

<b>Part (a) Prepare the journal entry/entries required to recognise the impairment loss on the FluSlay formula in the accounting records of PharmCon for FY2021</b>			<b>Marks</b>
<ul style="list-style-type: none"> <li>• <b>Support your answer with a detailed impairment calculation.</b></li> <li>• <b>Round all calculated amounts to the nearest R1 000</b></li> </ul>			
<b>Impairment journal entry</b>	<b>Dr. R'000</b>	<b>Cr. R'000</b>	
<b>30 June 2021</b>			
Dr. Impairment loss (P/L)	3 650		1
Cr. Accumulated amortisation and impairment on formula (SFP)		3 650	
<i>Recognition of impairment loss on FluSlay formula</i>			
<i>Marker's note: If a candidate prepares a calculation and finds that the recoverable amount exceeds the carrying amount (i.e. no impairment) he/she will not prepare a journal entry. In this case, the calculations should still be marked in the absence of a journal</i>			
<b>The impairment loss is calculated as follows:</b>	<b>R'000</b>	<b>R'000</b>	
Carrying amount at 30 June 2021 (given)		37 850	1
Recoverable amount at 30 June 2021, calculated as the <b>higher of:</b>		34 200	1P
Fair value less costs of disposal (C1)	34 200		
Value in use (C2)	32 410		
Impairment loss		3 650	
<b>C1: Calculation of fair value less costs of disposal</b>			
	<b>Mada- gascar</b>	<b>Kenya</b>	
<i>Calculation of most advantageous market:</i>			
Selling price	39 440	38 800	0.5 + 0.5
Pharmaceutical product regulatory review costs	(2 880)	(2 880)	0.5 + 0.5
Legal fees	(1 960)	(1 070)	0.5 + 0.5
New chemical registration fees payable to regulator	(650)	(650)	0.5 + 0.5
<b>Net price</b>	<b>33 950</b>	<b>34 200</b>	
Thus, most advantageous market		34 200	1P
<i>Therefore fair value less cost of disposal</i>		34 200	

<b>C2: Calculation of value in use</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>	<b>2026</b>	<b>2027</b>	<b>2028</b>	<b>2029</b>	<b>2030</b>	<b>2031</b>	<b>Marks</b>
Continued sales of FluSlay drugs*	15 800	11 900	9 300	6 800	6 150						2
Pharmaceutical product production costs*	(4 800)	(3 620)	(2 830)	(2 069)	(1 870)						2
Costs to maintain expected sales*	(1 200)	(1 050)	(980)	(760)	(700)						2
Incremental litigation insurance cover	(50)	(52)	-	-	-	-	-	-	-	-	2
<b>Net cash inflows</b>	<b>9 750</b>	<b>7 178</b>	<b>5 490</b>	<b>3 971</b>	<b>3 580</b>						
Growth (decline) rate @ (12%)						3 150	2 772	2 440	2 147	1 889	3
Discount rate @ 7%											1
<b>Present value of future cash flows</b>										<b>32 410</b>	
<i>If included additional FluSlay sales from enhancements to the formula.</i>											<i>[- 1]</i>
<i>If included FluSlay formula enhancement costs and additional production and sales costs directly related to additional FluSlay sales.</i>											<i>[- 1]</i>
<i>If included promotional product support campaign.</i>											<i>[- 1]</i>
* Marks for correctly applying the inclusion in the calculation over the first 5 years.											
N1: Marks allocated for excluding future cash flows related to improvements to future cash flows related to the formula.											
N2: Mark for excluding future cash flows related to uncommitted restructuring (IAS36.44).											
										<b>Available</b>	<b>20</b>
										<b>Maximum</b>	<b>20</b>
										<i>Communication skills – presentation</i>	<i>1</i>
										<b>Total for part (a)</b>	<b>21</b>

<b>Part (b) Evaluate the impact of the production challenges in September 2020 by –</b> (i) calculating all relevant variances in respect of material for the AlexKids production, as follows: <ul style="list-style-type: none"> <li>• material price and mix variances in detail per material type;</li> <li>• a material yield variance based on the total variance only.</li> </ul> <ul style="list-style-type: none"> <li>• Round all amounts to the nearest cent.</li> </ul>					<b>Marks</b>																							
<b>Material prices</b>																												
	<b>AI</b>	<b>F</b>	<b>BP</b>	<b>S</b>																								
AQ x AP	58 000	69 600	10 800	12 000																								
Price variance	–	–	–	4 000 F	1C																							
<b>Material mix variance</b>																												
<b>Act input in std mix</b>			<b>Actual input</b>																									
<b>Grams</b>	<b>Rand</b>	<b>Mix variance</b>	<b>Grams</b>	<b>Rand</b>																								
10,600	R 61,480	R 3,480	10,000	R 58,000	1.5																							
21,200	R 61,480	R (8,120)	24,000	R 69,600	1.5																							
10,600	R 12,720	R 1,920	9,000	R 10,800	1.5																							
10,600	R 16,960	R 960	10,000	R 16,000 *	2.5																							
<b>53,000</b>	<b>R 152,640</b>	<b>R (1,760)</b>	<b>53,000</b>	<b>R 154,400</b>																								
	2.88																											
<p>* Marker note: this amount could be R1,2 if the standard cost card is adjusted. However, then ALL variances must be based on R1,2 thereafter.</p> <p>A number of possible alternatives were noted and considered during the marking process.</p> <p><b>Alternative 1:</b></p> <table border="1" style="width: 100%;"> <tr> <td></td> <td style="text-align: center;"><b>AI</b></td> <td style="text-align: center;"><b>F</b></td> <td style="text-align: center;"><b>BP</b></td> <td style="text-align: center;"><b>S</b></td> <td></td> </tr> <tr> <td>AQ x SP</td> <td style="text-align: center;">58 000</td> <td style="text-align: center;">69 600</td> <td style="text-align: center;">10 800</td> <td style="text-align: center;">16 000 (10 000 x 1,6)</td> <td style="text-align: center;">1</td> </tr> <tr> <td>Mix variance</td> <td style="text-align: center;">3 480 F</td> <td style="text-align: center;">8 120 A</td> <td style="text-align: center;">1 920 F</td> <td style="text-align: center;">960 F</td> <td style="text-align: center;">2C</td> </tr> <tr> <td>Total AQ in std mix x SP<sup>1</sup></td> <td style="text-align: center;">61 480 (53*1/5*R5,8)</td> <td style="text-align: center;">61 480 (53*2/5*R2,9)</td> <td style="text-align: center;">12 720 (53*1/5*R1,2)</td> <td style="text-align: center;">16 960 (53*1/5*R1,6)*</td> <td style="text-align: center;">4</td> </tr> </table>						<b>AI</b>	<b>F</b>	<b>BP</b>	<b>S</b>		AQ x SP	58 000	69 600	10 800	16 000 (10 000 x 1,6)	1	Mix variance	3 480 F	8 120 A	1 920 F	960 F	2C	Total AQ in std mix x SP <sup>1</sup>	61 480 (53*1/5*R5,8)	61 480 (53*2/5*R2,9)	12 720 (53*1/5*R1,2)	16 960 (53*1/5*R1,6)*	4
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<b>Material yield variance</b>																												
<b>OUTPUT QUANTITY APPROACH</b>																												
Expected output		51,940.00	(53 000 x 0.98)		1																							
Actual output		45,050.00	(53 000 x 0.85)		1																							
Material loss		(6,890.00)																										
Cost of material		2.94	(1 440 / 490)		1																							
<b>YIELD LOSS</b>		<b>(20,248.16)</b>			1																							
<p>A number of possible alternatives were noted and considered during the marking process.</p>																												

<u>Alternative 1:</u>			
<b>OUTPUT QUANTITY APPROACH</b>			
Expected output	51,940	(53 000 * 0.98)	
Actual output	<u>45,050</u>	(53 000 * 0.85)	
Material loss	(6,890)		1
Cost of material	2.94	(1 440 / 490)	1
<b>YIELD LOSS</b>	<b>(20,248.16)</b>		1
<u>Alternative 2:</u>			1
Actual input	53,000	(Given)	
Abnormal loss %	13%		
Abnormal loss	(6,890)		
Cost of material	2.94	(1 440 / 490)	
<b>YIELD LOSS</b>	<b>(20,248.16)</b>		2
<u>Alternative 3:</u>			1
<b>INPUT QUANTITY APPROACH</b>			1
Actual output	45,050	(53,000*0.85)	
Standard input for actual output	45,969.39	(45,050/0.98)	
Actual input	53,000		1
Abnormal loss on input	7,030.61		1
Cost of input	2.88		
<b>YIELD LOSS</b>	<b>(20,248.16)</b>		1
<u>Alternative 4:</u>			1
Actual input	53,000	53,000	
Standard input	<u>500</u>	<u>490</u>	
Expected output	<u>106</u>	<u>108</u>	
Actual input	53,000	53,000	1
Abnormal loss	<u>6,890</u>	<u>6,890</u>	
	46,110	46,110	
Standard input	<u>500</u>	<u>490</u>	1
	<u>92.22</u>	<u>94.10</u>	
Yield difference	(13.78)	(14.06)	
Cost per 500	1,440.00	1,440.00	
<b>YIELD LOSS</b>	<b>(20,248.16)#</b>	<b>(20,248.16)</b>	1
# (13.78*1440)/0.98			1

Alternative 5:							
	Standard input				Act input in std mix		
	a	b	c	d	e	f	
			(a*b)	(c-f)		(e*a)	
	Cost per gram	Grams	Rand	Yield variance	Grams	Rand	
AI	R 5.80	9 194	R 53 324	R (8,156)	10,600	R 61,480	0.5
F	R 2.90	18 388	R 53 324	R (8,156)	21,200	R 61,480	0.5
BP	R 1.20	9 194	R 11 033	R (1,687)	10,600	R 12,720	0.5
SW	R 1.60	9 194	R 14 710	R (2,250)	10,600	R 16,960	0.5
	<b>Total</b>	<b>45 969</b>	<b>R 132 392</b>	<b>R (20,248)</b>	<b>53,000</b>	<b>R 152,640</b>	0.5
			2.88			2.88	
	Actual output	45,050	(53 000 / 0.85)				1
							1
Alternative 6:							
Usage variance							
Actual output			45,050	45,050			1
Standard input for actual output				45,969			1
Cost of material			<u>2.94</u>	<u>2.88</u>			1
			R132,391.84	R132,391.84			
Actual input	53,000						
Rand Value	R154,000						
Material Usage variance	(R22,008.16)	(R132,391.84 – R154,000)					1
Mix	(R1,760)						1C
Yield	(R20,248.16)						
					<b>Available</b>		<b>12</b>
					<b>Maximum</b>		<b>12</b>
					<b>Total for part (b)(i)</b>		<b>12</b>

Part (b) Evaluate the impact of the production challenges in September 2020 by – (ii) recommending improvements that could be made to the production and procurement processes for AlexKids medication, based on the variances calculated in (b)(i), as well as those noted by management.		Marks
<ul style="list-style-type: none"> <li>Round all amounts to the nearest cent.</li> </ul>		
1.	The <b>change in sweetener price</b> is a planning variance as it represents a change in the materials price that was not controllable – management should have adjusted the cost card to the new rate before the variances were calculated.	1
2.	Management should consider <b>researching other suppliers</b> , especially <b>local suppliers</b> , that may be able to <b>offer better deals</b> (and are based in SA).	1
3.	Consider <b>negotiation</b> with suppliers for <b>bulk discounts</b> .	1
4.	<b>Consider whether EOQ</b> would be a better inventory model to use than JIT: consider stock-holding cost versus production breakdowns as a result of delivery issues.	1
5.	Regarding <b>materials</b> , a significant impact on profit is the <b>adverse yield variance</b> which arose as a result of the <b>incorrect calibration</b> of machinery and abnormal loss – there should be <b>better supervision</b> (e.g. employ an additional supervisor, schedule more checks).	1
6.	The <b>favourable variance</b> (fixed overhead volume) for AlexKids implies that the compressors used for AlexKids <b>operated at greater than planned capacity</b> because of the extension of machine time – <b>consider</b> whether it will be possible in future to <b>continue</b> to use the capacity by, for instance, working double shifts or over the long term, purchasing more machinery.	1
7.	<b>Replace machinery</b> with machinery that uses <b>newer technology</b> , which will alert users to <b>incorrect calibration</b> .	1
8.	<b>Rearrange the factory layout</b> so that the company is more easily able to <b>respond to changes</b> .	1
9.	Have <b>contracts with employees</b> that allow for <b>overtime</b> and working double shifts when required (consider cost-benefit).	1
10.	The <b>favourable fixed overhead volume variance</b> reflects that the company <b>responded</b> to the increased <b>demand up until full capacity</b> .	1
11.	As much as <b>demand increased</b> the company's capacity was reached which resulted in the <b>decreased market share</b> .	1
12.	Consider <b>increasing production capacity</b> , <b>new facilities</b> , or <b>double shifts</b> .	1
13.	<b>Strict controls</b> must be in place to <b>authorise changes</b> to the standard mix. For example, the change in the proportion of the materials used may result in changes to the medical properties of the medicines produced.	1
	This may lead to customers getting sick and may result in lawsuits against the company and fines by regulators	1
<b>Available</b>		<b>15</b>
<b>Maximum</b>		<b>6</b>
<i>Communication skills – logical argument</i>		<i>1</i>
<b>Total for part (b)(ii)</b>		<b>7</b>
<b>Total for part (b)</b>		<b>19</b>

Part (c) Discuss any ethical considerations that would arise for PharmCon from employing a key-stakeholder relationship manager, based on the discussion and resolutions at the recent board meeting of the company. <i>Note to markers: This question is marked based on the discussions made and the principle discussed. Candidates can motivate their discussion from not being in the best interest of the company, good for the self and good for others, various ethical theories and KING IV.</i>		Marks
1.	<p><b>Appointing</b> a key-stakeholder relationship manager / <b>creating the position:</b></p> <ul style="list-style-type: none"> <li>In principle, the appointment of a key-stakeholder relationship manager may be justifiable – and consistent with Principle 16 of King IV whereby the board should adopt a <b>stakeholder inclusive approach</b> that <b>balances the needs, interests and expectations of material stakeholders in the best interest of the organisation over time.</b></li> </ul>	1
2.	<p>Their <b>reason and motive</b> for the role and job description (for this position) would be to build close, influential relationships with industry bodies and lawmakers in the RSA healthcare industry:</p> <ul style="list-style-type: none"> <li>Consequently the <b>motives and integrity of the board in the best interest</b> of the company could be seen as questionable.</li> </ul>	1
3.	<p>CEO / COO's <b>believes</b> that companies are for-profit companies and need to increase the prices to invest in research of life-saving products:</p> <ul style="list-style-type: none"> <li>Management <b>do not believe</b> that the moral obligation of the company extends beyond compliance with laws and regulations and maximizing profit and although they are rationalising their reason, this could still be perceived to be ethical based on <b>their set of moral values.</b></li> </ul>	1
4.	<p>The <b>recruitment process</b> of appointing the manager:</p> <ul style="list-style-type: none"> <li>Should the appointment of the stakeholder relationship manager be done in a manner that does not involve a <b>transparent and rigorous recruitment process</b> (which appears to be the case as the CEO is targeting a particular individual), there is a risk that not necessarily the <b>best person for the job</b> (that exudes specific characteristics and competence for the job) will be appointed / <b>no other qualities</b> of the person are considered apart from their connections.</li> </ul>	1
5.	<p>Appointment of a former Member of the Executive Council for Health in Gauteng which has <b>existing relationships with government, regulatory and industry bodies</b> to influence decisions:</p> <ul style="list-style-type: none"> <li>The appointment of a former Health MEC as the PharmCon key-stakeholder relationship manager could create a <b>possible conflict of interests for herself</b> as she will need to use her own personal friendships and relationships for the company's agenda which may not be in line with her <b>own believes.</b></li> <li>The fact that the individual who is earmarked for the role of key-stakeholder relationship manager previously held a position which is a <b>political appointment</b>, increases the risk that they could be politically-connected.</li> </ul>	1  1

6.	<p>This decision could influence <b>pricing (financial capital) at the expense of the other capitals</b> (good for self and good for others): (possible predatory pricing):</p> <p><b>Good for self:</b></p> <ul style="list-style-type: none"> <li>This decision will <b>benefit PharmCon</b> (and direct stakeholders like shareholders, the South African economy, SARS and employees) if they continue to earn ‘<b>super-profits</b>’ – solely benefiting these stakeholders of <b>the company</b>.</li> </ul> <p><b>Good for others:</b></p> <ul style="list-style-type: none"> <li>PharmCon is <b>not taking all relevant stakeholders (society)</b> into account in their decision as the Society has not been taken into consideration.</li> <li>This decision and the maintenance of high prices will not be beneficial for the South African society because this will potentially make healthcare <b>unaffordable for many individuals</b> in South Africa / Granting of patent protection rights for longer periods, which would lessen the number of available <b>generic affordable</b> pharmaceutical products to maintain prices.</li> <li>If PharmCon successfully lobbies for enhanced patent protection laws, it will have an <b>adverse effect on new market entrants</b> into the pharmaceutical industry, thus reducing competition. This will likely result in higher drug prices and less innovation and economic participation from emerging pharmaceutical companies. This will have a <b>far-reaching economic impact</b>.</li> <li><b>Unemployment might increase</b> with the reduction of competition that will have a <b>direct impact on economic growth</b> that will further have a negative impact on the most vulnerable in society.</li> <li>Not following the due processes can result in the <b>release / selling of medicine which did not go through all the regulatory requirements</b> and can be detrimental to health of the users / broader public.</li> </ul>	<p>1</p> <p>1</p> <p>1</p> <p>1</p> <p>1</p> <p>1</p>
7.	<p><b>Salary:</b> The financial director has been tasked that sufficient funds are made available in the <b>budget for appointment</b> of key-stakeholder relationship manager (appointment of financial director):</p> <ul style="list-style-type: none"> <li>Furthermore, <b>concern needs to be expressed about the budget</b> to fund this position and whether the PharmCon <b>can actually afford</b> this position and what the impact could possibly be for the companies profit. (cost versus benefit in the short-, medium and long term).</li> </ul>	<p>1</p>
8.	<p>Furthermore the board resolved that an additional amount be set aside in the <b>budget to fund strategic donations</b> to legislative and regulatory bodies:</p> <ul style="list-style-type: none"> <li>Without more detail, such payments could also be perceived as a <b>bribe</b> and bribes are not in the best interest of the society at large.</li> <li>If such inputs are <b>not seen</b> as bribes and aimed at ensuring <b>the sustainability of the industry and being a socially responsible corporate citizen</b>, balanced with the interests of the consumers, this engagement with regulatory bodies and law makers would be good for society.</li> </ul>	<p>1</p> <p>1</p>
9.	<p>Possible <b>consequences</b> for this decision:</p> <ul style="list-style-type: none"> <li>These actions are <b>illegal in terms of SA law</b> (e.g. Prevention and Combating of Corrupt Activities Act and also Taxation laws / Price fixing</li> </ul>	



	(legality of payments) and non-compliance to laws and regulations are not ethical or in compliance with KING IV.).	1
	<ul style="list-style-type: none"> <li>Given the motives behind the new proposal, there may be <b>negative consequences</b> for the company should the public become aware (bad reputation / loss of stakeholder trust / fines), which cannot be considered in the best interest of PharmCon.</li> </ul>	1
	<ul style="list-style-type: none"> <li>This will affect the <b>ethical culture</b> through their leadership going forward and impact future decision making.</li> </ul>	1
	<b>Available</b>	<b>18</b>
	<b>Maximum</b>	<b>10</b>
	<b>Total for part (c)</b>	<b>10</b>