higher education & training

Department:
Higher Education and Training
REPUBLIC OF SOUTH AFRICA

MARKING GUIDELINE

NATIONAL CERTIFICATE

FINANCIAL MANAGEMENT: FARMING N6

15 JUNE 2018

This marking guideline consists of 8 pages.

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QUESTION 1 : THE RIGHT TO USE LAND

1.1 1.1.1 A prerequisite for farming is that the farmer must have the right to use the land and this right can be obtained in various ways as outlined in the constitution of the Republic of South Africa. (1)

1.1.2
- Joint farming
- Leasing
- Purchasing land (3)

1.2
- Project agreement✓
  A project agreement is the simplest form of a joint farming enterprise because only one, or at most a few, projects are involved in the joint venture.✓
  It can be used to determine whether cooperation between the participants is such that a more sophisticated and permanent agreement can be made.✓ (Any ONE explanation)
- Wage agreement✓
  The junior partner receives a fixed cash salary. As in the case of a project agreement, a wage agreement can be used to determine whether cooperation between the participants is such that a more sophisticated and permanent agreement can be made.✓
- Branch agreement✓
  The junior partner receives a fixed cash salary plus a portion of the margin above specified costs of a specific production branch for which he is solely or mainly responsible.✓
- Wage/profit sharing agreements✓
  The underlying principle in this type of cooperation agreement is that each participant shares in the farm profit in proportion to the labour, capital and managerial know-how that he contributes to the generation of the farm profit.✓
- Partnership or full profit sharing agreement✓
  The junior partner shares almost equally with the senior partner and participate in the management of the farm at a larger scale than in an ordinary wage/profit sharing agreement.✓ (5 × 2) (10)

1.3
- A big advantage for both parties is that this type of agreement is relatively simple and therefore leaves little opportunity for misunderstanding. ✓✓
- It gives the lessee a wide discretion.✓
- It relieves the lessor of any management inputs.✓
- A disadvantage for the lessee is that he/she alone carries the risks of production and prices.✓✓
- Under favourable circumstances, the lessor does not share in the prosperity.✓✓
- Overcropping can be applied by the lessee and as a result the lessor will be left with a less productive farm when the contract expires.✓✓
- A potential problem for both parties is that it may be difficult to decide on a reasonable rent.✓✓ (12)

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1.4
- Type of farming
- Production branches
- Region
- Management
- Capital resources
- Alternative sources of income (6)

1.5
- The profit is shared in proportion to the capital and labour that each partner contributes.
- The capital contribution of each partner is remunerated at a predetermined rate and the remainder of the profit is shared in proportion to the labour and contribution of each partner.
- The capital and labour contribution of each partner are remunerated at a predetermined rate and the remainder of the profit is shared between the partners according to a predetermined ratio. (3 × 2) (6)

1.6 Price of land = $\frac{\text{yearly NFI – Cost of living}}{\text{Capitalisation rate}}$ – additional capital need✓

$= \frac{250\,000 - 100\,000}{0{,}12} - 70\,000$✓

= R1 180 000✓✓ (4)

1.7 1.7.1

	Capital		Labour		TOTAL
Partner A	700 000 × 8%✓ = R56 000	+	500 hours × R12✓ = R6 000	=	R62 000
Partner B	600 000 × 8%✓ = R48 000	+	1 100 hours × R12✓ = R13 200	=	R61 200
			GRAND TOTAL	=	R123 200✓

(5)

1.7.2 $\frac{300\,000 - 123\,200}{2} = R88\,400$

Partner A: 62 000 + 88 400 = R150 400

Partner B: 61 200 + 88 400 = R149 600 (3)

[50]

QUESTION 2: THE MANAGEMENT OF FARM MACHINERY AND BUILDINGS

2.1
- Fuel and lubricants
- Labour
- Interest on capital investment
- Cost of providing shelter
- Insurance premiums and licence fees
- Repair and maintenance
- The cost of depreciation (7)

2.2 2.2.1 These costs remain the same✓✓ irrespective of whether the equipment or machinery are used a lot or not at all. Examples include insurance premiums and licences.✓

2.2.2 Variable costs depend on the usage.✓✓ Examples include fuel and lubricants.✓

2.2.3 These are costs which are difficult to classify as variable or fixed.✓✓ An example is depreciation which is difficult to classify under normal conditions.✓

(3 × 3) (9)

2.3
- Convenience and speed✓ – Farm implements are often acquired with the primary aim of facilitating operations, expediting them and/or making them less tedious.✓
- Increased income✓ – The yield is higher yield because larger areas can be cultivated.✓
- Reduction in costs✓ – The cost structure of the farm can be reduced by combining labour and farm implements in the right proportion.✓
- Reduction of labour bottle-necks✓ – Problems that farmers may experience in general with motivating labour and labour relations often compels them to mechanise. ✓
- Tax considerations✓ – The tax situation in which a farmer finds himself/herself could influence the decision to mechanise.✓ (5 × 2) (10)

2.4
- New implements require a greater capital investment than used ones.
- Used implements are usually more suited to smaller farms. The high fixed costs per unit on smaller farms will have a direct influence on the profitability, while economies of scale on larger farms will ensure that the fixed costs of new implements per unit will be lower.
- Used implements are less reliable than new ones and productivity with them are usually less because of interruptions for repairs.
- Used implements can also result in lower yields than when using new ones.
- In general, used implements have higher variable costs while depreciation, interest on capital and insurance of new implements will be higher.
- The farmer's mechanical ability is important when buying used implements.

(6 × 2) (12)

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2.5
- The difference in purchase price
- Annual usage of the implements
- Savings in labour that larger implements will bring about
- Availability of labour and capital
- Size of existing implements on the farm
- Urgency of the activities to be carried out by the implements (6 × 2) (12)

[50]

QUESTION 3: THE INVESTMENT OF FUNDS

3.1 Some investments are geared at delivering a fixed income and do not necessarily keep up with inflation, while others are geared at real growth.

3.2 Certainty that the amount of capital that is invested will continue to exist for as long as it pleases the investor.

3.3 The risk related to an investment and the potential return from it, are closely related.

3.4 Some investors allow the opportunity to modify the initial investment at a later stage without suffering any losses.

3.5 Liquidity refers to the ease with which an investment can be converted to cash without any losses.

3.6 When choosing between investment alternatives, the farmer should take his marginal rate of taxation into account, for example, if a farmer falls in a relatively high income category with a resultant high tax liability, he should select a tax-free investment or an investment with capital growth rather than one that provides a regular income.

3.7 Certain types of investments need more knowledge and time to manage than others.

3.8 The amount of money that a farmer has available for an investment, will to a large extent determine which investment alternative he will consider.

3.9 The period over which funds are available for investment, has an influence on the investment alternative that can be considered.

3.10 When to cash in the investment or to invest money in a certain form depends on what is expected in the near future.

3.11 The farmer should invest funds in a number of companies and industries instead of investing all funds in one company.

3.12 It is when the farmer maintains the buying power of his/her initial capital investment.

(12 × 2) **[24]**

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QUESTION 4: FINANCIAL PLANNING: FARM BUDGETING SYSTEM

4.1 It is a written plan✓ of future action, expressed in physical ✓and financial✓ quantities, to achieve ✓set objectives with available resources. (4)

4.2 Select the right combination of production branches.

- Write down the available resources.✓
- Estimate the annual requirements of each production enterprise.✓
- Estimate the margin above specified cost per unit for each potential production branch.✓

FORMULA:

Margin above specified cost = margin above specified cost per hectare/ required limiting resource unit per hectare

- Tabulate the resource requirements.✓
- Draw up a branch planning table.✓
- Make a summary of production branches and calculate the expected margin above specified costs for the whole farm enterprise.✓
- Verify the final plan.✓
- Make a summary of the surplus resource capacity.✓ (6)

4.3

- Estimate the gross production value.
- Estimate the production, marketing and administrative costs.
- Estimate the remuneration of the providers of foreign capital (interest on loans, rental, etc.).
- Estimate the extent of nonfarming activities such as nonfarm income, private expenditure.
- Estimate asset value and extent of debts. (5)

4.4

- Choose the intervals at which the financing budget will be prepared.
- Record the estimated cash receipts.
- Record the estimated cash and credit expenditure.
- Compile a summary of the cash position.
- Consider adjustments.
- Exert control. (6)

4.5

- Fit facilitates planning.
- Coordination of activities is provided.
- It is a means of better control.
- It gives timeliness of the farming operations.
- Tracking down of progress can be done.
- It assists with decision making. (5)

[26]

QUESTION 5: ANALYSIS AND INTERPRETATION

5.1 5.1.1 $\frac{\text{NFI before tax}}{\text{Average total capital employed}} \times 100$

5.1.2 $\frac{\text{FP before tax}}{\text{Average net worth}} \times 100$

5.1.3 $\frac{\text{Remuneration to foreign capital before tax}}{\text{Average foreign capital employed}} \times 100$

5.1.4 $\frac{\text{Remuneration to foreign capital – tax savings}}{\text{Average foreign capital employed}} \times 100$

5.1.5 $\frac{\text{GPV}}{\text{Average total capital employed}}$

5.1.6 $\frac{\text{Annual debt servicing}}{\text{GPV}}$

(6 × 2) (12)

5.2
- Permanent employee costs
- Mechanical costs such as fuel and lubricants
- Costs related to fixed improvements
- General costs such as bank charges, telephone, etc.
- Remuneration to providers of foreign capital (5)

5.3 5.3.1 Manpower efficiency = $\frac{\text{Workers' remuneration}}{\text{Hectares cultivated}}$✓

$= \frac{\text{R80 000}}{\text{1 000 ha}}$✓

= R80/ha✓✓

Manpower efficiency = $\frac{\text{GPV} \times 100}{\text{Workers' remuneration}}$✓

$= \frac{\text{R4 000 000 (2 000} \times \text{2 000)} \times 100}{\text{R80 000}}$✓

= 5 000✓✓ (8)

5.3.2 Crop efficiency = $\frac{\text{Physical yield}}{\text{Hectares cultivated}}$✓

$= \frac{\text{2 000 tons}}{\text{1 000 ha}}$✓

= 2 tons/ha✓✓ (4)

5.3.3 Efficiency of equipment = $\frac{\text{Equipment costs (variable costs)}}{\text{Hectares cultivated}}$✓

$= \frac{\text{R50 000 + R90 000 (140 000)}}{\text{1 000 ha}}$✓

= R140/ha✓✓ (4)

5.3.4 Efficiency of equipment = $\frac{\text{Capital investment in equipment}}{\text{Hectares cultivated}}$✓

$= \frac{\text{R500 000}}{\text{1 000 ha}}$✓

= R500/ha✓✓ (4)

5.4
- Allocation of gross production value
- Allocation of farming costs to individual branches
- Profitability of individual branches
- Comparison of relative profitability of individual branches (4 × 2) (8)

5.5
- The profit or loss of a specific production branch is equal to the difference between the allocated gross production value and the allocated costs.✓
- This profit or loss then represents the gross margin.✓✓
- The gross margin represents the contribution of each individual production branch towards the redemption of the total fixed costs and the total indirectly, allocatable costs and ultimately to the realisation of farm profit.✓✓ (5)

[50]

TOTAL: 200

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