shares is a company.
* The **number of shares** is used in the calculation (shares are issued at different prices over time).
* 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).

**ACTIVITY 2: Dividend pay-out rate and Majority Shareholding**

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

**REQUIRED:**

2.1 Calculate H. Haw’s percentage shareholding before and after the issue of additional shares on 30 June 2018.

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

2.3 Haw convinced the CEO to repurchase 160 000 shares from a close friend who was not interested in being a shareholder of the company on 1 March 2019.

 2.3.1 Explain the effect of this re-purchase on Haw’s % shareholding.

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

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

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

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

**INFORMATION:**

|  |  |  |
| --- | --- | --- |
| **A.** | **Details of share capital** |  |
|  |

|  |  |  |
| --- | --- | --- |
|  | **2019** | **2018** |
| Number of shares | 850 000 | 650 000 |
|  | R6 070 000 | R4 550 000 |

 |  |
| B. | H. Haw a senior director on the Board, owns 350 000 shares on 1 March 2018. Additional shares were issued on 30 June 2018. Haw was on holiday and missed the opportunity to purchase any shares.  |  |
|  |  |  |
| **C.** | **Financial Indicators calculated.**  |  |
|  |

|  |  |  |
| --- | --- | --- |
|  | **2019** | **2018** |
| Earnings per share (EPS) | 98 cents | 112 cents |
| Dividends per share (DPS) | 84 cents | 58 cents |
| Interest rate on fixed deposits | 6,5% | 6% |

 |  |

**3. The Cash Flow Statement**

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| **CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 2018** |
|  |
| **Cash flow from operating activities** | **626 000** |  |
| Cash generated from operations | 950 000 | \* Net Profit adjusted (Cash part)\*Changes in working capital |
| Interest paid | (75 000) | \*Cost of borrowing (loans) |
| Taxation paid  | (123 000) | \*Compulsory payment to SARS |
| Dividends paid | (126 000) | \*Necessary payment to Shareholders Amount to distribute: **DECISION** |
|  |  |  |
| **Cash flow from investing activities** | **(455 000)** |  |
| Purchase of fixed assets | (520 000) | **DECISION.**  |
| Proceeds from the sale of fixed assets | 45 000 | **DECISION** |
| Decrease in fixed deposit | 20 000 | To invest: **DECISION**Maturity: Fixed date (period)  |
|  |  |  |
| **Cash flow from financing activities** | **170 000** |  |
| Proceeds from the issue of shares  | 400 000 | **DECISION** |
| Share buy-backs  | (80 000) | **DECISION** |
| Decrease in loan | (150 000) | **DECISION** |
|  |  |  |
| **Net change in cash and cash equivalents** | **341 000** | **CONSEQUENCE OF DECISIONS**  |
| **Cash and cash equivalents at beginning** | (69 000) | OVERDRAFT |
| **Cash and cash equivalents at end** | 272 000 | CURRENT ASSET |

*The Cash Flow Statement will reveal decisions by directors that will have consequences on ALL aspects of the company, affecting all three sections, and the overall cash flow situation.*

**COMPARATIVE CASH FLOW STATEMENTS (FOR TWO YEARS):**

**A. Extract from the Financial Statements:**

|  |
| --- |
|  |
|  | **2018** | **2017** |  |
| Depreciation  | 64 300 | 34 600 |  |
| Fixed assets (carrying value) | 2 042 700 | 2 167 000 |  |
|  |  |  |  |

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| **CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 2018** |
|  |
|  | **2018** | **2017** |  |
| **Cash flow from operating activities** | **626 000** | **92 000** |  |
| Cash generated from operations | 950 000 | 520 000 |  |
| Interest paid | (75 000) | (130 000)  |  |
| Taxation paid  | (123 000) | (88 000) |  |
| Dividends paid | (126 000) | (210 000) |  |
|  |  |  |  |
| **Cash flow from investing activities** | **80 000** | **(520 000)** |  |
| Purchase of fixed assets | **?** | (520 000) |  |
| Proceeds from the sale of fixed assets | 160 000 | - |  |
| Change in fixed deposit | **?** | - |  |
|  |  |  |  |
| **Cash flow from financing activities** | **250 000** | **260 000** |   |
| Proceeds from the issue of shares  | **400 000** |  |   |
| Share buy-backs  | **-** | **(240 000)** |  |
| Decrease in loan | **(150 000)** | **500 000** |  |
|  |  |  |  |
| **Net change in cash and cash equivalents** | **?** | **(168 000)** |  |
| **Cash and cash equivalents at beginning** | **?** | 99 000 |  |
| **Cash and cash equivalents at end** | 887 000 | **(69 000)** |  |

**Possible Questions:**

 USING AMOUNTS ON THE CASH FLOW STATEMENT TO CALCULATE:

3.1 Calculate the amount spent to purchase fixed assets in 2019

3.2 Calculate the change in the fixed deposit. Indicate if this is an inflow or outflow of

 cash.

3.3 Calculate the net change in cash and cash equivalents in 2019.

 DECISIONS IN RESPONSE TO LAST YEAR (QUOTE FIGURES)

3.4 Identify ONE decision that directors took last year that they did not take this year

 and ONE decision they took this year, and not last year.

 CONSEQUENCES

3.5 Identify TWO decisions revealed by the Cash Flow Statement taken last year,

 and explain the consequences of these decisions.

3.6 Comment on the impact of the decisions regarding financing activities over the

 two year. Mention the overall effect on the total capital employed.

\*\*\*\* RESPONSIBLE / IRRESPONSIBLE DECISIONS must be discussed at this point.

 OVERALL IMPACT ON CASH

3.7 Comment on the change on CCE from 1 July 2016.

**ACTIVITY 1: Interpreting Financial indicators**

**REQUIRED**:

|  |  |  |
| --- | --- | --- |
| 1.1 | Comment on the **profitability** (operating efficiency) of the business. Quote and explain TWO relevant financial indicators (with figures).  | (6) |
|  | *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 by 3%; operating expenses was not well controlled. Increased from 31% to 36%; operating profit dropped from 21% to 16%.*  |  |
|  |  |  |
| 1.2 | 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.  | (9) |
|  | *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.*  |  |
|  |  |  |
| 1.3 | 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.
 | (6) |
|  | *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*  |  |
|  |  |  |
| 1.4 | 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.*  |  |
|  |  |  |
| 1.5 | The company paid R3,50 per share to repurchase 50 000 shares during April 2018. 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.  | (6) |
|  | *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; 350 cents last year)**Looking at trends, although the NAV is declining, the MP is increasing; an indicator of investor confidence.*  |  |

**ACTIVITY 2: Dividend pay-out rate and Majority Shareholding**

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| --- | --- | --- |
| 2.1 | **Calculate H. Haw’s percentage shareholding before and after the issue of additional shares on 30 June 2018.** |  |
|  | Before: 350 000/650 000 = 53,8% After: 333 000/850 000 = 41,2%  |  |
|  |  |  |
| 2.2 | **Explain why Haw 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.  |  |
|  |  |  |
| 2.3.1 | **Explain the effect of this re-purchase on Haw’s % shareholding.** |  |
|  | The total number of shares would decrease from 850 000 to 690 000 shares Haw’s % shareholding: 350 000/690 000 = 50,7% ☑ |  |
|  |  |  |
| 2.3.2 | **Explain why the other shareholders would be concerned about this transaction, once they received inside information about the share buyback.** |  |
|  | Ethical issueHe has used his position (senior director) to influence the re-purchase of sharesHe wants to regain his majority status.  |  |
|  |  |  |
| 2.4 | **Show the change on the dividend pay-out rate by doing a calculation.** |  |
|  | 2018: 58/112 = 51,8% 2019: 84/98 = 85,7%  |  |
|  |  |  |
| 2.5 | **Provide TWO possible reasons why the directors decided to change the trend of previous year.**  |  |
|  | To satisfy shareholders, who may be concerned about the decrease in profitability.They have no strategic plans for growthThey in the process of balancing the dividends distributed over the last 5 years.  |  |

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| 2.6 | **Will the shareholders be satisfied with this change on policy? Provide TWO points.** |  |
|  | The short-term investor who is looking for improved dividends as his returns on investment would be dissatisfied. The long term investor would consider the growth of the company and the possibility of better dividends over a longer period.  |  |
|  |  |  |

**Cash Flow Statement:**

**Example:**

|  |  |  |
| --- | --- | --- |
| 3.1 | **Calculate the amount spent to purchase fixed assets in 2019** |  |
|  | 2 042 700 + 160 000 + 64 300 – 2 167 000 = 100 000 |  |
|  |  |  |
| 3.2 | **Calculate the change in the fixed deposit. Indicate if this is an inflow or outflow of cash.** |  |
|  | 80 000 + 100 000 – 160 000 = 20 000 ; inflow.  |  |
|  |  |  |
| 3.3 | **Calculate the net change in cash and cash equivalents in 2019.** |  |
|  |

|  |  |
| --- | --- |
| **Net change in cash and cash equivalents** | **956 000** |
| Cash and cash equivalents at beginning | (69 000)\* |
| Cash and cash equivalents at end | 887 000 |

\* closing balance of last year is opening balance of this year. |  |
|  |  |  |
| 3.4 | **Identify ONE decision that directors took last year that they did not take this year and ONE decision they took this year, and not last year.** |  |
|  | 2018: Shares bought back, 240 0002019: Fixed assets sold at carrying value, 160 000 |  |

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| 3.5 | **Identify TWO decisions revealed by the Cash Flow Statement taken last year, and explain the consequences of these decisions.** |  |
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|  |  |
| --- | --- |
| **DECISION** | **CONSEQUENCE** |
| Fixed Assets purchased, R520 000 | Intention to improve productivity. May have contributed to profitability in the next year |
| Shares bought back, R240 000 | Impact negatively on cash resourcesCompany was to do solvency and liquidity tests before repurchasing |
| Increase in the loan, R500 000 | Increase in risk, debt/equity ratioAttempt to address cash flow situationMoney used to purchase fixed assetsLarge dividend payment |

 |  |
|  |  |  |
| 3.6 | **Comment on the impact of the decisions regarding financing activities over the two year.** **Mention the overall effect on the total capital employed.**  |  |
|  |

|  |  |
| --- | --- |
| **DECISION** | **IMPACT** |
| Shares were issued in 2019, R400 000Loan was repaid, R150 000 whereas, R500 000 was taken out last year.  | The loan received last year showed no impact on the operating activities (low profitability), it was possibly negative gearing, causing directors to start repaying.New shares issued did not impact on interest charges, possible used to pay back the loan. The overall impact on capital was not significant (260 000 last year compared to 250 000 this year)The major influence last year was the increase in loan, contributing to greater risk. SE increase in the current year would contribute to reducing the risk factor in terms of debt/equity ratio. |

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| 3.7 | **Comment on the change on CCE from 1 July 2016.** |  |
|  |  The company had a favourable cash balance of R99 000. Poor decisions (explained above) led to a net decrease in CCE, of R168 000Corrective actions implemented in the current year led to a positive change of R956 000.  |  |
|  |  |  |
|  |  |  |