



UNIVERSITY  
OF  
JOHANNESBURG

## UNIVERSITY OF JOHANNESBURG

### DEPARTMENT OF ACCOUNTANCY

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SESSION 1

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**INFORMATION DOCUMENT**

## SESSION 1 QUESTION 1

(100 MARKS)

MyHyper Group (Pty) Ltd ('MyHyper') is a retail group with its head office located in Cape Town. MyHyper has three major retail business segments – MyHyper Food, MyHyper Furniture and MyHyper Botswana.

MyHyper was founded by Ms Bheki Williams, a visionary with a reputation for going beyond the norm. The first MyHyper store opened in 1999 when Bheki purchased the Millennium Trading Store (established in 1900) in Claremont, Cape Town. Bheki's brothers, Tendani and Oscar, assisted her with the purchase and the three siblings agreed on a 50%/25%/25% shareholding, with Bheki holding the 50%. They renovated the building and totally rejuvenated the supermarket, which they then named MyHyper Food.

In 2003, Tendani and Oscar joined the business on a full-time basis, and the siblings began an expansion programme by opening MyHyper Food stores in Sea Point and Wynberg. The new stores followed Bheki's strategy and then, from 2003 to 2010, more supermarkets were opened as the company expanded to regions beyond the Western Cape.

In 2008, the company purchased a chain of three furniture stores in Cape Town from the liquidators of a financially distressed company, and MyHyper Furniture came into being. The furniture stores were rebranded and the MyHyper ethos of excellent service at low prices was introduced. The stores sell both furniture and appliances.

By 2021, the company had expanded to many more stores around the country. The year-end for all entities in the MyHyper Group is 30 September.

### Subsidiaries

All subsidiaries are wholly owned by MyHyper Group (Pty) Ltd.

#### MyHyper Food (Pty) Ltd

MyHyper Food prides itself on achieving a competitive edge by offering competitive prices, value and a complete one-stop shopping experience. MyHyper Food's mission is to become the shopping destination of choice for customers in the growing lower sector of the LSM<sup>1</sup> 7 range. The vision is to become a prominent innovative nationwide food business offering a full range of groceries, fresh produce, prepared foods, delicatessen and bakery products and other fast moving consumer goods such as small domestic appliances, gifts, stationery and toys. MyHyper Food operates 76 retail branches in all major centres in South Africa.

#### MyHyper Furniture (Pty) Ltd

MyHyper Furniture targets the LSM 7 group and strives to provide customers with complete home and appliance solutions through quality products at affordable prices. MyHyper Furniture operates 57 retail furniture stores in South Africa.

#### MyHyper Botswana Ltd

MyHyper Botswana is incorporated in Botswana and was previously called Suprasave National Cooperative Ltd ('Suprasave'). MyHyper purchased the entire share capital of Suprasave on the effective date of 1 September 2020. Suprasave was a well-established retail operation in Botswana. MyHyper intends to expand Suprasave even further in order to capitalise on their success.

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<sup>1</sup> The **Living Standards Measure** (LSM) is a marketing and research tool used in South Africa to classify standards of living and disposable income. It segments the population into ten groups based on their relative means, with LSM 1 being the grouping with the least means and 10 being the grouping with the greatest means.

## Review of operations

The following was extracted from the CEO's FY2021 feedback in the annual financial statements:

MyHyper is an innovative retailer ideally positioned to take full advantage of any potential increase in living standards in South Africa. Despite the pandemic, the impact of load-shedding and difficult consumer conditions in South Africa, the MyHyper group continues to achieve value creation and sustainable growth for all of its stakeholders.

The Food and Furniture segments continued to perform well during the financial year ended 30 September 2021 (FY2021). Whilst increases in turnover were marginal, both segments were able to achieve increases in operating profits through improved margins and containment of operating costs. The Food segment was the outstanding achiever in the Group. Given the greater impact of the pandemic on the furniture sector, the Furniture segment did well to still achieve profit growth of 20%.

## Introduction of online shopping

MyHyper is considering the introduction of online shopping in its food stores. The idea is to develop a smartphone application with which customers can order items to be delivered to their homes within 60 minutes.

Orders will be directed to the customer's nearest store; this store will then prepare and deliver the ordered items. Customer payment will be done exclusively via credit or debit card through the smartphone application.

MyHyper has already conducted an initial feasibility study and has in principle decided to proceed with the proposal. The only outstanding matters now are determining the fee to be charged per delivery, and choosing one of the following two business models for the delivery of the ordered items:

- MyHyper Food will purchase its own motorcycles and employ its own delivery riders; or
- MyHyper Food will outsource delivery to riders who own their own motorcycles and who will be remunerated per kilometre (km) travelled.

The cost accountant prepared the following information during the initial feasibility study:

| <b>Delivery Costs</b>   |            |   |
|---|------------|---|
| Salary of an in-house delivery rider  | R20 000,00 | per month                                       |
| Cost of a motorcycle (VAT incl.)  | R34 500,00 | per motorcycle                                  |
| Motorcycle comprehensive insurance (VAT incl.)                                      | R460,00    | per month                                       |
| Motorcycle maintenance (VAT incl.)  | R1 725,00  | per year  |
| Cost of fuel  | R15,00     | per litre                                       |
| Agreed buyback sales price of motorcycle after 12 months (VAT incl.)                | R16 000,00 | per motorcycle on condition mileage <26 000 kms |
|   |            |   |
| <b>Projected online shopping data</b>   |            |   |
| Average number of items per order   | 33,50      |   |
| Average sales value per online order (excluding delivery fee and VAT)               | R758,00    |   |
| Average gross profit percentage per order (excluding delivery fee or delivery cost) | 30%        |   |
| Average delivery distance per return trip (per customer)                            | 6,2        | kilometres                                      |

|  |    |                   |
|--|----|-------------------|
| Average fuel consumption per 100 km            | 4  | litres            |
| Average number of deliveries per day per rider | 15 | per day per rider |
| Average delivery days per delivery rider       | 22 | per month         |

## Potential acquisition

The board of directors of MyHyper recently identified Queen Hyper (Pty) Ltd ('Queen Hyper') as a potential acquisition target. Queen Hyper is a retail company with three supermarkets located in Krugersdorp, Fochville and Vereeniging. Queen Hyper is well-known for its cheap prices and friendly service since its incorporation in 1988. The company is family-owned and initial discussions indicate that the family is ready to exit the retail industry.

The main reasons why Queen Hyper was identified as a potential target are as follows:

- It will assist MyHyper with its geographical footprint.
- The acquisition of an established, successful business will lead to near-instant profitability as opposed to growing organically.
- MyHyper would be able to reduce its costs due to synergistic benefits. MyHyper believes it could reduce Queen Hyper's operating expenses with 12%.

In anticipation of the potential acquisition, the CFO of Queen Hyper prepared the following:

| <b>QUEEN HYPER (PTY) LTD</b>  |  |               |                 |                 |
|---|--|---------------|-----------------|-----------------|
| <b>STATEMENTS OF PROFIT OR LOSS FOR THE YEARS ENDING 30 SEPTEMBER</b> |  |               |                 |                 |
|   |  | <b>Actual</b> | <b>Forecast</b> | <b>Forecast</b> |
|   |  | <b>2021</b>   | <b>2022</b>     | <b>2023</b>     |
|   |  | <b>R'000</b>  | <b>R'000</b>    | <b>R'000</b>    |
| Revenue   |  | 899,281       | 1,085,254       | 1,322,010       |
| Cost of sales   |  | (697,830)     | (841,727)       | (993,005)       |
| Gross Profit  |  | 201,451       | 243,527         | 329,005         |
| Operating expenses  |  | (159,045)     | (168,587)       | (178,702)       |
| Depreciation  |  | (13,548)      | (13,548)        | (13,548)        |
| Operating profit  |  | 28,858        | 61,392          | 136,755         |
| Interest income   |  | 620           | 580             | 410             |
| Interest expense  |  | (7,350)       | (6,890)         | (5,130)         |
| Earnings before tax   |  | 22,128        | 55,082          | 132,035         |
| Income tax  |  | (7,680)       | (17,578)        | (36,915)        |
| Net profit  |  | 14,448        | 37,504          | 95,120          |
| Retained income at beginning of year                                  |  | 3,372         | 13,780          | 47,244          |
| Ordinary dividends declared   |  | (4,040)       | (4,040)         | (4,040)         |
| Retained income at end of year  |  | 13,780        | 47,244          | 138,324         |
|   |  |               |                 |                 |

| QUEEN HYPER (PTY) LTD                               |  |                |                |                |
|---|--|----------------|----------------|----------------|
| STATEMENTS OF FINANCIAL POSITION AS AT 30 SEPTEMBER |  |                |                |                |
|   |  | Actual         | Forecast       | Forecast       |
|   |  | 2021           | 2022           | 2023           |
|   |  | R'000          | R'000          | R'000          |
| <b>ASSETS</b>                                       |  |                |                |                |
| <b>Non-current assets</b>                           |  | <b>106,023</b> | <b>112,625</b> | <b>121,456</b> |
| Property, Plant and Equipment                       |  | 106,023        | 112,625        | 121,456        |
| Deferred taxation                                   |  | -              | -              | -              |
| <b>Current assets</b>                               |  | <b>92,143</b>  | <b>107,197</b> | <b>189,854</b> |
| Inventories   |  | 70,034         | 72,771         | 77,137         |
| Trade and other receivables                         |  | 5,589          | 5,924          | 6,280          |
| Cash and cash equivalents                           |  | 16,520         | 28,502         | 106,437        |
| <b>Total assets</b>                                 |  | <b>198,166</b> | <b>219,822</b> | <b>311,310</b> |
| <b>EQUITY AND LIABILITIES</b>                       |  |                |                |                |
| <b>Equity</b>                                       |  | <b>25,780</b>  | <b>59,244</b>  | <b>150,324</b> |
| Ordinary share capital                              |  | 12,000         | 12,000         | 12,000         |
| Retained earnings                                   |  | 13,780         | 47,244         | 138,324        |
| <b>Non-current Liabilities</b>                      |  | <b>59,040</b>  | <b>39,320</b>  | <b>34,590</b>  |
| Interest-bearing borrowings                         |  | 52,500         | 35,000         | 31,340         |
| Deferred taxation                                   |  | 6,540          | 4,320          | 3,250          |
| <b>Current liabilities</b>                          |  | <b>113,346</b> | <b>121,258</b> | <b>126,396</b> |
| Current portion of interest-bearing borrowings      |  | 10,170         | 11,670         | 10,440         |
| Trade and other payables                            |  | 98,546         | 104,458        | 110,726        |
| Provisions  |  | 4,630          | 5,130          | 5,230          |
| <b>Total equity and liabilities</b>                 |  | <b>198,166</b> | <b>219,822</b> | <b>311,310</b> |

| QUEEN HYPER (PTY) LTD - ASSUMPTIONS        |  |  |         |         |
|--|--|--|---------|---------|
|  |  |  | 2022    | 2023    |
|  |  |  | R'000   | R'000   |
| Revenue growth                             |  |  | 20.68%  | 21.82%  |
| Cost of sales growth                       |  |  | 20.62%  | 17.97%  |
| Operating expense growth                   |  |  | 6.00%   | 6.00%   |
| Depreciation growth                        |  |  | 0.00%   | 0.00%   |
| Operating profit growth                    |  |  | 112.74% | 122.76% |
| Interest income decline                    |  |  | -6.45%  | -29.31% |
| Interest as percentage of outstanding debt |  |  | 14.76%  | 12.28%  |
| Effective tax rate                         |  |  | 31.91%  | 27.96%  |
| PPE growth                                 |  |  | 6.23%   | 7.84%   |
| Inventories growth                         |  |  | 3.91%   | 6.00%   |
| Trade and other receivables growth         |  |  | 5.99%   | 6.01%   |
| Decrease in Interest -bearing borrowings   |  |  | -25.53% | -10.48% |
| Trade and other payables growth            |  |  | 6.00%   | 6.00%   |
| Provisions growth                          |  |  | 10.80%  | 1.95%   |
| Inflation                                  |  |  | 6%      | 6%      |
| WACC                                       |  |  | 16%     | 16%     |

| <b>FCF Valuation as at 1 October</b>                        |           |             |             |
|---|-----------|-------------|-------------|
| <b>Income statement method</b>                              |           | <b>2022</b> | <b>2023</b> |
| Operating profit  |           | 61,392      | 136,755     |
| Maintenance of assets (depreciation adjusted for inflation) |           | (14,361)    | (15,223)    |
| Movement in provisions                                      |           | (500)       | (100)       |
| Taxes paid  |           | (19,798)    | (37,985)    |
| Inventories   |           | 2,737       | 4,366       |
| Trade receivables   |           | 335         | 356         |
| Trade payables  |           | 5,912       | 6,268       |
| Capex   |           | (20,150)    | (22,379)    |
| FCF   |           | 15,567      | 72,058      |
| Terminal cash flows (Growth of 10% into perpetuity)         |           |             | 1,321,072   |
| Total FCF   |           | 15,567      | 1,393,130   |
| Equity value @WACC of 16%                                   | 1,048,743 |             |             |

- **Recent Queen Hyper board meeting**

The minutes of a meeting of the board of directors of Queen Hyper, held at the beginning of September 2021, reveal that the board was very pleased with the revenue figures achieved during FY2020 and FY2021. They confirmed that their strategy to increase the prices on facemasks and sanitation products had really paid off. The products sold exceptionally well, despite price increases of up to 400% on some of the products.

Furthermore, Queen Hyper's refusal to pay rent on the properties it leases for its stores in Krugersdorp, Fochville and Vereeniging for a period of time during the nation-wide lockdown, also positively impacted on its financial position as the stores continued to trade but did not pay any rental expenses for several weeks.

The minutes also note that the CFO, a CA(SA), expressed some concerns on the price increases and non-payment of rentals to lessors, but he was outvoted by the other directors.

### **Incentive scheme**

Over the last few years, the board of MyHyper has become increasingly aware of the challenge of retaining valuable senior managing directors at its head office. To address this issue, a share incentive scheme was introduced to encourage the senior managing directors employed by MyHyper to remain with the company. The board agreed to an incentive scheme where each senior managing director would receive a maximum of 1 000 shares in the MyHyper Group upon fulfilment of the agreed upon terms. The first tranche of the shares was granted on 1 October 2019 for all senior managing directors in the employ of the company at that date. The next tranche was granted on 1 October 2020 for the new senior managing directors that joined the group on 1 January 2020. MyHyper will be responsible for transferring these shares and each shareholder will proportionally reduce their interest at the vesting date to accommodate this. The terms of the agreement below were accepted by all senior managing directors.

| Tranches  | Number of senior managing directors | Begin date     | End date          | Entitled to voting rights during the vesting period |
|-----------|-------------------------------------|----------------|-------------------|---|
| Tranche 1 | 4                                   | 1 October 2019 | 30 September 2022 | No  |
| Tranche 2 | 2                                   | 1 October 2020 | 30 September 2023 | No  |

Additional terms:

- If an employee terminates their contract during the vesting period, they will not be entitled to any shares.
- The number of shares awarded will be determined as follows:
  - a. 1 000 shares: The net profit before tax over the three-year period applicable exceeds forecasted amounts by at least 15%
  - b. 750 shares: The net profit before tax over the three-year period applicable exceeds forecasted amounts by at least 10% but by less than 15%
  - c. 500 shares: The net profit before tax over the three-year period applicable exceeds forecasted amounts by at least 5% but by less than 10%
  - d. No shares will be awarded should any of the above targets not be met.

**The following fair values were provided by the consulting experts of MyHyper:**

| Date                               | Fair value per share                                      | Fair value per share                                      |
|------------------------------------|---|---|
|                                    | - Excluding the effect of the profit before tax forecasts | - Including the effect of the profit before tax forecasts |
| 1 October 2019                     | R200  | R230  |
| 30 September 2020 / 1 October 2020 | R210  | R250  |
| 30 September 2021                  | R220  | R260  |

**Assumptions and estimations:**

- During FY2020, MyHyper expected one senior managing director to leave during the vesting period. This expectation was revised during FY2021, and it is now expected that no senior managing directors will leave the group during the vesting period.
- For Tranche 1 – the profit before tax is expected to exceed the forecasted amounts by 7% for the three-year period ending 30 September 2022. This expectation remained unchanged for the FY2020 and FY2021.
- For Tranche 2 – for the FY2021, the profit before tax is expected to exceed the forecasted amounts by 11% for the three-year period ending 30 September 2023.

**MyHyper Food store in Mokopane**

During FY2019, MyHyper Food signed an exclusive purchase contract with Captain Morgan (Pty) Ltd (Captain Morgan), an unrelated entity specialising in the production of organic avocados. In terms of the agreement, Captain Morgan would provide 20 kilograms (kgs) of organic avocados to the Mokopane store every month for R15 000 to be delivered and paid at the end of every month. Due to the exclusivity of the agreement, it was stipulated at inception that the contract would be non-cancellable, and that MyHyper Food would be responsible for the full payment each month regardless of the circumstances of the store. The Mokopane store was permanently closed on 1 October 2020. MyHyper Food's management determined that it was not feasible to transfer these avocados to another branch due to their short shelf life and high transport costs of avocados. However, MyHyper Food was able to negotiate with a local Mokopane supermarket, Badal Traders, who agreed to purchase all the avocados from MyHyper Food each month for the remaining 30

months of the contract. Badal Traders would only be willing to pay MyHyper Food R12 000 per month. MyHyper Food's management agreed to these terms on 1 October 2020.

### Sale of non-core assets

On 1 October 2016, MyHyper Furniture purchased two vehicles to assist with its delivery load in the Cape Town region. The first vehicle, a Nissan NP200, was purchased for R230 000, including R2 000 for delivery fees and R9 000 for professional branding of the MyHyper Furniture logo on the sides of the vehicle. The second vehicle, a Ford Ranger, was purchased for R300 000, including administrative costs of R5 000. Both vehicles have a useful life of nine years and a residual value of nil, which estimations have remained unchanged since their purchase.

With the country-wide expansion of the MyHyper Furniture stores, the delivery load in the Cape Town region began to ease, and management decided to dispose of both these vehicles during FY2021. The board approved the plan to sell the vehicles on 1 May 2021 and management on the same day actively marketed these vehicles by listing them on popular websites for second-hand vehicles. At this date management was confident that both vehicles would be sold within 12 months.

The fair value less commissions to selling agents of these vehicles were provided by the financial accountant as follows:

| Date       | Vehicle      | Fair value less commission to selling agent |
|------------|--------------|---|
| 1 May 2021 | Nissan NP200 | R90 000                                     |
| 1 May 2021 | Ford Ranger  | R120 000                                    |

On the last day of FY2021, the NP200 was sold for R110 000 through an agent from one of the websites the vehicle was listed on. The agent is entitled to an 8% commission on the sale.

The Ford Ranger remained unsold by the financial year-end of 30 September 2021. However, due to a microchip shortage in the automobile market, the fair value of the vehicle had increased to R160 000 net of commission charges.

### Inventories

Inventories in MyHyper's stores were damaged during the looting that took place in Kwa-Zulu Natal during July 2021. The total write-down amounted to R2 400 000. This amount is material to the bottom line of the entity and the CFO is uncertain whether the write-down should form part of the cost of sales line item, which would affect the gross profit of the group and one of his key performance indicators. The CFO proposed that the write-down should form part of other operating expenses instead.

### Additional information:

- The Group applies International Financial Reporting Standards (IFRS).
- The Group recognises all vehicles at cost in terms of *IAS 16: Property, Plant and Equipment* and depreciates vehicles using the straight-line method.
- The Share Capital of MyHyper at 1 October 2020 was R1 000 000 and remained unchanged for the FY2021.
- The consolidated retained earnings balance, correctly calculated, for the MyHyper Group at 1 October 2020 was R21 800 000. This amount **includes** the effects of the above transactions.
- The MyHyper Group recorded a consolidated profit after tax of R19 000 000 for the FY2021, **excluding** the effects of the above transactions.
- All entities in the MyHyper Group are registered for Value Added Tax (VAT).