



**TOE408W
ZAC408H
SECOND PAPER**

October/November 2011

APPLIED MANAGEMENT ACCOUNTING

Duration : 3 Hours

100 Marks

EXAMINATION PANEL AS APPOINTED BY THE DEPARTMENT.

Use of a non-programmable pocket calculator is permissible.

This examination question paper remains the property of the University of South Africa and may not be removed from the examination venue.

READING TIME: 30 MINUTES

NO CANDIDATE WILL BE ALLOWED EITHER TO LEAVE THE VENUE DURING THE FIRST HOUR OF THE EXAMINATION OR TO ENTER THE VENUE AFTER ONE HOUR AFTER THE EXAMINATION HAS BEGUN.

THIS PAPER CONSISTS OF 7 PAGES WHICH CONSISTS OF ONE QUESTION (QUESTION 2) (EXCLUDING THE REQUIRED PART WHICH WILL BE HANDED OUT SEPARATELY).

THIS IS NOT AN OPEN BOOK EXAMINATION

PLEASE COMPLETE THE COVER PAGE OF EACH ANSWER BOOK IN FULL.

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QUESTION 2**100 marks**

RAPS Group Limited ("RAPS") is listed on the main board of the JSE Securities Exchange SA and operates a chain of South African retail food stores. These retail stores focus primarily on convenience-shopping and are operated predominantly on a franchise-basis. The directors of RAPS Group are investigating expansion options that would facilitate accelerated entry into the growing Africa market. As part of these investigations, the directors have identified OKAY (Proprietary) Limited as a potential target for acquisition.

OKAY (Proprietary) Limited ("OKAY") is a private company operating a chain of supermarkets located in South Africa, Zambia and Botswana. The company grew from humble beginnings in the 1970s to being one of the largest privately-owned supermarket groups in southern Africa. OKAY owns the businesses and is not operated on a franchise-basis. OKAY is still 75% owned by its founding-family.

A. Retail industry information

In South Africa, an increasing percentage of food and groceries are sold by the large food retail groups. These groups operate different types of food retail stores and wholesalers, including convenience stores, supermarkets and hypermarkets.

The food and grocery market is set to grow in South Africa, but significantly greater growth is expected in sub-Saharan Africa over the next two decades. The South African food-retail industry experienced tough trading conditions in 2010 and 2011, due to the slow recovery from the worldwide recession, the high levels of competition and the low levels of food inflation.

To curb costs, supermarket groups of sufficient size often buy directly from manufactures. These supermarkets operate at low profit margins and thus rely on the sale of large quantities.

Gross profit margins are calculated easily, but supermarket groups often struggle to calculate the net profit margins of individual items or groups of items, due to the large number of activities and costs incurred. In an attempt to better quantify costs, some supermarket groups have implemented Activity based costing (ABC) systems, which usually involve the following steps:

1. Identify major activities;
2. Assign costs to activity pools;
3. Determine cost drivers for each activity; and
4. Assign the cost of activities to individual items or group of items based on its demand for the activity.

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SELECT & SWIPE Limited

Most supermarket groups, including SELECT & SWIPE Limited (“S&S”) – a company listed on the Alternative Exchange (Alt^x) of the JSE Securities Exchange SA – own only a small percentage of the properties from which they operate; instead they enter into long-term lease contracts for periods of between 10 and 20 years, normally renewable for a further 10 to 20 years. Retail space is usually leased at shopping centres and the large quantities of floor space often leased make it impractical for more than one such key-tenant to operate in the same centre. This barrier to competition in the same place is normally further entrenched through a relevant clause in the lease contracts, limiting a competitor supermarket to occupy space at the same location.

The operating rentals of S&S mostly comprise minimum monthly payments with additional payments based on turnover levels. The turnover rentals, where applicable, average 1.5% of turnover.

S&S owns the businesses and do not operate them on a franchise-basis. The company further owns most of the vehicles used in its delivery fleet. S&S operates predominantly in South Africa, but the company also owns a few supermarkets in southern Africa.

Relative to the food retail industry, S&S obtained particularly negative results in 2011, due to difficulties in coping with the negative trade environment. Cost-control and other measures have been put in place to counter these effects. Analysts are optimistic that S&S will recover from this slump, to be in-line with the rest of the industry in 2012.

Over the past couple of years, no large changes have occurred in the shareholding of S&S.

MASSMART HOLDINGS Limited

Recently, one of the most newsworthy events in the larger retail industry has been the acquisition of Massmart Holdings Ltd. by Wal-Mart Stores Inc.

Massmart is a South African listed company and the owners of several brands, including Game, Builders Warehouse and Makro. The acquirer, Wal-Mart Stores Inc., is a large retail company based in the United States of America.

Following many developments, where Wal-Mart even at one time considered abandoning their intentions, the deal was finally approved on 31 May 2011, subject to certain conditions.

B. Ratios and figures

At 31 August 2011	Relevant to S&S
Closing share price (cents per share)	425
Headline earnings per share (cents per share) – most recent financial year ended	16
Headline earnings per share (cents per share) – analysts' consensus forecast for 2012 financial year	21
Debt:Equity ratio (based on market values)	0,08:1
Before-tax interest paid as a percentage of earnings before interest and tax	6%
Assume 365 days in one year	

C. Information relating to OKAY (Pty) Ltd:

Summarised statements of comprehensive income for the year ended 31 August

	2011 (draft) R'm	2010 (audited) R'm	2009 (audited) R'm
Revenue	585,2	549,9	501,4
Cost of goods sold	(474,0)	(445,8)	(404,0)
Gross profit	111,2	104,1	97,4
Trading expenses	(86,0)	(83,2)	(75,5)
Depreciation	(19,8)	(19,7)	(19,3)
Employees, occupancy and other expenses	(66,2)	(63,5)	(56,2)
Interest received	0,6	0,5	0,7
Operating profit	25,8	21,4	22,6
Taxation	(7,5)	(6,8)	(7,0)
Profit for the year	18,3	14,6	15,6
Dividends paid	(14,9)	(13,9)	(13,0)
Effect on retained income	3,4	0,7	2,6

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Summarised statement of financial position as at 31 August

	2011 (draft) R'm
ASSETS	
Non-current assets	38,5
Equipment	34,5
Vehicles	3,0
Other	1,0
Current assets	54,0
Inventory	33,3
Trade receivables	19,7
Cash and equivalents	1,0
Total assets	<u>92,5</u>
EQUITY AND LIABILITIES	
Total shareholders' equity	16,2
Current liabilities	76,3
Trade and other payables	74,0
Tax	2,3
Total equity and liabilities	<u>92,5</u>

Additional information relevant to OKAY:

- OKAY's non-current assets are reflected in the statement of financial position at net carrying values and are not shown on a revaluation basis. RAPS estimated the values of OKAY's non-current assets and inventory on 31 August 2011 are:

	Replacement cost R'm	Net realisable value R'm
Equipment	50,0	33,0
Vehicles	5,0	2,9
Inventory	33,8	32,0

- The average age of the equipment owned by OKAY is older than the same equipment of the listed company, S&S. OKAY will have to replace some of its equipment sooner if the company is to match S&S in this regard, which should have a corresponding accounting impact of a 6% increase in OKAY's depreciation expense.

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- An investigation revealed that the salaries of top management (included in employees, occupancy and other expenses) are below market-related pay and will have to be increased by R1 million (in current monetary terms) to match the market. An average rate of inflation equal to 10% applied to management salaries over the past couple of years.
- In accordance with common industry practice, OKAY also enters into long-term lease contracts for its premises. Lease contracts comprise minimum monthly payments and, on average, an additional payment equal to 2% of turnover. Where a tenant selects a greater percentage of its rental payment to relate to turnover, the fixed monthly amount is usually lowered.
- OKAY have matched the growth in earnings of listed company, S&S, to a large extent, except that OKAY achieved (relatively) superior results in 2011.
- OKAY recently received negative publicity when it condoned the actions of one of its exclusive egg suppliers, who allegedly mistreated male hatchlings as part of its usual production processes. OKAY has since distanced itself from this supplier and now buys eggs from an alternative supplier on a price-competitive basis, with a superior animal-rights track record. A due diligence investigation further revealed a contingent liability relating to OKAY's waste-disposal practices in the past. An expert was consulted, who estimated the possible penalties and legal-settlement cost, and its corresponding probability of occurrence:

Probability	Cost R'm
60%	6,0
40%	0,5

- Revenue of OKAY is expected to grow by 7% in 2012.

D. Further information relating to the potential merger or acquisition of OKAY Limited

The directors of RAPS estimate that certain savings could be obtained should RAPS acquire control of OKAY. The directors also expect some expenditure to be incurred. Specific details include:

1. Expected savings (pre-tax) in distribution, marketing and accounting costs for years in the future:

2012 R'm	2013 R'm	2014 R'm
0,8	1,2	1,5

Growth in this benefit from 2015 and later is expected to equal 5% per annum.

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2. Expected integration and new software implementation costs for years in the future:

2012	2013	2014
R'm	R'm	R'm
4,0	1,0	0,3

Should OKAY be acquired by another potential bidder, the net value of cost synergies (after integration costs) is expected to equal R5 million after tax.

EXAMINATION PANEL AS APPOINTED BY DEPARTMENT

FIRST EXAMINERS: MRS A COMBRINK MR AE NOBATYI
 MR A DE GRAAF MRS A RAVAT
 MRS J FOOT MRS F TAYOB
 MR S NDLOVU MRS F VENTER

SECOND: MR FJC BENADE MR L CRAFFORD
 PROF B VAN HEERDEN

EXTERNAL: MR GJ PLANT (UP)

TOE408W/ZAC408H
APPLIED MANAGEMENT ACCOUNTING
OCTOBER / NOVEMBER EXAM 2011
PAPER 2
REQUIRED

YOU HAVE 2,5 HOURS TO ANSWER THIS PAPER

THIS REQUIRED PART CONSISTS OF 3 PAGES.

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Note to candidates:

Pay particular attention to the exact wording of the required section, and the number of marks allocated. Answers should be carefully planned before being executed and clearly numbered. The length and extent of answers should relate to the allocated number of marks.

REQUIRED	Marks																
<p>(a) Analyse the working capital management of OKAY (Pty.) Ltd. at 31 August 2011 based on the available information and discuss your findings using the following format:</p> <table border="1" style="width: 100%; border-collapse: collapse; margin-top: 10px;"> <tr> <td colspan="3" style="padding: 5px;">Analysis and calculations</td> <td style="text-align: center; vertical-align: middle; padding: 5px;">(5)</td> </tr> <tr> <td colspan="3" style="padding: 5px;">...</td> <td></td> </tr> <tr> <td style="width: 33%; padding: 5px;">Discussion of findings</td> <td style="width: 33%; padding: 5px;">Indicate whether levels are typical/ low or high as compared to the industry</td> <td style="width: 33%; padding: 5px;">Possible reasons for your findings, considering the industry</td> <td style="text-align: center; vertical-align: middle; padding: 5px;">(8)</td> </tr> <tr> <td style="padding: 5px;">...</td> <td style="padding: 5px;">...</td> <td style="padding: 5px;">...</td> <td></td> </tr> </table>	Analysis and calculations			(5)	...				Discussion of findings	Indicate whether levels are typical/ low or high as compared to the industry	Possible reasons for your findings, considering the industry	(8)		
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Discussion of findings	Indicate whether levels are typical/ low or high as compared to the industry	Possible reasons for your findings, considering the industry	(8)														
...															
<p>(b) Analyse and discuss the expenditure reported in the supplied statements of comprehensive income of OKAY (Pty.) Ltd. for the years ended 31 August 2009 to 2011.</p> <ul style="list-style-type: none"> • Pay particular attention to the behaviour of the following costs relative to revenue; • Cost of goods sold; • Depreciation; and • Employees, occupancy and other trading expenses. 	<p style="text-align: right;">Analysis (9) Discussion (8)</p>																
<p>(c) Discuss briefly the reason for the requirement by the JSE Securities Exchange for listed companies to calculate Headline Earnings. Include the typical types of adjustments made in the calculation of Headline Earnings that are not made for basic earnings per share.</p>	(3)																
<p>(d) List the typical key-shareholding levels affecting the level of control in a company and discuss the possible impact of the Companies Act 71 of 2008 in this regard, which became effective on 1 May 2011, on these levels. Make use of a table format in your answer, as follows:</p> <table border="1" style="width: 100%; border-collapse: collapse; margin-top: 10px;"> <tr> <th style="width: 60%; padding: 5px;">Typical key-shareholding level</th> <th style="width: 40%; padding: 5px;">Reason</th> <td style="text-align: center; vertical-align: middle; padding: 5px;">(4)</td> </tr> <tr> <td style="padding: 5px;">0,01% – x,xx%</td> <td style="padding: 5px;">...</td> <td></td> </tr> <tr> <td style="padding: 5px;">(x,xx% + 0,01%) – y,yy%, etc.</td> <td style="padding: 5px;">...</td> <td></td> </tr> <tr> <td colspan="2" style="padding: 5px;">Effect of the Companies Act 71 of 2008</td> <td style="text-align: center; vertical-align: middle; padding: 5px;">(3)</td> </tr> <tr> <td colspan="2" style="padding: 5px;">The new act allows for...</td> <td></td> </tr> </table>	Typical key-shareholding level	Reason	(4)	0,01% – x,xx%	...		(x,xx% + 0,01%) – y,yy%, etc.	...		Effect of the Companies Act 71 of 2008		(3)	The new act allows for...				
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The new act allows for...																	
<p>(e) Explain the relevance of a <i>control premium</i> relative to the usual key-shareholding levels affecting the level of control, when valuing a private equity (unlisted) shareholding based on:</p> <ol style="list-style-type: none"> 1. A Price / Earnings (P/E) multiple method 2. An Enterprise Discounted Cash Flow Model, based on Free Cash Flow. <p>(Assume no changes were made to the usual key-shareholding levels and that control is not affected by matters other than shareholding, e.g. agreements.)</p>	(4)																

<p>(f) Calculate the following values for OKAY (Pty.) Ltd. as at 31 August 2011, based on available information:</p> <ol style="list-style-type: none"> 1. Net asset value based on carrying values (1) 2. Net asset value based on replacement cost of items included in the statement of financial position (2) 3. Net asset value on a liquidation-basis (4) 4. Value calculated using the Gordon Dividend Growth Model, assuming a cost of equity equal to 13%. (4) <p>Where appropriate, you should annotate calculations and possible required adjustments, but ignore any possible effects of Secondary Tax on Companies, Dividend Tax and Capital Gains Tax.</p>	
<p>(g) Estimate the fair market value of a 100% equity shareholding in OKAY (Pty.) Ltd. as at 31 August 2011, by using a valuation method based on a forward Price / Earnings (P/E) multiple. (22)</p> <p>You should annotate calculations and adjustments made, but ignore any possible effects of Secondary Tax on Companies, Dividend Tax and Capital Gains Tax. Round figures to the nearest R0,1 million.</p>	
<p>(h) Explain the strengths and/or weaknesses of each of the following as determined earlier, if used by RAPS Ltd. to estimate a probable purchase price for a 100% shareholding in OKAY (Pty.) Ltd.:</p> <ol style="list-style-type: none"> 1. Net asset value based on carrying values 2. Net asset value based on replacement cost of items included in the statement of financial position 3. Net asset value on a liquidation-basis 4. Value determined based on the Gordon Dividend Growth Model 5. Value determined using a method based on a P/E multiple (½ mark per valid point) 	
<p>(i) Determine the net benefit of the estimated savings, after expenditure, in the case of acquisition of OKAY (Pty.) Ltd. by RAPS Ltd., using a method based on discounted cash flow. Assume a discount rate of 12,5% (pre-tax) and round figures to the nearest R0,1 million. (4)</p>	
<p>(j) Generalise from the actual Wal-Mart / Massmart-case possible difficulties and probable synergies, other than the savings already identified, that should be considered before RAPS Ltd. acquires OKAY (Pty.) Ltd. (8)</p>	
<p>(k) Identify any six of the foremost activities of a supermarket group that could serve as activities for ultimately identifying the cost drivers in such a supermarket group, if an Activity-Based Costing (ABC) system is to be implemented. (6)</p>	
<p>TOTAL MARKS</p>	<p>100</p>