ASSESSMENT OF PROFESSIONAL COMPETENCE

DECEMBER 2020

EXAMPLES
OF VARIOUS LEVEL OF COMPETENCE
IN EACH OF THE TASKS

HOW TO USE THE EXAMPLES

This report has been compiled from selection of scripts that demonstrated the level of competence in each task, which the examiners felt fairly represent the expectation for the level of competence in each task.

It is important to refer to the examiner comments on the APC for 2020 to assist in understanding the task before referring to the specimen examples below.

The examples are taken directly from candidate scripts, and no effort has been made to change spelling, grammar, errors etc.

TASK (a)

Respond to Charles Lancome's email regarding the accounting for 'bearer plants' and 'bearer plant produce'.

Highly competent

The candidate has focused on potential errors and aspects that may need to checked again. This response has excellent coverage of the issues in this task, as well as the various other accounting aspects encompassed in this task. The candidate addresses majority of the key issues that were presented in the general ledgers.
The response is clearly communicated, providing the necessary succinct explanations to the issues identified whilst at the same time displaying good understanding of the technical issues. The candidate also demonstrates the necessary pervasive and critical evaluation skills by including comments and/or questions that are clear and correct, without any unnecessary theory.

TO Charles
from: Financial Analyst
Subject: Capex on bearer Plants and Produce
Date: 17 December 2020
Good morning Sir,

I trust my email finds you well.

Thank you for the email for my input on the accounting. Kindly refer below for my input. Feel free to let me know should you need me to look at the possible future changes.

1. Pegging and Fencing: The pegging and fencing should be treated as a separate PPE item and not capitalised to plant produce. This is because it is not an integral part of the bearer plant and does not have same depreciation process as the bearer plants. For PPE items depreciation should commence when the asset is in the condition and location necessary for it to operate as intended by management. Kindly note that fencing as soon as it is erected it has reached the location and condition of acting as a marking and deterrent to trespassers therefore operating as intended by management. Depreciation for fence should therefore commence as soon as the fencing is fully constructed. For plant produce depreciation should only commence once they reach maturity. I therefore think we need to split the two.

Identifies that it is appropriate to rather recognise the borehole, water-pump, pegging and fencing as separate assets, rather than capitalise these cost to the bear plant ledger account. Furthermore, the candidate provides explanations of the implications of recognising the above assets as separate assets i.e. the depreciation of those separate assets would then be considered as the costs directly attributable to the bearer plant and as such eligible for capitalisation.

2. I agree that **Equipment rental cost should be capitalised** but we should be careful to only capitalise equipment associated with the development of bearer plants. For example equipment to construct the fence should be capitalised to the fence and not to bearer

plants. This is because only costs that are directly attributable to the bearer plants should be capitalised to them. it is worthy looking into which equipment costs does this relates to.

Applies the overarching principles of "directly attributable" through response with the required level of application. This principle is first illustrated in relation to the equipment rental.

3. Borehole and waterpump: The cost of borehole and waterpump should be capitalised as a separate component of PPE. This is because the borehole and waterpump are not an integral part of the PPE and are capable of operating separately with different useful life as bearer plants. However, the depreciation of the borehole and waterpump should be capitalised to PPE. For bearer plants that has not reached maturity we need to check we have not overstated our assets by not depreciating the borehole and waterpump. This is because, as soon as the borehole and waterpump are operating as intended by management we need to start depreciation. The depreciation can then be capitalised to bearer plants if this is used for plant growth before maturity and capitalised to produce when the plants are fully mature and start producing fruits.

Identifies that it is appropriate to rather recognise the borehole, water-pump, pegging and fencing as separate assets, rather than capitalise these cost to the bear plant ledger account. Furthermore, the candidate provides explanations of the implications of recognising the above assets as separate assets i.e. the depreciation of those separate assets would then be considered as the costs directly attributable to the bearer plant and as such eligible for capitalisation.

4. Cash discount received: This should reduce the cost of bearer plants as they reduce the cost. The cost should include the amounts that we paid and since we did not pay for the discount portion of the price we need to exclude this on the calculation of the cost.

Identifies and explains that the discount should rather reduce the cost of the bearer plant and provides a valid reason i.e. that it is not a cost incurred.

5. Cost contingency: It is imperative that we take another look at the cost contingency. this is because the cost contingency is a provision and we need to discount our estimated cost using a reasonable market related discount rate. we could use our WACC for this but adjusting as WACC is an after tax rate. The interest expense by winding of time should be expensed and the changes in our estimated contingent cost should either increase or decrease the cost of bearer plants. This should be disclosed as part of the provisions.

Identifies that the cost contingency is a future cost and should be present valued. Furthermore, the response proceeds to discuss variable lease payment. The candidates response is concerning because dismantling provisions are not contingencies but rather liabilities with uncertainty in amount/timing. Secondly, contingencies should not be recognised in financial statements due to the fact that they are not considered as incurred

Interest on debt funding: I agree with the inclusion of interest on debt funding. However, we need to ensure the following:

- Interest income that we earned from our temporary investment of the debt finance is deducted from the capitalised interest.

Identifies and applies IAS 23: borrowing costs principles to the interest capitalized and explains that only specific borrowing can be considered for capitalization. The candidate also bring forth insight in relation to any investment income earned on the temporary investment of the specific borrowing.

- If the interest is specifically for the orchard we can capitalised the whole interest less interest on the investments. If it is from a general pool of borrowings we need to calculate our capitalisation rate to determine the amount to capitalise. Let me know if you need me to look deep into this.

6. Abnormal wastage: IAS 16 prohibits the capitalisation of abnormal wastage of material or labour. Therefore cost of abnormal waste of material should be expensed when incurred and not capitalised. Abnormal water loss should be recorded as an expensed as we incur the losses.

Identifies and discussed that abnormal water wastage cannot be capitalised but should rather be expensed. This is consistent with the requirements of IAS 16.

7. It can be argued that tree prunning is rather maintenance of the tree rather than cost of growing it (construction). I therefore recommend that we expense the cost of tree prunning an expense. However, I am not yet experience in the agriculture industry. if the prunning is a necessary cost for the tree to achieve optimal growth I can agree that it should be capitalised. perhaps we can discuss shits while I have a look at the process again

8. Employee training costs: The costs of training the employees are usually not directly attributable to the growing of the tree. these are usually administration costs to improve efficiency of the employees and therefore should be expensed when incurred. However, if it is on the job training and the employees were being trained while conducting work on the orchard we capitalise the normal costs of the training process for example the material used. But the costs of losses due to inexperience and the instructors should be expensed.

Presents a valid argument in relation to the capitalisation of training costs.

9. Depreciation of the Plant and Equipment: The depreciation of the plant and equipment that was directly used in the growing of the trees can be capitalised to the orchard. Therefore this costs should be added to the cost of bearer plants and not deducted. If the machinery is used generally across the orchards we can use estimated hours per orchard to allocate the depreciation across bearer plants and/or plant produce.

Identified that the depreciation on the plant and equipment should rather be capitalised to the bearer plant and should not be deducted as it is considered a directly attributable cost.

10. Head Office Costs: Head office costs are usually general administration costs and should therefore expensed as and when incurred. These costs while they are directly attributable to the business they are not directly attributable to the bearer plants development and growth. These cannot therefore be capitalised.

Identifies and explains that head office and the cost accountant's costs are overheads/administration cost and as such cannot be capitalised. This is consistent with the IAS 16 principles.

11: Wages during the strike: The employees were not working on the bearer plants during this period therefore these are contractual costs paid related to the cost of employment and not to the bearer plants. Therefore these should be expensed.

Identifies that wages paid during the 3-week strike are considered not directly attributable and thus cannot be capitalised.

General: After the adjustments are made for these costs we need to recalculate depreciation on the new cost of bearer plants. If these were the same costs which were capitalised from prior year we also need to restate the opening balance and perform a prior period error note. Let me know if you need to have a look at these.

Identifies the potential IAS 8: Accounting Policies, Changes in estimates and **errors** implications for the financial statements.

It is also important to have a look at the VAT treatment of the expenses. Most of these costs are eligible to claim VATinput and therefore the costs capitalised should be costs excluding VAT.

BEARER PLANT PRODUCE:
1:Professional fees: May you kindly provide additional information regarding the professional fees. We can only capitalise professional fees directly attributable to bearer plants like inspectors' fees but we cannot capitalise general professional fees like accounting which should be capitalised as part of administration fees.

Identifies and explains the need for further information relating to the professional fees and provides a valid reason showing good understanding of the case study and IAS 16.

2: Prunning costs: I am of the opinion that this is general tree maintenance cost and not attributable to the development of the produce. I will do proper research to check industry norm and practice regarding this. The consideration is whether prunning is a necessary process for the fruit development. If it is not this should be expensed. Refer to my discussion on the bearer plants

Part (a)

3: Cost Accountant: This is not a cost that is directly attributable to the development of the produce. This should therefore be expensed as part of administration cost

Identifies and explains that head office and the cost accountant's costs are overheads/administration cost and as such cannot be capitalised. This is consistent with the IAS 16 principles

4: Further orchard development: The capitalisation of these costs depends on their nature. generally further orchard development will improve the orchard capacity and this should be

Identifies that further orchard development should be capitalized rather at the bearer plant and not the bearer plant produce. This point shows good understanding of the case study and the various stages of development of the avocados.

capitalised to the bearer plants and not the produce. This will be depreciated over the remaining part of bearer plant useful life.

5: delivery vehicle: The delivery vehicle to transport the produce from the field to the grading areas and shades can capitalised but the delivery costs to the customer after the whole process is complete can be expensed as part of selling expenses. This is because until the produce has been graded it is not yet in the location and condition as required by management and are not yet saleable.

Identifies that the delivery vehicles depreciation and road transportation costs cannot be a cost incurred in relation to the bearer plant produce, and as such cannot be capitalised. The candidate shows good insight by further elaborating that this is possibly a selling and distribution cost.

6: salaries during strike: Refer to my discussion above on why this should not be capitalised. It is not directly attributable to produce.

6. Road transportation logistics: May you kindly provide further details of where will be transporting the avocados to. if it is road transportation to the port or to customers this cannot be capitalised to produce as this is part of the selling expenses which are not directly attributable to the produce growth. If it is road transportation from the orchards to our facilities we can capitalise this to our produce.

Identifies that the delivery vehicles depreciation and road transportation costs cannot be a cost incurred in relation to the bearer plant produce, and as such cannot be capitalised. The candidate shows good insight by further elaborating that this is possibly a selling and distribution cost.

Depreciation: IAS 41 does not provide guidance on the depreciation of bearer plants. Therefore one can seek guidance in IAS 16. IAS 16 requires that depreciation begins when the asset is in the location and condition necessary for it to operate as intended by management.

Identified the inappropriateness of the depreciation of the bearer plant produce. Depreciation commences when the asset is a condition ready for operation, the candidate correctly identifies that at the point that the bearer plant produce is in the condition intended by management, bearer plant produce is transferred to inventory and as such depreciation would NOT be necessary. This show excellent understand of the accounting principles in relation to IAS 41 and IAS 2

Bearer plants do not operate but the condition intended by management are still when they are harvested. At this point the plant will be measurable at fair value less cost to sell and transferred to inventory. Therefore there is no time depreciate the cost.

Applicable to both bearer plants and produce: We should consider if there are any indicators of impairment on the produce and the plants. Indicators on the plants may include serious damage by diseases which may reduce the plant bearing capacity. in which case we should estimate the recoverable amount and determine if there is impairment loss when recoverable amount is less than carrying amount.

Identified the need to consider any impairment indicators. The candidate links this point to the valid and relevant issues that could give rise to the need to recognize impairment.

indicators of impairment on the produce may include weather damage or disease infection as well. It is a requirement for IAS 16 to test for impairment for PPE items if there are indicators of impairment.

Transfer: Transfers to Inventory: before the bearer plant produce is transferred to inventory it should measured at fair value less cost to sell. The adjustment should therefore increase or decrease carrying amount of the produce and the corresponding journal entry going into profit or loss.

The last point raised on the gain or loss on transfer to inventory is not appropriate. The adjustment to fair value would be recognised on transfer to inventory and would not affect the bearer plant produce ledger account but rather recognised directly in profit or loss. Recognising the fair value gain or loss in the bearer plant produce ledger account would result in a mixed measurement basis of the bearer plant produce. This is due to the fact some of the produce would be measured at cost and some at fair value. This is not consistent with the requirements of IFRS.

The fair value less cost sell will then be the cost when we transfer into inventory. it may be necessary to include services of a specialist when measuring fair value less cost to sell.

Thank and kind regards

Financial Analyst.

What elevated this candidate's attempt to highly competent included the fact that:

- Limited number of inaccuracies and error in the response provided.
- Excellent application to of the relevant theory to BK and the avocado farming industry.
- Identification and discussion of issues that are not necessarily triggered by the general ledger but are applicable and relevant to this task.

Competent

Overall, this response displays the necessary level of competence required for this task. The candidate achieves good coverage of the potential issues/errors in the general ledger accounts and also displays sufficient technical knowledge of cost capitalisations, as well as the various other accounting aspects encompassed in this task. The candidate also demonstrates the necessary pervasive and critical evaluation skills by including comments and/or questions that are clear and mostly correct, without any unnecessary theory.

From: Financial Analyst

To: Charles Lacome

Subject: RE: Capex on bearer plants and their produce

Dear Charles

Thanks for welcoming me to the BK family, and I am glad I could be of assistance in these - I trust my review will be helpful in ensuring our auditors are happy.

<u>Bearer plants</u>

As these are recognised as assets in terms of IAS 16, my review of the following items is in ensuring the items comply with the standard. Here are some accounts to consider:

A. Establishment of new orchards

- Equipment rental of R148K

It appears that this equipment was specifically used for the development of the avocado trees, and it is therefore appropriate to capitalise the costs related to the equipment to the avocado trees during the development stage as these are costs directly attributable to developing the avocado trees.

We need to ensure the costs related to this equipment rental complies with IFRS16 if indeed there is a lease contract in terms of that Standard. Note that the cost to be capitalised is not necessarily the cash outflows that took place for the rental of the equipment, but rather the expenses incurred in developing the avocado trees.

Identifies that the rental cost can be capitalised to the bearer plant. The candidate also goes on to give an in-depth discussion of the potential IFRS 16 issues. What stands out about this in-depth discussion is that the candidate presents an argument that the depreciation and finance costs would be the costs incurred if the agreement is capitalised as a lease in terms of IFRS 16. Furthermore, the candidate brings in the argument of the practical expedient i.e. low value and a short term lease. This argument presents higher level application of this specific issue in this task.

If the equipment rental complies with IFRS16 and is not an asset of low value and is not short term, a right-of-use asset that depreciates would be recognised, together with a lease liability for the lease payments. The expenses incurred would therefore be the depreciation related to the right-of-use assets and the finance costs for the lease liability.

Where the lease is of low value or is short term, the lease costs would be straight-lined into lease expenses. The lease expenses would therefore be capitalised to the avocado trees during the development stage as it will be costs directly attributable to developing the avocado trees.

Therefore, we need to consider the abovementioned and compare to the capitalised R148K and adjust the avocado trees accordingly.

- New borehole and water pump of R185K

I agree that the cost related to the borehole and water pump need to be recognised as assets as these are used in the operation to gain future economic benefits from the produce that the avocado trees will bear.

However, we need to consider whether it is appropriate to attach the cost of the borehole and water pump to the avocado trees (as a component of the bearer plants) or recognise them separately. This is because the borehole and water pumps could have separate useful lives to the trees and would therefore be more appropriate to recognise them separately. In addition, these water pumps could apply to assets beyond the avocado trees and would therefore be more appropriate to recognise them separately.

I would suggest that these are recognised and depreciated separately according to their own useful life. Where these are used in the development of the avocados, we should capitalise the depreciation thereof to the cost of the avocados as these will be directly attributable costs to the development of avocados.

Identifies that it is appropriate to rather recognise the borehole and water-pump as separate assets, rather than capitalise these cost to the bear plant ledger account. Furthermore, the candidate provides explanations of the implications of recognising the above assets as separate assets i.e. the depreciation of those separate assets would then be considered as the costs directly attributable to the bearer plant and as such eligible for capitalisation.

- cash discounts of R45k

As the discount reduced the cash outflow for the purchases of trees initially, I suggest that it be excluded from the cost of the trees. The cost effectively did not occur and would therefore be inappropriate to recognise as an asset.

Identifies and explains that the discount should be excluded from the bearer plant ledger account and provides a valid reason i.e. that it is not a cost incurred.

-tree purchases on long-term credit

As the trees are purchased on long-term credit, the cost recognised should be the present value of the future cash outflows of the debt repayments. The appropriate cost is the discounted cashflows.

I suggest that where the future cash outflows have not be discounted, the adjustment be made.

Identifies that it is appropriate to capitalise the present value of the long term credit purchase and this needs to be check to ensure the discounted cash flows are capitalised.

- cost contingency of R176K

Cost of the avocado trees may only be from the purchase price, directly attributable costs to bring asset to location and condition as intended and present value of future dismantling costs.

If this cost contingency is not related to future dismantling costs, we should consider whether it is part of the purchase price as a variable payment. The Interpretations Committee is still debating the issue on whether variable payments that depend on BK's future performance should form part of the cost of a PPE item such as the avocado trees.

Since this is the case, judgement is required on treating this cash contingency, and this will potentially be a contentious issue with the auditors. Since IAS16 provides no specific guidance, the best option is to consider how other Standards treat variable payments.

I suggest we view the treatment in IFRS 16 for right-of-use assets because of the similarity of IFRS 16 lease right-of-use assets to IAS 16 assets. This is because (while the cost measurement at initial recognition differs) the subsequent treatment of right-of-use assets are subjected to IAS 16 subsequent measurement treatment.

In IFRS 16, a variable lease payment that depends on an index is initially measured according to that index and added to the lease liability (which is a component of the right-of-use asset). That implies that the variable lease that depends on other factors is not added to the initial value of the lease liability. I suggest that we discount the cash contingency and recognise the present value to the cost of the avocado trees as per the guidance from IFRS 16 and recognise a corresponding present-valued liability.

Identifies that the cost contingency is a future cost and should be present valued. Furthermore, the response proceeds to discuss variable lease payment. The candidates response is concerning because dismantling provisions are not contingencies but rather liabilities with uncertainty in amount/timing. Secondly, contingencies should not be recognised in financial statements due to the fact that they are not considered as incurred. The candidate should have rather questioned the nature of this account and a plausible explanation could be that only costs actually incurred can be capitalised. Contingent cost are considered as budgeted cost and are yet to be incurred.

- interest on debt funding of R277K

I agree that any interest incurred for the financing specifically applied to the development of the avocado trees should be added to the cost as these are directly attributable costs to developing the

Identifies and applies IAS 23: borrowing costs principles to the interest capitalized and explains that only specific borrowing can be considered for capitalization.

avocado trees, measured in terms of IAS 23 Borrowing costs.

I therefore suggest that these costs should be carefully evaluated in that they (i) apply specifically to the development of avocado trees by evaluating how the debt was applied and (ii) whether the appropriate interest was used based on that.

B. Growth phase costs

- orchard management of R888K

Identifies and discussed that abnormal water wastage and training cannot be capitalised but should rather be expensed. This is consistent with the requirements of IAS 16.

The salaries and wages thereof to manage the orchards should not be capitalised to the avocado

The discussion on orchard management cost is not accurate. Costs directly attributable to the bearer plants are eligible for capitalisation up until the point at which the asset is ready and available for use in the manner intended by management. It is thus not correct to say that the orchard management costs are maintenance and should not be capitalised.

trees as these costs are related to the maintenance of the trees, and not the development. Any costs after initial recognition that are not for improving or increasing the capacity of the avocado trees cannot be capitalised.

- irrigation wastage

The wastage of irrigation should not be capitalised to the trees as it is abnormal costs. Abnormal wastage costs are not seen to be directly attributable or necessary to the development of the avocado trees.

- employee training

The training costs are specifically prohibited from being capitalised. This is because these are not seen as directly attributable to developing the avocados.

- head office costs

These costs should not be capitalised as they are not directly attributable to developing the avocado trees.

A further explanation is required in relation to the head office costs. The candidate should have elaborated to explain that the head office cost are considered as an overhead or administration cost.

- wages during the labour strike

These costs can be argued to not be directly attributable to developing the avocado trees as they were incurred with the employees (who are responsible for developing avocado trees) being absent.

Identifies that wages paid during the 3-week strike are considered not directly attributable and thus cannot be capitalized.

- depreciation of bearer plants

This cost could be erroneous given the corrections that need to be made as stated above.

<u>Bearer plants produce</u>

IAS 41 is quite strict on ensuring that bearer plant produce is at the appropriate value. The first preference is that the carrying amount should be at fair value less costs to sell (FVLCTS), and can only be carried at cost if the quoted prices are unavailable and alternative fair value metrics are "clearly unreliable".

The term clearly unreliable on other ways to measure fair value make the requirement quite strict. We therefore may need to spend some time assessing whether indeed we are unable to measure the fair value using the other methods available in IFRS 13.

IAS 41 provides no specific guidance to how costs of the unpicked avocados should be treated, whether they should be capitalised or not, and judgement is therefore required.

I suggest that the approach should be based on whether the costs are in improving the capacity of the unpicked avocados or are in maintaining them. This is guidance from IAS 16 that we should consider, I believe this approach will need to a fair presentation of the financial position of BK.

I therefore suggest that these costs be expensed (and be adjusted out of bearer plants produce):

- cost accountant salary, as the accountant is not directly involved in the growing of the unpicked avocados

- depreciation of delivery vehicles and the road transportation costs as the unpicked avocados are not in any way transported, so the cost thereof does not apply to the unpicked avocados

Identifies that the delivery vehicles depreciation and road transportation costs cannot be a cost incurred in relation to the unpicked avocado's (bearer plant produce), and as such cannot be capitalised. This point could've shown deeper insight if the candidate had further elaborated that this is possibly a cost related to IAS2: Inventory or a selling and distribution cost.

- head office costs as these costs are not directly involved in improving the unpicked avocados

- interest on debt funding because in terms of IAS23, bearer plant produce would not be a qualifying asset for borrowing costs capitalisation as it is short-term in nature

In addition, the 'further orchard development' costs are more appropriate to be capitalised to the avocado trees in terms of IAS 16. This is inappropriate as the further orchard development is to the tree (which produces unpicked avocados) as opposed to the unpicked avocados themselves.

Identifies that further orchard development should be capitalized rather at the bearer plant phase and not produce phase. This point shows good understanding of the case study and the various stages of development of the avocados.

Depreciation expense would need to be adjusted given the changes mentioned above.

Part (a)

Harvested products transferred to trading should have been at fair value less cost to sell (FVLCTS) on that date of transfer. The difference between the carrying amount and the FVLCTS is to be recognised as a gain or loss in profit or loss.

The last point raised on the gain or loss on transfer to inventory is not appropriate. The adjustment to fair value would be recognised on transfer to inventory and would not affect the bearer plant produce ledger account but rather recognised directly in profit or loss. Recognising the fair value gain or loss in the bearer plant produce ledger account would result in a mixed measurement basis of the bearer plant produce. This is due to the fact some of the produce would be measured at cost and some at fair value. This is not consistent with the requirements of IFRS.

Thanks once again for involving me in this, Charles.

Best regards

Financial Analyst

Despite the above technical inaccuracies / concerns, these were outweighed by the sufficient valid comments and/or questions, hence competent for this task.

Limited competent

Overall, this response does not display the level of competence required for this task. Although the candidate considers some the items included in the general ledger accounts these were not considered to be sufficient identification and coverage of the potential issues/errors in this task. Furthermore, the comments and/or questions lack the necessary depth and are mostly superficial without the necessary application and critical evaluation / technical justification.

TO: Charles Lancome
FROM: Financial Analyst
DATE: 17 December 2020
ATTACHED: Review of bearer plants and their produce

SUBJECT: CAPEX ON BEARER PLANTS AND THEIR PRODUCE

Dear Charles

I trust that you are well.

Please kindly refer to the attached document where i have reviewed the general ledger accounts of bearer plants and their produce and noted any errors or areas we may need to check again. I have also included the reasons for my decisions as requested.

Should you have any queries, please do not hesitate to contact me.

Sincerely
Financial Analyst

ATTACHED: Review of bearer plants and their produce

GENERAL

Bearer plants are recognised and measured in terms of IAS 16. The entity has an accounting policy choice in respect of the measurement of the bearer plants. BK has elected to us the cost model. This means that the bearer plant will be initially measured at its cost. Cost includes:
- Its purchase price, including import duties
- any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and

In terms of IAS 16.16(b), requires us to determine when a bearer plant reaches maturity, that is when it is in the "location and condition necessary for it to be capable of operating in the manner intended by management. This determination is important because it is when the entity must cease capitalising costs as part of the asset and begin depreciating.

An unnecessary theory dump upfront, which is unapplied to the case study, detracts from the quality of the response.

The bearer plant produce is recognised and measured in terms of IAS 41. Due to the fact that there is an inability to use the FV model (IAS 41.30), the cost model will be used. However, per IAS 41.3, it states that at the point of harvest, it will be measured at FV less costs to sell.

In terms of the expenditure IAS 41 does not specify the accounting requirements for subsequent expenditure on biological assets. The interpretation committee concluded in September 2019, that an entity may either capitalise subsequent expenditure or recognise it as an expense. BK has chosen to capitalise and thus we would need to determine if the expenditure is maintenance or improvement.

BEARER PLANTS

Establishment of new orchards

- Cash discount received: This should not be capitalised to the cost of the plant as it is specifically excluded from cost per IAS 16.16 (a)

Identifies and explains that the discount should be excluded from the bearer plant ledger account and related IAS 16 reference.

Part (a)

- Import duties: It is correct to capitalise this cost, provided it is the import duties relating to the cost price of the costs which can be capitalised per IAS 16.

Provides and account of what has been correctly done. This is inappropriate as the task was specific to error or potential errors e.g. import duties; interest of debt funding

- The tree purchased on long-term credit: It is correct to capitalise this cost. However, this cost must be capitalised at the present value of the loan.

Identifies that it is appropriate to capitalise the present value of the long term credit purchase.

- Interest on debt funding: The interest could be capitalised per IAS 23 provided the requirements in this standard are met. bearer plants are specifically included per IAS 23.7 (f) as a qualifying asset and it would meet the definition of substantial period of time as the tree takes 5 years to get to maturity.

Provides and account of what has been correctly done. This is inappropriate as the task was specific to error or potential errors e.g. import duties; interest of debt funding

- Cost contingency: This cost shouldn't be capitalised. As it is specifically excluded from the purchase price per IAS 16.16 (a)

Growth phase costs

- Irrigation (abnormal wastage): These costs should not be capitalised to the cost of the bearer plant. This is specifically excluded per IAS 16.22.

Identifies and discussed that abnormal water wastage/wages in the three week strike cannot be capitalised as per the requirements of IAS 16.

- Head office costs: These costs should not be capitalised as they are not directly attributable.

Candidates response focuses predominately on directly attributable with limited further application/explanation in a number of instances e.g. head office costs, depreciation on delivery vehicle and road transportation

- Wages during the 3-week strike: These costs would not be capitalised as it would not be directly attributable to the plant. Furthermore, this would be considered "wastage" as the employees did not actually work on the bearer plant.

BEARER PLANT PRODUCE

- Head office costs: Shouldn't not be capitalised as they are not directly attributable.

Part (a)

- Orchard development: Should not be capitalised. Could be capitalised to bearer plant but not the produce as it is not directly attributable.

Identifies that further orchard development should be capitalized rather at the bearer plant phase and not produce phase.

- Wages during the 3-week strike: These costs would not be capitalised as it would not be directly attributable to the produce. Furthermore, this would be considered "wastage" as the employees did not actually work.

Identifies and discussed that abnormal water wastage/wages in the three week strike cannot be capitalised as per the requirements of IAS 16.

- Interest on debt funding: This would not be capitalised as it would not meet the definition of IAS 23. As it wouldn't be a substantial period of time. Fruit hangs for less than a year.

- Depreciation on delivery: Shouldn't be capitalised as it is not directly attributable

Candidates response focuses predominately on directly attributable with limited further application/explanation in a number of instances e.g. head office costs, depreciation on delivery vehicle and road transportation

- Road transportation shouldn't be capitalised as it is not directly attributable.

Candidates response focuses predominately on directly attributable with limited further application/explanation in a number of instances e.g. head office costs, depreciation on delivery vehicle and road transportation.

- Composting and weed control shouldn't be capitalised as it related to the bearer plant and not the produce.

Overall, the candidate failed to achieve sufficient coverage of valid issues and did not display the necessary level of technical knowledge or pervasive and critical evaluation skills that were required to be assessed as competent in this task.

Part (b)

TASK (b)
Respond to Charles Lancome's email regarding the accounting considerations related to the proposed sales agreement with Supreme Brands.

Highly competent

From: Financial Analyst
Sent: 17 December 2020
To: Charles Lancome
Subject: RE: Sales agreement with Supreme Brands

Hi Charles,

That's great news on getting a new offer in from Supreme Brands. I have taken a look through your notes on the accounting of our revenues and provided my commentary on the 5 step process below.

Step 1:

I agree with you on step one. It would appear as we have a valid contract which clearly identifies the two parties (BK & Supreme Brands) and our respective rights in the contract, in terms of the deliveries and prices they are entitled to as well as our payments. The payment terms are clear, and it is probable we would collect the consideration from Supreme Brands considering they are one of our largest customers (solid existing relationship and experience) as well as their offer to pay 50% up front.

Valid additional aspect: The candidate points out that it is probable that BK will collect the consideration from Supreme Brands, with sufficient application to the case study (i.e. Supreme Brands is one of BK's largest customers with an existing relationship and experience / they will pay 50% of the consideration upfront).

Step 2:

I disagree with you that there is one performance obligation. A series of distinct goods or services in a series as you have stated would need to meet the criteria of being a performance obligation satisfied over time. From your previous email with background on BK you noted that the rights of ownership of the avocados transfer to the importer (in this case Supreme Brands) at the point of loading (ie: at the shipping port in Cape Town).

For this to be a performance obligation satisfied over time. When looking at this criteria it does not appear as though we satisfy the performance obligation over time as Supreme Brands does not simultaneously receive and consume the benefits associated with our delivery of these avocados, as the title transfers at a point in time once we have loaded these items at Cape Town shipping point.

Core issue (step 2): The candidate disproves Charles's statement that the transfer of the avocados is a "series of distinct goods", through sufficient application of the requirements of IFRS15.23 and .35 (i.e. proving that the transfer of the avocados is not a performance obligation satisfied over time).

We do not create or enhance an asset that Supreme Brands controls, as they do not yet control the avocados. And finally, the avocados can have an alternate use as we can sell these to another party, and we have no right for payment up until the point that we have loaded these items at the shipping point.

From the above it would appear we do not have a performance obligation recognised over time and as such cannot identify one performance obligation being a series of distinct goods substantially the same with the same pattern of transfer. As such we would consider these to be distinct performance obligations which are satisfied at a **point in time**.

We also need to note that there would be a number of performance obligations satisfied at different points in time. Each delivery of avocados and related arrangement of shipping could be benefited on its own as each individual order of avocados, as well as being able to benefit solely from just the avocados without the shipping. (ie: the avocados could be benefited from by Supreme Brands without our organisation of the shipping and insurance). The shipping and insurance arrangement is not integrated with, modifying, or highly interdependent on the avocado delivery and would be considered distinct and separately identifiable.

Core issue (step 2): The candidate correctly indicates that the shipping terms may give rise to an additional performance obligation. Since it was not necessary to address both core issues under step 2 to be considered competent for this task, this was considered to be a valid additional aspect.

From the above it would appear that we have separate performance obligations for each delivery (May - Oct = 6 POs) and for the arrangement of the shipping and insurance (6 POs). Thus, we would have a total of 12 performance obligations in respect of the Supreme Brands contract.

n step 2, it was not necessary to conclude on the actual number of performance obligations since Charles did not want the "exact, detailed technical answer". However, the candidate was not penalised for trying to reach a conclusion in this regard. Furthermore, it should be noted that the actual number of performance obligations is debatable and may require a high level of judgment.

<u>Step 3</u>

I disagree with you that the price of the contract is variable. As mentioned above there are effectively 12 performance obligations being 2 performance obligations to be settled each month from May to October in 2021. Each of these performance obligations has a fixed-prcie per the contract in Euro terms. The amounts payable in future are known,

The candidate indicates that the consideration in the contract is not variable, since the amounts payable in future are known while the foreign exchange rates are unknown. The candidate is implying that the variability relates to the form of the consideration rather than to specific contract terms or conditions, but their argument could have been clearer in this regard.

however, it is the future exchange rates which are unknown. From the revenue recognition perspective there are no variable consideration amounts within the contract, rather we are likely to have foreign exchange movements due to the movement in the Rand:Euro exchange rate. foreign exchange amounts are accounted for in terms of IAS 21.

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As I will detail in the next point, there are a number of performance obligations which are satisfied at a point in time. As such we would need to recognise revenue at each of these points, respectively. The transaction price is known (in Euro terms) and not variable, and we can determine the amount of revenue to be recognised by applying the spot rate on the date the revenue is recognised if there is a receivable related, or at the initial spot rate if we are still derecognising the contract liability.

This would have been more appropriate under step 5, but not incorrect though.

Secondly, I disagree with your point that the remaining consideration to be paid on 15 November 2021 should be discounted. The amounts should be discounted if we consider the to be a significant financing component. However, we can use the practical expedient and not discount this amount as the promised amount of consideration is expected to be received within 12 months of initiation of the contract (November with the contract beginning in March 2021 after the receipt of initial payment). Therefore, we do not need to discount the final amount receivable but rather recognise the transaction price as the total EURO amount of 2,745,421.

The candidate correctly indicates that the practical expedient can be applied in respect of the financing component, and that discounting of the transaction price will therefore not be required. The candidate also showed sufficient application in this regard, by applying the actual contract period to the requirements of the practical expedient. Since it was not necessary to address both core issues under step 3 to be considered competent for this task, this was considered to be a valid additional aspect.

Step 4:

I disagree with this treatment. As detailed above we have 12 separately identifiable and distinct performance obligations, being the avocado order and arrangement of shipping for each of the 6 months of the contract (2 per month). Hence we would need to allocate the transaction price accordingly between these 12 performance obligations.

Valid additional aspect: The candidate correctly indicates that the transaction price will have to be allocated to the performance obligations based on stand-alone selling prices, since there is potentially more than one performance obligation in the contract.

As you are aware this would need to be done based on the stand alone selling price of the related promises in the contract. However, I do want to note that it may be difficult to identify a SASP for the sale of avocados many months into the future as we are used to performing the sale in contracts of avos more on demand or within a shorter request

Valid additional aspect - higher level application: The candidate correctly indicates that it may be necessary to estimate stand-alone selling prices, due to the uncertainty involved. Note the application in this regard - the candidate is not only making a blunt theoretical statement!

period. We may need to relaibly estimate a SASP for the sale of avocados months in the future using one of the methods of estimation. I would advise that we get the experts advice on the best approach for allocating this transaction price so we can appropriately measure the revenue recognised with each delivery. We may be able to use a market related estimate for the SASP of the arrangement of shipping services as these services are usually provided in the market.

Step 5:

Valid additional aspect: The candidate correctly points out that the performance obligation for the transfer of the avocados is not satisfied over time (as stated by Charles), and links this back to the previous discussion of IFRS15.35 under step 2.

I disagree with the method of recognition provided. As discussed in the above steps, it does not appear appropriate that the satisfaction of performance obligations is measured over time for the delivery of avocados. As per the terms of contract for exports from your previous background email, we transfer risk and title of ownership of the avocados at the point of loading. This happens once we get the avocados to the Cape Town port and load these onto the ships to be shipped. At this point the risks of ownership have passed to Supreme Brands and we can recognise satisfying the performance obligation of delivery of the avocados.

The candidate correctly indicates that risk and title of ownership of the avocados will transfer at the point of loading, based on CIF terms, and not only at the European port as indicated by Charles.

As stated above, with each delivery we have a separate performance obligation (with each months delivery) to arrange the shipping and insurance thereof for the delivery of the avocados from the loading port to the port of destination in Europe. With this performance obligation it is not actually us (BK) providing the shipping and insurance services, but rather we are just arranging for a third party provider to perform these services for our purchaser. This indicates we are acting as an agent in the arrangement of the shipping and insurance services (which is further validated by the fact that we no longer control the inventory once loaded, and that we are not primarily responsible for actually shipping the goods to Europe).

Valid additional aspect: The candidate raises valid principle vs agent considerations in respect of the shipping and insurance.

With this arrangement of shipping and insurance performance obligation it would appear that we would satisfy our performance obligation at a point in time, too. As we are acting as the agent, our primary responsibility is to arrange the shipping services and related insurance for the shipment we have loaded. Once our avocados are on the ship and this ship begins its journey to European port, it is the shipping company's responsibility to get it there safely, and it is the insurance company's responsibility to pay or reimburse any related damages if these occur. Our performance obligation of arranging this has been satisfied at that point in time that it is loaded and begins its journey as we no longer have any duties to perform. So all 12 performance obligations are recognised at a point in time.

Valid additional aspect: The candidate considers whether the performance obligation for shipping will be satisfied over time or at a point in time.

<u>Initial Payment Received</u>

I agree that the initial payment received upfront will be recognised at the spot rate ont he date it is received. This amount will correspondingly be recogniseds as a contract liability at the same rate as you have stated.

I disagreed with your point on how the revenue will be recognised at and the related contract liability remeasured as we perform. In terms of IFRS 22, the contract liability would be recognised at the initial spot rate when received. This must be derecgonised at the same initial spot rate, and not remeasured as each related performance obligation is satisfied. Similarly, the revenue being recognised which corresponds to the derecognition of the contract liability (ie: the first 50% of the contract) would need to be recognise at the same initial spot rate used for the contract liability in terms fo IFRIC 22.

Valid additional aspect: The candidate correctly indicates that the contract liability will not be remeasured for changes in the foreign exchange rate after initial recognition, and that the related revenue will therefore also be recognised at the same initial spot rate (and not the spot rate on transaction date as indicated by Charles).

As we would have allocated our transaction price above to the separate performance obligations, we would be able to identify when we have satisfied 50% of the promised transfer of goods and related recognition of revenue. In the performance of the first 50% of the contract (ie: the first two deliveries) we would recognised these at the initial spot rate used on 1 March 2021.

Note: The candidate explains the actual revenue recognition - not really necessary, but not incorrect.

When we have satisfied past 50% and fully derecognised our contract liability we would recognise the revenue at the spot rate on the date the performance obligation was satisfied and a related trade receivable at this same rate (ie: for the last delivery we would recognise this a the spot rate of delivery in October 2021 when the control of the items pass at the shipping point.).

I agree with your final two points on the recognition of a receivable in respect of the remaining 50% of revenue within the contract and a and that this will be derecgonised once the final payment is received.

<u>Other accounting considerations:</u>
I would like to note that our year end is on the 30th September 2021, and hence this is during the performance of the contract with Supreme Brands. As we would likely have satisfied more than 50% of the contract obligations and recognised more than 50% of revenue (purely based on the fact that we have delivered 5 out of the 6 deliveries with October being the smallest quantity), this would mean that we would have a trade receivable on our financial statement.

Valid additional aspect: The candidate correctly indicates than any trade debtor would have to be translated to spot rate at year-end, with any resulting gains or losses recognised in profit or loss.

As this trade receivable is a monetary item in terms of IAS 21 we would need to translate this item at the closing exchange rate with any movements in this balance being recognised as a foreign exchange gain or loss on the profit or loss statement.

Furthermore, due to this being a significant contract with one of our customers that is likely to represent a large portion of our sales, we may need to provide disclosure of the terms and size of the contract and related revenue being recognised in the notes to our financial statements. This will provided our users with more useful information. However, we must not include the name of the client.

Valid additional aspect: The candidate raises valid disclosure considerations regarding the transaction in the financial statements (not only considering generic disclosure requirements of IFRS15).

I hope this email has answered all your questions on the revenue recognition process. If there's anything you'd like to discuss or if you would like me to have further discussions with the experts we bring in please do get in touch.

Overall: The candidate was considered competent in this task since they demonstrated their ability to apply their pre-researched technical knowledge to the information on the day, by responding directly and concisely to Charles's notes without dumping or forcing a pre-prepared response. Furthermore, the candidate displayed the required level of technical competence in this task by correctly identifying and discussing all the required core issues, as well as a sufficient number of valid additional aspects. The candidate's response was elevated to highly competent based on the following:

- The exceptional coverage of the various issues (the candidate correctly identified no less than 11 valid additional aspects, including one higher level aspect, which is far more than what was required to be considered competent in this task);
- the exceptional technical accuracy displayed; and
- the overall clear and concise nature of the response.

Kind regards,
Financial Analyst.

Competent
From: Financial Analyst Sent: 17 December 2020 To: Charles Lancome Subject: Accounting implications for sales agreement with Supreme Brands Hi Charles I hope you are well and safe. I had a look at your notes regarding the accounting treatment for the Forward purchase agreement and have highlighted what you should consider and what we need to change as i don't agree with per my application of IFRS 15 revenue standard. Per step 1 of the revenue recognition standard: I agree with you that we will have a contract with Supreme Brands and the contract will have commercial substance.

We also need to consider whether it is probable that we will collect the consideration, and i think it will be as Supreme Brands is going to pay us upfront and we have no past history of them not settling their debt.

Valid additional aspect: The candidate points out that the probability of collection of the consideration from Supreme Brands needs to be considered as well, with sufficient application to the case study (i.e. upfront payment / no past history of not settling their debt).

Therefore Step 1 of the revenue recognition model is met.

Step 2: Identifying the Performance obligations

This is where it gets a bit tricky. I feel that there is distinct good and services that is identified, **one being the sale of the avos where risk and rewards transfer when the avos are loaded on the ship** and **the other being the arrangement of the insurance and freight for the avos.**

Note: Although the candidate points out that risk and rewards will transfer when the avos are loaded on the ship, no benefit is given for addressing the core issue related to step 5, since it is not considered in the correct context. To be given the benefit for the core issue related to step 5, it should have been clear that candidates are challenging Charles's statement in step 5 that Supreme Brands will obtain control of the avocados once it is delivered to the European port, which is not the case here.

My reasoning behind this is that the goods do not meet the definition of para 35 of IFRS 15 where the goods are transferred over time due to the customer not receiving and consuming the benefit of the avos as they are grown and delivered but only once it is on the ship risk and rewards pass, and the avo is not a asset that Supreme Brands controls as it is created as we don't know how many avos we are growing and harvesting each month on a whole and what relates to them, and the asset the avo has many alternative uses to us, as we can sell it locally or domestically.

Core issue (step 2): The candidate disproves Charles's statement that the transfer of the avocados is a "series of distinct goods", through sufficient application of the requirements of IFRS15.23 and .35 (i.e. proving that the transfer of the avocados is not a performance obligation satisfied over time). The application is important here, since no benefit was given for only listing the theoretical requirements without any application to the case study.

Therefore para 22(a) of IFRS 15 would apply as the avo sold and the insurance and freight are distinct. Each delivery of Avos is distinct due to the fact that the customer can benefit from the avos received on their own with other resources that are readily available such as other delivery and freight companies, and the promise to transfer the goods (avos) is separately identifiable from the delivery and insurance arrangements.

Note: It was not necessary to prove that the avocados are distinct - since Charles considered the avocados to be a "series", he must have already concluded that the avocados were distinct goods - therefore there was no concern to raise in this regard. The candidate was, however, not penalised

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The sale of Avos:

The monthly deliveries of the agreed upon amount of Avos and the price are distinct as the ownership of the avos have been transferred upon shipment. The monthly orders are different due to pricing. If the buyer arranges their own shipment the avos can still be provided from BK and Supreme Brands would obtain benefit of the avos thus meeting para 27 in IFRS 15.

Note: Refer comment above. Also note that it is inappropriate to quote paragraph numbers to Charles without any further explanation. As much as theory that is not applicable should not be regurgitated, it is important to note that Charles should not need to open his IFRS to understand what Financial Analyst is trying to say here. Paragraph numbers does not tell him anything and it should be given to him.

Arrangement of insurance and shipping:

This service could be performed on the buyers behalf on a different shipment or on different goods. It is thus distinct as the services could be benefited from their own, and the promise to provide the service of arranging the freight and insurance is distinct in the contract as CIF, specified it is performed on the buyer behalf. As such it is separate from the sale of the Avos.

Core issue (step 2): The candidate correctly indicates that the shipping terms may give rise to an additional performance obligation. Since it was not necessary to address both core issues under step 2 to be considered competent for this task, this was considered to be a valid additional aspect.

Thus there is 2 Performance obligations that occur each month, therefore there would be 12 performance obligations in total for the whole contract, each month would have a performance obligation to deliver goods (avos) and to arrange insurance and freight costs.

Note: In step 2, it was not necessary to conclude on the actual number of performance obligations since Charles did not want the "exact, detailed technical answer". However, the candidate was not penalised for trying to reach a conclusion in this regard. Furthermore, it should be noted that the actual number of performance obligations is debatable and may require a high level of judgment.

Step 3 Determining the transaction price

Based on the information provided with the sales agreement with Supreme Brands we can see that the transaction price is determined before hand which is the number of cartons to be supplier per month at a committed price, therefore the total purchase commitment will be the fixed price for the transaction price.

Note: This information is irrelevant since it does not speak to Charles's notes. Forcing some pre-prepared information?

Even though the contract is stipulated in euros it will not make it amounts to be received as variable consideration. For variable considerations to exist the requirements in para 51 and 52 of IFRS 15 need to be met and as these are not met it is concluded as not being a variable consideration and is taken as a fixed consideration. Thus the transaction price is the EUR 2,745,421.

Note: Although the candidate is trying to challenge Charles's statement that the transaction price is variable, the argument is insufficient and no benefit was given. Again, it is not appropriate to only refer to paragraph numbers without any further explanation. This paragraph leaves more questions than answers - what does paragraph .51 & .52 say and why are these not met?

Furthermore there is no significant financing component as half of the payment is made in advance and the other half is made in less than a year, thus there is no need to calculate any present value as the transaction is for a period of 7 months from May to October.

Core issue (step 3): The candidate indicates that the practical expedient can be applied in respect of the financing component, and that discounting of the transaction price will therefore not be required. The candidate also showed sufficient application in this regard, by trying to apply the actual contract period to the requirements of the practical expedient. (Although the period of 7 months is incorrect, this was forgiven since the focus was on the contract period being less than 12 months). It should also be noted that the first part of the discussion is questionable since it was not necessarily correct to conclude that there is no significant financing component - there might be a significant financing component, but the practical expedient can be applied. This was, however, forgiven since the candidate did eventually get to the practical expedient issue, which was the crux of the matter.

Step 4 allocate the transaction price to the Performance obligations.

As there is 12 performance obligations identified we will need to allocate the transaction price to both of them.

We would originally allocate the transaction price to each performance obligation based on the relative stand alone price, if the relevant stand alone price cannot be performed such as the price of the insurance and freight is set by another party we would need to use the methods in para 79 of IFRS 5 to assist us with the pricing.

Valid additional aspect: The candidate correctly indicates that the transaction price will have to be allocated to the performance obligations based on stand-alone selling prices, since there is potentially more than one performance obligation in the contract.

BK would have to estimate the stand alone selling price at the amount that would be expected to be received from Supreme Brands for each month.

The three methods are:
1 Adjusted market assessment
2 Expected cost plus margin approach
3 Residual approach

Once the selling price is calculated on each Performance obligation it will be used to determine the transaction price of the goods.

Note: The candidate was not given any benefit for stating that BK would have to estimate the stand-alone selling prices, since there was no reference to the volatility and price uncertainty of export markets. Therefore, there was insufficient application to be given a benefit for higher-level application, and this discussion was considered to be purely theoretical in nature.

Step 5 Recognise revenue

The revenue will be recognised per a month based on when the performance obligation is satisfied. Therefore each month revenue will be recognised for the quantity of avos agreed for that month times the agreed price when the avos are loaded on the ship in the Cape Town Harbor.

Revenue is thus recognised at a point in time when the goods are on the ship and when the insurance and freight are arranged and paid for. Supreme brands will obtain control over the goods when it is loaded on to the ship.

Core issue (step 5): The candidate correctly indicates that control of the avocados will transfer at the point of loading. Ideally, the explanation could have been stronger by linking it to the CIF terms and/or indicating more clearly that Charles's statement in this regard was being challenged. Nevertheless, the candidate was given the benefit of the doubt here.

To measure the amount of revenue to be recognised per each shipment we would take the cost per the avo x the number of avos x the exchange rate when risks and rewards transfer. The only difference will be for the revenue received in advance. This will be treated differently as the value of the amount received will be considered under IFRIC 22 which deals with Foreign currency and advance consideration. Under this standard BK is rewards BK is required to record the contract liability on the date it was received and translate it at the spot rate of date of receipt. However when revenue is recognised it is accounted for using the exchange rate used for the contract liability as BK has already received the funds at the specific date and would have already translated the currency. There is no foreign exchange gain or loss on the revenue received in advance as it will not be remeasured.

Valid additional aspect: The candidate correctly indicates that the contract liability will not be remeasured for changes in the foreign exchange rate after initial recognition, and that the related revenue will therefore also be recognised at the same initial spot rate (and not the spot rate on transaction date as indicated by Charles).

The only other accounting considerations you will need is the accounting of the trade debtor, as the debtor owes in foreign currency, you will need to restate the debtors balance at year end to the exchange rate and take the gains and losses to profit and loss, and you will have to do the same when Supreme brands settles their debts.

Valid additional aspect: The candidate correctly indicates that the trade debtor would have to be translated to spot rate at year-end (and on settlement date), with any resulting gains or losses recognised in profit or loss.

I hope the explanations above assist you with your work. There is a grey area around the number of performance obligations and when the performance obligations are satisfied over time or in a point in time. I think our final decision should be made when we have consulted the IFRS expert.

Kind regards

Financial Analyst

Overall: The candidate was considered competent in this task since they demonstrated their ability to apply their pre-researched technical knowledge to the information on the day, by responding directly to Charles's notes. Although there were some hints of pre-prepared information coming through, this was not considered to be pervasive and therefore forgiven. Furthermore, the candidate displayed the required level of technical competence in this task by correctly identifying and discussing at least one core issue for each of steps 2, 3 and 5, as well as four other valid additional aspects.

Limited competent

To: Charles Lancome (CFO)
From: APC candidate
DATE: 17 December 2020

SUBJECT: Accounting for sales agreement

Hi Charles

I trust you're doing well. Please see below the information as you have requested. I hope you find it useful, and please contact me if you have any queries in this regard.
I have made comments for your consideration under each of the headings you had provided to me in your email. As I know this is for the board of directors, I have tried to keep this short and sweet, with only the most salient and relevant information included.

Step 1 - Identify the contract with the customer

I agree with what you have considered here, but it may also be important to remember the following as BK will need to instruct the lawyers as to what exactly it needs in the contract:
- Both BK and Supreme brands must have agreed to and approved the contract before it can be accounted for
- The rights of both parties as well as the obligations must be clearly identified, along with the payment terms in line with the purchase agreement

Note: It was not necessary to consider paragraphs (a) - (d) of IFRS15.9, since these were in essence already covered by Charles. The candidate was, however, not penalised for including this information. The theoretical nature of these considerations were somewhat concerning though.

- the probability to collect consideration must be considered. As Supreme brands are a long standing customer, this shouldn't be an issue. But I recommend the debtors and finance department just do an analysis on the payment patterns and behaviours of Supreme brands to ensure that payment and on time payment is probable.

Step 2: Identify the performance obligations

Here I feel you are on the right track, but I disagree slightly with your explanation - and also want to give you some additional considerations at this point.
The goods in the contract are distinct goods, and the promise to transfer these goods are separately identifiable as the contract states the dates and amounts of avocados to be delivered.

Valid additional aspect: The candidate points out that the probability of collection of the consideration from Supreme Brands needs to be considered, with sufficient application to the case study (i.e. long standing customer).

Note: The candidate is arguing that the avocados are distinct goods, which was irrelevant in the context of the task. Since Charles considered the avocados to be a "series of distinct goods", he must have already concluded that the avocados were distinct goods - therefore there was no concern to raise in this regard. The candidate is clearly missing the point here, i.e. although the avocados are distinct goods, it is not necessarily a **series** of distinct goods as indicated by Charles. This seems like dumping of pre-prepared information, with no application to the information given on the day.

However, as the actual avocados are all of different harvested batches, and the agreement states that these must be delivered on specific and separate dates. Thus although the performance each month is exactly the same in nature, there are 6 separate performance obligations for each delivery.

It must be noted that some directors may ask whether the shipping, freight and insurance costs are not a separate performance obligation. This is not a separate performance as is significantly integrated with the providing of produce - and cannot be sold and provided separately from the delivery of avocados. It is thus not considered to be distinct.

Note: The candidate is concluding that the shipping is not a separate performance obligation, which is not necessarily the case.

Furthermore, these costs are considrred to be as a direct result of the contact with the customer as BK does not usually provide shipping or insurance services as a stand alone service. Thus these are merely contract costs and should be expensed as selling and distributing type of costs in the income statement. This is also as there is no repayment of these costs - but it fully borne by BK.

Note: This is technically incorrect. Although this treatment is allowed in terms of US GAAP, it is not allowed in terms of IFRS.

Step 3 - Determine the transaction Price

Part (b)

I disagree with your assessment of determining the transaction price. I feel the transaction price should rather be looked at as follows:

The transaction price is fixed. The transaction price is defined as the considerations the entity expects to be entitled to.The contract states exactly what the transaction price will be per month (and thus per each performance obligation).

Variable consideration relates to conditions that exist that mean the customer will actually pay different amounts based on conditions in that contract, for a specific performance. This is usually due to rebates, discounts penalties etc. However here, the cash flow in Euro's from Supreme brands is contractually set and fixed - and fluctuations in the revenue recognition is based purely on exchange rates.

Core issue (step 3): The candidate correctly indicates that the consideration in the contract is not variable, since the variability relates to exchange rates rather than specific contract terms.

The revenue will be translated into Rands on various dates - but that affect will be accounted for separately under IAS 21.

With regards to the financing component - IFRS 15 states that there is no significant financing component if the period between the transfer of the goods/ performance and the payment is less than 12 months. As the period of payment and delivery takes place all within 8 months, there is no significant financing component. Therefore any contractual assets and liabilities can be measured at their fair values.

Core issue (step 3): The candidate hints towards the fact that the practical expedient can be applied in respect of the financing component, and that discounting of the transaction price will therefore not be required. The candidate also showed sufficient application in this regard, by applying the actual contract period to the requirements of the practical expedient. Since it was not necessary to address both core issues under step 3 to be considered competent for this task, this was considered to be a valid additional aspect.

Step 4: Allocate the transaction Price

I disagree with this step being irrelevant. As discussed earlier, 6 performance obligations can be identified. There is a contractual revenue to be earned for each one, and thus these contractual amounts can be allocated to each performance obligation.

Note: The candidate did not specify that the transaction price will be allocated based on stand-alone selling prices, therefore no benefit given.

Although the revenue will be recognised at various spot translation rates, the price can be allocated to the 6 performance obligations as follows:

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Note: The actual allocation of the transaction price was not necessary since Charles did not require the "exact, detailed technical answer". This allocation is incorrect (with no indication of how the amounts were arrived at) and detracts from the overall quality of the response.

Performance Obligation, Delivery of avocados in set month:	Transaction Price in EUROS
May	421255
June	545646
July	690983
August	676103
September	263511
October	147923

Step 5: Recognise revenue

I disagree with the timing of the revenue recognition for the following reasons.
In order to recognise revenue at a point of time (which I believe it should be) you must first disprove the over time requirements:

The requirements are disproved as follows:
1. The customer does not simultaneously receive and consume the benefits
2. The delivery of goods does not create an asset or enhance an asset that the customers controls

Note: No benefit was given for paragraph .35 considerations, since the candidate only dumped the theoretical requirements without any application.

3.The avocados may have alternative use, and BK does not have enforceable right to payment for performance to date, but rather enforceable only according to the contract terms.

Thus the revenue is recorded at a point in time as the following indicators of control as per IFRS 15 are present:

Note: These considerations do not really add any value - the focus should rather have been on the CIF shipping terms and the related transfer of control.

1. Once the avocados are on the ship - BK has the right to payment
2. Legal title transfers to the customers once the avocados are on the ship
3. The significant risks and rewards of ownership have transferred once the goods are on board the ship.

As per CIF principles explained in IAS 2, the customers controls the goods once the avocados are loaded onto the ship in Cape Town.

Core issue (step 5): The candidate correctly indicates that control of the avocados will transfer at the point of loading. Ideally, the discussion could have been stronger by linking it more directly to Charles's incorrect statement in this regard. Nevertheless, the candidate was given the benefit of the doubt here.

I agree with the rest of your assessment except for the following:

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When the contract liability is Debited to recognise revenue, it will be debited at its last measured exchange rate which will be the spot rate on the day the cash is received upfront. The difference between this and the revenue recorded at the spot date on the day the goods are shipped, creates an IAS 21 forex difference.

Note: This discussion is technically incorrect - no benefit given.

Other considerations include:

This agreement will boost the cash balances towards any here end - which will help the current assets on the balance sheet. Liquidity is not a problem, but an increased cash balance from its current very low state would be helpful when trying to secure finance for other projects - for example the guacamole project.

Overall, the candidate missed both the core issues under step 2, which means that the candidate could not be assessed as competent for this task. This was compounded by the fact that the candidate only raised two other valid additional aspects, which was considered to be insufficient. Furthermore, the response was riddled with technical inaccuracies as well as some evidence of dumping pre-prepared information. Considering all of these factors together, the response was assessed as limited competent.

Warm regards,
APC Candidate

TASK (c)
Provide Charles Lancome with the requested input.

Highly competent

From: Financial Analyst
Sent: Thrusday, 17 December 2020
To: Charles Lancome
Subject: General journal entries

Hi Charles

I hope you are well.

Please see my memorandum attached regarding the journal entries.

Please contact me should you have any further queries.

Thank you so much,

Kind Regards
Financial Analyst

ATTACHMENT:

To: Charles Lancome
From: Financial Analyst
Date: Thrusday, 17 December 2020
RE: General journal entries

I have reviewed the general journal in detail and have identified the following:

GJ027:
Concerns:
- The cost of ripenening looks quite high. My concern is the overstatement of inventory therefore I would like to understand these costs better.

Candidate is concerned about the R711 543 - the fact that it is a sizeable amount. This is an acceptable concern, we would have wanted to understand why the candidate thought it quite high. We would have liked to see a justification such as, due to the journal being recorded in mid-March and these transactions are deemed to be non-routine. Therefore is a valid concern and one would need further clarity to understand the nature of this transaction.

Part (c)

- I was of the impression that the ripening function is performed by BK at BK's premises. This should thus be recorded as a cash outflow depicting the costs spent on it as raising an accounts payable liability indicates that we owe a creditor the cash which is not the case if BK is performing the service.

Valid concern: The candidate is making use of the Pre-release information that was given, where it was indicated that ripening happens at BK's premises, hence why would a creditor be raised? This showed a good understanding of the company (case study).

Specific source documents required:

The layout of this response is done well as the candidate links the source documents to the specific journal entry.

- Invoices relating to these costs that have been capitalised to confirm that they are valid costs that relate to the avocado inventory and are appropriately capitalised to the inventory.

Because the candidate is questioning the size of the amount capitalized - they want to get the invoices relating to these costs that have been capitalized. They are telling us what kind of invoices are required. The invoices will come from third parties and as such is deemed to be sufficient and appropriate audit evidence. (In addition to confirming if in house cost or creditor)

- The overhead allocation workings showing how the capitalisation value of these costs were determined

The candidate has identified that there must be some allocation method that is used for their expenses especially because of the size of the amount and because the amount has been credited to accounts payable.

- The remittance advice received from the creditor showing that the payment has not yet been made.

GJ059:
Concerns:
Abnormal wastage of labour is not a cost of sale as it is not incurred in the production process for the purpose of bringing the avocado's into a sellable condition. As such, this should be expensed as part of operating expenses and not cost of sales.

- I would like to understand the reasons these abnormal costs were incurred, was there a labour strike?

Candidate has identified that any abnormal loss/ wastage should not be capitalized in terms of IAS 2. But could be valid, if the exceptions in IAS 2 is met. Asking, if it relates to labour strike, indicates good application of IAS 2 theory.

Specific source documents required:

- Bank statement showing proof of payment
- Calculation schedule showing how BK arrived at the value of R20,000 for this cost.
- Schedule showing qualitative factors of why this cost was incurred and what labour instance it related to.

Due to the nature of this specific transaction - the bank statement the most appropriate audit evidence.

GJ074:
Concerns:
- The suspense account is merely a holding account that is meant to clear on a timely basis. Please confirm how long this refund was unallocated for and whether there are other instances where the suspense account is not being cleared?

The candidate is questioning the nature of the suspense account. Also based on their knowledge, a suspense account should be cleared within a short period. Therefore they are also questioning how long it has taken to clear this account - this is also alluding to the potential cut-off issue as it has taken the company 10 months to post this specific transaction since the transaction date.

- Further, creditors clerks are meant to keep track of all invoices and refunds for each creditor, is it common for there to be unallocated refunds? This could be indicative of the fact that the creditor department is not performing their function appropriately and is not keeping track of the transactions occurring.

Candidate is questioning the internal controls of the company - which is valid due to the nature of this transaction.

Specific source documents required:
- Credit note received from transport company showing the value and reason for the refund.

The proof of payment/ Credit note will be third party confirmations and as such are the strongest audit evidence we can get to get comfort over this specific transaction.

- If payment has been received from the company, provide the auditors with the proof of payment.
- General Ledger breakdown of the Suspense Account and Distribution costs account
- The initial invoice to which the credit note relates in order to verify its contents

GJ078:
Concerns:
- The write down of inventory is normally treated as an impairment expense. This expense should be posted to an impairment expense account in order to keep track of the impairments noted for inventory throughout the year.

- It is concerning that the inventory was overvalued by such a significant amount. Is there a reason that the selling price is so much lower than the cost price? This needs to be investigated further as it is indicative that BK may be incorrectly costing their stock.

The candidate has noted that the write down is quantitatively material. This is because the write down is 13% of the inventory value which is potentially excessive.

Specific source documents required:
- The sales listing showing the selling price of each item immediately after year end
- The inventory valuation report showing the cost price of each item immediately before year end
- The auditors may select a sample and will thereafter request a sample of invoice for the period immediately after year end.
- Managements calculation schedule showing how they arrived to the total impairment amount required.

Candidate indirectly realizes that the calculation of NRV can sometimes be complex (has various aspects/ assumptions). Therefore the calculation schedule would be a starting point and then additional supporting evidence would be to test the inputs of the calculation. They identified the invoice after year end to ensure the SP used in the calculation is accurate.

- Managements schedule showing the assumptions used when performing these calculations and the justification thereof.

Overall, the candidate was able to identify at least more than one concern for most of the journal entries.
Also they were able to identify at least more than one sufficient and appropriate audit evidence for the transactions.
The candidate really had a good understanding of this task and used the pre-research and information on the day in order to respond to this task appropriately.

I hope the above assist you with your concerns.

Kind Regards,

Financial Analyst.

Competent

From: Financial Analyst
Sent: 17 December 2020
To: Charles Lancome
Subject: Selected Journal entries

Hi Charles

I have had a look at the General journal entries and i have highlighted some concerns on them below, and the support we require to provide to the auditors below.

Concerns:
1. The capitalisation of the avocado storage - the auditors might question whether we can capitalise the cost of storage as IAS 2 does not allow it unless it is necessary in the production process before further processing. I think the main concerns is that can we prove that we need to store the avos so that they can ripen and that ripening is a further process of our Inventory.

Candidate is indirectly identifying that IAS 2.16 (c) is applicable ie the capitalization of storage costs.
The candidate takes it a step further by noting that there is inventory that is sold as "ripe and ready". Therefore for this inventory, all the ripening/ storage costs are necessary to get the "ripe and ready inventory" to its condition of sale.

2.GJ059 was posted on a Sunday which is unusual, was this an authorised journal? Why is the journal coming from the bank account and not from the salary and wages payable account? This seems like there is something more to it and should be investigated further incase unauthorised journals are being produced to conceal theft or fraud.

This is a valid concern as the candidate is questioning how genuine this transaction is due to the fact that it was posted on a Sunday.

3. Back dated journal entries for GJ074 and GJ078- is it correct for someone to post so far back dated journals?

Candidate has identified the significant time lapse between the transaction date and posted date of the two journals. There could potentially be cut off issues for these specific transactions.

We need to see if these journals were authorised correctly and if the person posting it has the authority to post these journals and it leads to concerns that many journals are processed in the current period that affect the prior period balances. Someone could be processing back dated journals to manipulate the accounting system and trial balance. Also if the refund was received long ago what was it doing in the suspense account for so long?

The candidate has mentioned the use of a suspense account, but was not given the benefit for this as they needed to take it a step further by providing additional insight relating to this journal ie the nature of the suspense account.

We definitely need to see who has the authority to post journals and whether all manual journals posted are appropriately authorised as there is lots of risks as explained above.

Require documents specific:

The layout of the candidate was really good – these are specifically linked the supporting documentation to the concern/ journal entry.
The key here was to identify sufficient and appropriate audit evidence ito of the legislation for each of the journal entries - it was not about the quantity of evidence listed.

Part (c)

Authorization is always necessary for general journal entries - this provides additional insight to the overall response of the candidate - but was not given specific credit on its own.

A schedule of the breakdown of the 711 543 would be our starting point to determine what makes up this specific amount. This however would not be sufficient as it it an internally generated document. The candidate further identifies that we would require invoices from third parties (which is partially correct) but needed to have taken it a step further by specifically saying what type of invoices would be required. R711 543 is a large amount, and considering that it could be made up of any kind of expenses (accounts payable) - more application was needed.

1. GJ027 - Inventory report to confirm the storage and ripening costs was capitalised to it. We would require the schedule to identify which costs relate to storage and which costs relate to ripening. We would require invoices or statements from the service provider to confirm the amount being capitalised is correct.

2. GJ059 - Timesheets of employees to confirm hours and cost of the wastage. Approval of Management over the timesheets to confirm wastage was acknowledged and approved. Payroll report and contracts/ rates schedule to confirm the labour rates and amount was recorded and calculated correctly. The bank statement to confirm the amount was in fact paid to the employee.

Credit was given for identifying the bank statement as an applicable source document (the strongest form of audit evidence)- especially because this relates to abnormal labour expenses and to the extent that the this transaction is genuine.

Report that identified the labour expenses as an abnormal wastage.

3. GJ074 - Bank statement for refund from trucking company, credit note to from trucking company to confirm that the amount was credited from BK account. Invoice that related to the refund to ensure the expense was recorded for it to be reduced.

Sufficient and appropriate audit evidence that has been identified by the candidate.
A credit note is not internally generated and thus third party confirmation which is the strongest available audit evidence.
No credit would be given for identifying an invoice as it is more appropriate for getting comfort over the original transaction but not the refund. The candidate was not penalized for this as they were able to identify other relevant sufficient and appropriate audit evidence.

4. GJ078 - Inventory Value report with calculations for NRV and inventory write down. Evidence of damaged or returned stock per credit notes or quality reports.

Credit given for the calculation of inventory write down - this would be your starting point when you are auditing the inventory write down balance.

General:
As a general requirement we will require the journal approval form to see who park and posted the journal and if it

was appropriately authorised.
I have added what I could come up with. I hope that this assists you with your tasks. Please feel free to contact me to discuss the concerns i have pointed out above.

The candidate was able to identify at least one concern for each of the journal entries.
In terms of the relevant source documents, they were able to identify sufficient and appropriate audit evidence for majority of the journals (except for one).
Overall, the candidate showed good insight and understanding of this task.

Kind Regards
Financial Analyst.

Limited competent

To: Charles Lancome
From Financial Analyst
Sent: Thursday 17 December
Subject: General journal entries

Hi Charles

Thank you for you query. I hope my explanation below will be of value

I will review the list of journal and not my concerns about the journal entries, and also list the source documents, records and reports that should be available for the external auditors to account these journal entries

Please find my response to attachment per journal reference:

GJ027:

Candidate is not making the link that Agricultural produce (inventory) will be measured in terms of IAS 2 principles.

But the candidate was not penalized because it can be argued that the "cost" element of the inventory will be FV as it was first measured ito IAS 41 before being reclassified to IAS 2.

Agricultural produce is required to be measured at fair value less estimated point of sale costs.
Cost to sell include all incremental costs directly attributable to the sale of biological assets

Concern: Is the ripening cost part of cold chain process to the customer to form part of sale cost.

The candidate is questioning if the ripening costs should be part of the sale cost? This is fundamentally incorrect as ripening costs should form part of the cost of the "ripe and ready" inventory.

Source: Either the cost will be from a supplier, where invoices can be traced, or it is part of internal cost allocation, where allocation schedule will be available for review

Candidate mentions that we should get an invoice from a supplier - this is too generic. What invoice? ie an invoice of the ripening/ storage costs / from which supplier?
Candidate mentions an allocation schedule - even though this is very brief - but they show that they see that there could possibly be an allocation method that is used by the company to allocate expenses.

GJ059

IAS 16 only allow the capitalisation of labour during the establishment and growth phase of bearer plants.

Candidate is mixing up the three standards namely IAS 41, IAS 16 and IAS 2.

Because the debit leg of this transaction is COS, the candidate should have already made the link that IAS 2 is the standard that is applicable in this instance.

This is a technical mistake.

Concern: Labour is being written off to cost of sales, when it is not part of IAS41 cost. If it was meant to be capitalised then write off should have been in accordance to IAS 16 for PPE
Source: Bank payment on 2/8/20

Bank payment is a sufficient and appropriate evidence.

should be made on payment request, either from payroll report, backed by approved time sheets, or from approved invoice specifying the detail of wage expense

The candidate is being very generic here. They mention a payroll report/ time sheets etc. But this is not linked to the transaction. The crux of this transaction is relating to the abnormal wastage of labour - therefore only supporting documentation that will help you getting comfort over this transaction - which is not a normal labour expense (but the abnormality of this expense).

GJ074

Part (c)

Concern: Refunds are normally due to overpayment of supplier invoice, or refund based on credit note.

The candidate assumes that the refund is due to the company overpaying. The assumption is also that no credit note was issued? This was not mentioned in the narration. The candidate is not getting to the crux of the issue, which the fact that we are processing this transaction through a suspense account, when it should have been accounts payable.

overpayment will raise concern about payment process, or lack of credit note raise concern about accurate processing of documents.

Source: Supplier statement and internal supplier detail ledger. These can be reconciled and queries raised about refund

Supplier statement is a third party confirmation, is a valid source document as you will be able to see the refund through the account.

GJ078

Concern

Agricultural produce is required to be measured at fair value less estimated point of sale costs.
Cost to sell include all incremental costs directly attributable to the sale of biological assets
In determining the fair value of bearer plant produce based on the expected net discounted cash flow, the expected future sales price and cost expected need to be taken into account

This is a technical mistake that the candidate is making. mixing up the fair value measurement with NRV ito IAS 2.

The application of factors mentioned above requires the use of estimates and judgment by management

This is valid - because NRV calculations are very complex and can require judgement. However, the candidate is linking this to FV and not NRV

Concern: Is the management estimated valid and accurate
Source: Calculation reports done by management to test for valid fair value estimates.

Again, for IAS 2, there are no FV estimates. So no benefit would be given here even though they have identified that calculation reports would be needed.

I hope the information above will be sufficient for any possible concerns you might have, and to give your staff sufficient time to prepare the documents.

Part (c)

Overall: The candidate was not able to identify at least one valid concern in each of the different transactions.
The candidate was also only able to identify very few examples of sufficient and appropriate audit evidence for the different transactions.

Throughout this task, the candidate made a lot of technical errors which also detracted from the quality of the response, especially since the three standards applicable were strongly triggered.

I look forward to later meeting to discuss my concerns

Kind Regards

Financial Analyst

Part (d)

TASK (d)
Prepare an internal control questionnaire to evaluate the adequacy of the salaries and wages system to prevent or detect and correct the situations alleged by the AAWU [Association of Avocado Workers Union].

Highly competent

From: Financial Analyst
Sent: Thursday 17 December
To: Charles Lancome
Subject: Re: Trade union concerns
Attachment: Attachment D

Hi Charles

Please see the internal control questionnaire attached, as attachment D.

Let me know should you need anything else.

Regards
Financial Analyst

ATTACHMENT D:

Internal control questionnaire of best practice procedures related to trade union allegations:

This response has been well structured to address the request for a questionnaire.

Control procedure description	Do we currently implement this control effectively? Yes	No
1. There should be a clear policy on the treatment of hardware and software and how to use the system. This policy must include a security policy.		
2. Have all staff involved in payroll been appropriately trained in terms of related payroll accounting standards and tax standards?		
3. There must be segregation of duties between the staff that does the hiring of staff (HR), the recording of timesheets (employees themselves), the preparation of payroll (payroll administrator) and the payment of payroll amounts (chief accountant).		
4. A review of the employee masterfile should be done regularly to ensure it is updated.		

Controls 1 - 3 are good general controls, which are specific to the wages and salaries process, to ensure that the general control environment is strong so that the application controls can operate effectively. The system description has also been considered and applied in the description of these control procedures.

Part (d)

1. Part of this review should include an extraction of a report from PAYROLL-IT which shows changes made to the masterfile and to confirm these changes are in line with the supporting documents, were made by authorised employees and were made accurately.

A control procedure around changes to the employee masterfiles is a good procedure to ensure the accuracy and completeness of the information from the valid EAO into the PAYROLL-IT system. The description of the control procedures is good and make good use of the system description.

5. For any new garnishee order deductions, the following procedures must be followed:

- The original court order must be inspected and a copy received from the messenger of the court.

These input controls are excellent higher level application. These controls demonstrate an understanding of application controls that would be present in the PAYROLL-IT system. The controls are relevant to ensuring that the information on the EAO's is captured on the system accurately and completely. This therefore addresses that AAWU allegation that third party debts are incompletely and inaccurately deducted from wages.

- This court order must be inspected to ensure it contains:
  - A case number
  - a stamp from the clerk of the court
  - a signature from an attorney
  - all the debtors details
- The HR consultant must confirm that the EAO amount does not exceed 25% of the employee's gross remuneration. This calculation must be reviewed and approved by the HR manager.

- A new deduction authorisation form should be completed with all the relevant details, and signed by both the relevant employee and the HR manager to confirm its accuracy and validity against the court order and their authorisation of the deduction.
  - During engaging with the employee, the HR manager should ensure the employee understands their rights with regards to the EAO, as well as ascertain whether the employee will struggle to stay financially afloat with the order.

- The deduction authorisation form should then be inputted into the employee masterfile by an HR consultant.
  - During the input of the form, some input controls must be implemented:
    - There should be a user friendly screen which is easy to follow
    - Validation tests on different input fields should also be in place, such as:
      - A field length test on the employee number field
      - A field range check must be done to ensure no negative amounts are included as the amount to deduct
    - All fields must be compulsory to complete to avoid any details missing from the data.
  - The HR manager must be required to approve the entry, and must review at a minimum, the following information agrees to the form:

        - Employee name and number
        - Garnishee amount to be deducted
        - Commencement and expiry date
- There must be strong general IT controls around the payroll system.
    - Access controls must be implemented to ensure only authorised employees have access to the employee masterfile.

    - A limited number of employees should be given write access to the employee masterfile.
- All deduction authorisation forms should be filed securely away, along with the copy of the court order and any other related documentation.
- The records of all payments made in respect of EAOs should be stored securely and should be made available to employees who wish to confirm the amounts they have paid off.

6. A trend analysis on the deductions made by BK in respect of its employees should be done to identify any months where unusual amounts were deducted. Investigations should be done into

> This control procedure is a good overall review procedure to identify any unusual amounts being deducted from employees wages.

these months and the deductions made.

7. The system should receive regular updates to ensure it treats PAYE and other deductions correctly. As the system is quite old, these updates are very important to ensure the legislation and other requirements are being implemented correctly.
8. The payslips must be configured to show all deductions made from the gross remuneration to arrive at the net amount paid.
9. The payroll administrator must review a sample of payslips against the employee masterfile to ensure that the sytem is calculating the deductions correctly.

> This control procedure is a good control to verify the accuracy and completeness of the output of the PAYROLL-IT system.

1(Employees should be asked to review their payslips and confirm they are in agreement of the amount received, specifically with regard to the EAO instalment amounts and overtime amounts received.
1 Any overtime worked must be supervised, and approved by the line manager.
1: Overtime must be monitored by the clocking in and out of the magnetic cards - the process of which must be supervised by the line manager.

> This control procedure demonstrates an understanding of the system description that was given on the day as well as good application thereof to the allegation of overtime being worked and not paid.

1: An read-only exception report of unusual hours must be extracted each week/month and investigations into these hours must be performed by the line managers. Subsequently, the line managers must approve a read-only report extracted of the total hours for the month, after reviewing the report as well as the clock card entries.
1· The payroll administrator must reconcile the approved hours by the line manager to the hours used by PAYROLL-IT to calculate the payroll amounts. The payroll administrator must have read-only rights to view the report of the total hours for the week/month. Additionally, she should not be able to edit the hours in the system. However, if an error is noted by her - this must be escalated

to the chief accountant.

- In order to adjust system hours, the approval of both the chief accountant and the respective line manager

This control procedure is well described to address the issue that hours might have been approved by the line mamager that has not been captured on the PAYROLL-IT system. By performing this reconciliation, the payroll adminstrator is able to identify hours worked per the approval but not included in the payment of the

1 The payroll administrator must also confirm the correct rates are being used by the system to calculate overtime pay, using her read-only rights to the employee masterfile.

This is a reasonable control procedure for overtime, as overtime is paid at a higher rate than normal time. A possible reason for hours worked and not being paid, could be that the hours are being paid at normal rates and not overtime rates, hence the allegation by the AAWU.

Overall: The structure of this response is very good. It is clear that the candidate understood what was required in this task.

The response describes good, appropriate general controls within which the application controls can operate effectively upfront. The control procedures are also very well worded and there is clear evidence of an understanding and application of the system description given on the day.

The response demonstrates thorough research on EAO legislation as well as good application of the research in the description of control procedures to ensure that Botala Khauta deducts amounts for valid EAOs only. Excellent input controls are identified and appropriately applied for the input of EAO information to ensure the validity of the information. The control procedures also address the allegation that inaccurate and incomplete deductions are made from the employees' wages and make use of the system description.

The overtime controls described make use of the system description and demonstrate an understanding of how the magnetic card system and the PAYROLL-IT system operate. There is further understanding of the importance of segregation of duties within the system and the description of read-write access for the line managers, and the payroll administrator reports demonstrate good application of the theory as well and the information on the day.

Part (d)

Competent

Internal Control Questionnaire

Indicate whether the following best practice procedures have been implemented at BK:
Where applicable, answers in red

The general controls described are relevant to the application controls for salaries and wages. They are well described and make use of the system description that was provided on the day.

Generally applicable to both concerns

- Controls over payroll software (PAYROLL-IT):
  - Software packages should not be more than 3 years old to avoid incompatibility issues and to ensure that latest features are applied. PAYROLL-IT is more than ten years old
  - Payroll packages should be updated regularly by skilled IT technicians to ensure that the software is operating well. This does not appear to be the case for PAYROLL-IT
  - Payroll packages should be integrated with the other relevant systems at BK to minimise the need for human input and to ensure that data quality is maintained. This is not the case for PAYROLL-IT
  - There should be access controls in place over the payroll system such that:
    - Only authorised users can access the system through a unique username and password
    - Passwords to access the payroll system should be changed every two weeks
    - Passwords to access the payroll system should consist of a mixture of numbers, letters and special characters and have a minimum length requirement
    - The system should have an automatic time-out function, after which point, the username and password must be entered again

- Sandy Oliphant should review any new banking details loaded by the chief accountant against the details provided before payroll is paid
- Sandy Oliphant should review that the chief accountant has captured the correct pay amount before the payroll amounts are processed

The control procedures described for overtime would prevent, detect or correct the allegation by AAWU that overtime has been worked by wage earners and not paid. The control procedures are well described, practical and relevant to BK. Furthermore, the procedures make good use of the system description that was given on the day.

Controls to address overtime discrepancies:

- Employees should not be able to enter or exit the farm without going through an appropriate gateway where they are required to scan their cards to prevent any employees from entering or exiting without registering their hours on the system

This control demonstrates an understanding of the information related to how wage earners record the time that is worked. Also, the procedures demonstrates an understanding that one of the issues could be that the employee as worked hours that have not been registered and therefore they are not paid those hours.

- There should be a guard at each valid entry and exit point to ensure that all employs scan their magnetic cards to prevent any employees from clocking inaccurate hours

- Line managers should have to sign an overtime approval document where workers have requested to work and have subsequently worked a stated number of overtime hours to prevent any workers from invalidly clocking extra hours where no overtime was approved.
- Line managers should submit these signed overtime approvals to Sandy Oliphant on a weekly basis. Sandy Oliphant should extract a weekly report from PAYROLL-IT detailing all instances of overtime worked and she should reconcile each entry to the relevant signed overtime approval form received from the line manager. Sandy should follow up on any discrepancies by speaking to the relevant line manager. Pay slips should only be generated in respect of employees where there is no discrepancy or where the discrepancy has already been resolved.

This is a good control between the overtime hours authorised by the line managers and the hours recorded in the PAYROLL-IT system. Should the reconciliation show hours on the approved list that does not appear on the report from PAYROLL-IT, this would indicate hours worked that possibly might not get paid.

- The payroll system should be formatted such that where the weekly hours worked for a given employee exceed the 40 hour limit, overtime rates are immediately applied to excess hours at a multiple of 1.5 times the employee's standard hourly rate

This is a reasonable control procedure for overtime, as overtime is paid at a higher rate than normal time. A possible reason for hours worked and not being paid, could be that the hours are being paid at normal rates and not overtime rates, hence the allegation by the AAWU.

- The chief accountant should compare amounts captured in respect of each employee's payment to their prior

The control procedures described for EAO's demonstrate evidence of research of EAO's. Furthermore, the research was used to describe relevant, practical controls that BK could implement to prevent and/or detect and correct the allegation by the AAWU that invalid EAO's are being deducted from the wage earners wages. Additionally, procedures are described that address the completeness and accuracy of the deductions to address the further allegation of the AAWU that the third party deductions are incomplete and inaccurate.

week/ month's amount and follow up on any discrepancies by agreeing any overtime to the relevant approval form or enquiring of the relevant line manager before capturing each payment amount

Controls to address EAO issues:

- Only Sandy Oliphant should be authorised to update the masterfile by means of a masterfile amendments log for any EAO order. These updates should then be reviewed by the HR manager against the supporting documents and any discrepancies should be corrected.
- Sandy should only update the EAO on the masterfile after doing the following:

This is a good control procedure to ensure that the information on the EAO is captured onto the employee masterfile (as given in the system description) and therefore can be used in the processing of the wages in the PAYROLL-IT system. The control procedures are well described and make good use of the system description.

  - Receiving the garnishee court order from the sheriff and confirming that the order s stamped by a clerk of the court and signed by an attorney. These documents should be stored in a fireproof safe.

- Confirming the name and ID number of the employee per the order to the employee's employment contract to ensure the order is valid and in respect of the correct person
- Confirming that the debt collector's details have been explicitly included on the court order together with the day on which the amounts are to be deducted
- Confirming that a case number is included on the court order to ensure the EAO is valid and legally binding
- Calculating the amount of the deduction per the court order relative to the employee's salary to ensure that the EAO does not exceed 25% of the employee's salary to determine whether the EAO is valid

- The following controls should be in place over the masterfile:

These are good general controls over masterfiles to ensure that the information is safe and that no unauthorised changes can be made to the information.

  - The masterfile should be write-protected with a password so that only authorised users can make changes to ensure that only valid and accurate EAOs are loaded
  - Katleho or Charles should review and approve the masterfile amendments log before the masterfile is updated.
    - Charles and Katleho should only approve updates to the masterfile if they have received and reviewed the appropriate documentation (in the case of an EAO, the above confirmations over the court order should be performed)
  - The masterfile should be backed up regularly and back ups should be stored offsite (ideally in the cloud)
- The HR manager should meet with the affected employee when an EAO is received to ensure that the employee is informed of the case and understands the implications thereof

This control procedure provides evidence of research that has been appropriately applied and described as a relevant and practical control.

- After the masterfile has been updated for new EAOs, Sandy Oliphant should extract a report from PAYROLL-IT of the deductions applied to the affected employee's salary and agree the EAO deduction per the system to the court order to ensure the system is applying the deduction correctly

This is a good control procedure to ensure the accuracy and completeness of the information captured from the EAO into the PAYROLL-IT system.

- Sandy Oliphant should extract a weekly report of all EAO deductions applied by PAYROLL-IT and compare the details and amounts to the original court orders to ensure that the amounts deducted are accurate. She should follow up on any discrepancies before presenting the payroll to the operations manager

Overall: This response provides a good description of general controls upfront. The controls are appropriately described as procedures that could be implemented to ensure that the application controls can operate effectively. There is good use of the system description through the identification of Sandy Oliphant and the chief accountant who are assigned appropriate responsibilities within the discussion.

The control procedures described for overtime address the allegation of overtime that was worked and not paid through the reconciliations between the time-keeping system and the PAYROLL-IT system. This demonstrates an understanding of the system description that was given in the information on the day as well as its application. The response also identifies a control procedure regarding the rate of pay for the overtime that was worked by the employees.

The response appropriately addresses the masterfile control procedures that would ensure that the input of the EAO information is valid, accurate and complete. There is clear evidence of research of the EAO legislation as well as the application of the research in the description of the control procedures. The control procedures demonstrate an understanding of Botala Khauta's responsibility regarding valid EAOs and are not merely a theory dump of legislative issues related to EAOs.

The response also appropriately and adequately deals with control procedures that would address the allegation that inaccurate and incomplete deductions are being made from employee wages for third party debts.

Part (d)

Limited competent

To: Charles Lancome
From: Financial Analyst
Sent: Thursday 17 December
Subject: Trade Union Concerns

Hi Charles

I'm glad your meeting with the union resulted in a calmer situation.
I've noted in your mail that there is still a few allegations to be solved, namely:

1. Overtime not being paid
2. Invalid garnishee deductions

I've reviewed the email prepared by Sandy Oliphant, and concur with your remark, the system description is too generic to cover the concerns off the union.

My suggested internal control questionnaire

General questions:

1. Are there written authorization to employ dismiss employees

This is not an appropriate control for the allegations by the trade unions.
The wording is also insufficient as it does not appropriately describe a control procedure that could be implemented by BK.

2. Are rate of pay authorised in writing by official outside of wage department

Rate of pay is an important consideration for overtime, however the question does not make use of the personnel described in the system description and does not appropriately describe a control procedure that BK could implement.

3. Are overtime authorised in advance by manager

The system description does describe the magnetic card system for the clocking in and out of employees. This control is therefore in appropriate in the context of the system that BK already has implemented.

4. Are independent official reviewing payroll

5. Are clocking system used, and are there supervision of the timing device, when clocking in and out
6. Are personnel records kept independently from payroll department, giving all there detail

7. Are control accounts maintained in respect of each of the deductions and paid over to the relevant source

The questions are not appropriately described to ensure that control procedures are given that can be implemented by BK to prevent, or detect and correct the allegation by AAWU that overtime has been worked by the employees and not paid to them.

For overtime

1. Is the timekeeping system automated

This question does not appropriately address the allegation of overtime that was worked and not paid in the context of the magnetic card system that BK already has implemented. Furthermore, this does not address the allegation appropriately as it does not describe the control procedure that should be implemented.

2. Is the system allowing employees to clock in or out for their designated shifts

This question does describe a reactive control that might help in identifying overtime that was worked and not paid, however, it would not prevent it from happening and would not sufficiently and appropriately address the union's allegations.

3. Is the system allowing overtime without a supervisory override

4. Is the system biometric to eliminate the risk of buddy punching

This question demonstrates that the system description was not taken into account in this response as the clocking system is a magnetic card reader and is not based on biometrics.

5. Is the system generating exception reports to supervisors for review

This question is not specific regarding what exception reports should be generated and by which system (the magnetic card reader or the PAYROLL-IT system). It also does not use the personnel described in the system regarding who should be reviewing the exception reports.

6. Is the hours worked detailed on the pay slip for employees to query and fixed where necessary

For garnishee order

There is some evidence of research of garnishee orders/EAO's demonstrated in the questions. However, the questions are not appropriately described to ensure that control procedures are given that can be implemented by BK to prevent, or detect and correct the allegation by AAWU that invalid EAO's are being deducted. Furthermore, there are no questions that address the allegation that the deductions are incomplete and inaccurate. Thus, one of the allegations is not being addressed by this response.

1. Is there is register where all EAO's are shown with details of:

This is a control procedure that would go some way in ensuring that the EAO is valid, however, the question is not specific in terms of who in the payroll function should maintain the register. Also, this register seems to be manual and thus the information is not in the system. This information needs to be captured into the Employee Masterfiles within the PAYROLL-IT system to ensure the validity of the information in the system (as given in the system description)
This will also then contribute to the accuracy and completeness of the deductions.

Part (d)

- Employee detail with ID number
- Value to be deducted
- Start date of deduction
- Total quantity of deductions to be made
- Where payment must be made.
- By what date payment must be made monthly

2. For every garnishee is their document from Sheriff that was signed by HR department

This question shows evidence of research of the garnishee orders, however, it is not specific in terms of who in the payroll function should inspect the EAO to ensure it is from the sheriff and sign it as evidence. Again, a lack of application of the system description that was given.

3. Did the employee sign document to make aware of deduction and details of deduction to be made

Demostrates evidence of research of EAO's.

4. Was detail of garnishee's send to financial department to load beneficiaries on system

This question does not make use of the system description that describes the process of payment within the HR function and not the financial department.

5. Are monthly information send to payment department, and is instruction signed of by independent official

This question does not make use of the system description that describes the process of payment within the HR function and not the financial department. The description explicitly explains that the chief accountant and the CFO and CEO are involved in the payment of the wages.

6. Is beneficiary of garnishee order contacted on a frequent basis to verify balance still outstanding

This question does not specify who in the payroll function (or HR function) should contact the beneficiary.

I hope you find these in order.
On you instruction I will roll the questionnaire out to rest of salary and wage system

Kind Regards

Financial Analyst

Part (d)

Overall: This response addresses general questions upfront, but the questions stated are not sufficient to describe the control procedures that need to be implemented by Botala Khauta within which the application controls should operate. Some of the questions are general and do not address the allegation and are outside the scope of the required, such as the question around the dismissal of employees. This would not address the allegations of invalid EAOs being deducted from employees, the incorrect or incomplete EAOs being deducted nor overtime worked that was not paid being deducted.

One of the questions does address the reviewing of work within the payroll cycle, but the system descriptions were not used in the question; it is merely stated that an independent official should review the payroll.

Questions are asked out the automation of the timekeeping as well as whether the system is biometric, which demonstrates a lack of application to the given system description. The questions posed would not address the allegation of overtime being worked by employees but not paid.
There is evidence of research of EAO legislation in the response, but the information was not applied appropriately in the form of control procedures that Botala Khauta could implement to address the union allegation of invalid EAOs being deducted from employees' wages. Furthermore, the response does not address the allegation that the incorrect or incomplete amounts were being deducted from employee wages.

TASK (e)
Respond to Charles Lancome's email regarding the PAYE concerns and possible other tax implications related to these transactions.

Highly competent

To: Charles Lancome
From: Financial Analyst
Date: 17 December 2020
Subject: PAYE Concerns

Good day Charles

I hope that I can assist you with the taxation related queries as per your email. I should mention that we may need to consult a taxation expert for any more complicated issues.

I will definitely try and give it my best shot with the tax knowledge I have.

Please refer to the attachment to this email for my concerns and queries regarding the PAYE implications as well as the other taxation implications such as donations tax.

You are more than welcome to contact me should you have any questions.

Kind Regards
Financial Analyst

Please consider the environment before printing this attachment - we are striving to be more sustainable!

ATTACHMENT TO EMAIL

1. Loans to CEO and CFO

1. The fact that the loans are interest bearing does not necessarily mean that there is no fringe benefit.
2. I would like to enquire as to the interest rate attached to these loans.
3. If the interest rate is lower than the official interest rate of South Africa a fringe benefit will exist which should be included in the PAYE calculation of you and Katleho.
4. The official interest rate of South Africa is currently 4.5%. It is the repurchase rate (repo rate) + 1%. Repo rate as at today, 17 December 2020, is 3.5%.
5. The only instance where a fringe benefit will have a R0 value is if it is below R3000 - which I doubt is the case here.

The candidate correctly identifies the issue - the rate wasn't provided and therefore if the loan rate was below the official rate, then there would be a fringe benefit.
The candidate goes on to correctly explain the official rate, with application.
Additionally the candidate clearly identifies the value to be calculated - the difference between the official rate and the rate paid.

6. The cash equivalent which should be included in your PAYE calculation will be the outstanding loans amount multiplied by the difference between the official interest rate and the rate at which interest is levied against the loan from BK.

Other taxation implications:
- If the loans are given at a rate lower than the official rate it can possibly be regarded as a dividend in specie if the loan is given to the CFO and CEO by virtue of their shareholding in the company, rather than as employees above.

This will trigger dividend withholding tax as Charles and Katleho are natural persons liable for dividend tax.

The candidate provides an accurate answer to another part of the task - that of providing other tax implications. Here the candidate identifies the loan as a the financial service that is exempt from VAT. Additionally, the candidate shows higher level application by considering why the loan was provided to the CEO and CFO, as well as accurate tax implications thereof.

- No VAT will be levied on this fringe benefit as it is a financial service and thus an exempt supply.

<u>2. Arrangement with financial institution</u>

1. BK employees actually receives a benefit of 3% interest which are not charge to them individually but are paid by BK.
2. The 3% interest paid to Fintap (Pty) Ltd qualifies as a fringe benefit in terms of the seventh schedule of the Income Tax Act.
3. Due to the fact that the employee receives a loan for a combined interest rate (3% BK plus 3,75% employee equals 3,75%) in excess of the official rate; the subsidy is seen as a fringe benefit and should be included in the PAYE calculation of the employee.

The candidate uses the pre-research of the official rate and compares it correctly to the rate provided on the day, that of the 6.75%.
There is a correct conclusion of the 3% being included in PAYE when the 6.75% is above the official rate.

4. The 3% should be calculated for each individual employee based on the outstanding loan amount for the month.

Other taxation implications
- BK will be able to deduct the interst paid under s11(a) of the Income Tax Act as it is expenditure incurred in the furtherance of our trade.

- No VAT will be levied on this fringe benefit as it is a financial service and thus an exempt supply.

The candidate once again considers other tax implications, this time correctly considering the deductibility for BK for taxable income, as well as the nature of the transaction being a financial service and hence exempt for VAT purposes.

<u>3. Tax consulting fees</u>

1. The seventh schedule provides for a fringe benefit where free services are rendered to an employee of the company.
2. The taxation services can be seen as a free service as the employees of BK does not have to pay any amount to receive this service.

3. We will need to determine if this taxation service has a no value as set out in the Income Tax Act.
4. It may not be 100% accurate to state that the employees do not receive any financial benefit - if the employees did not receive this service for free they might have had to pay someone else to do it for them and thus a financial benefit is actually obtained by the employees.
5. The Seventh Schedule assigns a no value to a fringe benefit for services rendered to the employees at their place of work which is stated that the tax services are rendered at BK's offices for the following reasons:

- Better performance of their duties - this is not applicable as the duties of BK's employees do not involve taxation services.
- As a benefit to be enjoyed by them at their place of work - It can be argued that this might be applicable. BK decided to hire the taxation consultants in order to ensure that employees tax returns are up to date and correct. BK's employees did not choose to receive this service, but now they can enjoy it on BK's premises. Thus the free services can be regarded of having no value for purposes of the PAYE calculation of the employees.

This transaction was the one transaction that was new on the day, although the fringe benefit should have been researched during the pre-release.

The candidate correctly identifies the fringe benefit and then goes into a discussion as to the value thereof. Regarding the value, it is debatable whether the no value rule applies and hence the discussion provided is relevant.

Other taxation implications
The taxation consulting fees will be deductible as a normal expense in terms of s11(a) for BK when calculating the taxable income of the company.
If the consultants are VAT vendors, VAT will be charged on the fees and therefore input VAT is claimable by BK. No VAT will be levied as the fringe benefit has no value.

The candidate once again deals with other tax consequences, considering s11(a). Then they go further and consider the VAT on the fees as well as on the fringe benefit, showing excellent depth.

<u>4. Directors emoluments</u>

The director fees received by a resident non-executive director (NED) are not regarded as remuneration in terms of the Fourth Schedule and BK is not obligated to deduct or withhold employees tax as all 4 NED's are residents. The director can however request a voluntary deduction of employees tax where BK must deduct the PAYE and issue the NED with a IRP 5 certificate.

The candidate correctly identifies that the non-executive directors are not employees. The candidate goes further and explains that the directors can choose to have an amount withheld in terms of PAYE.

Other taxation implications:
The fee will be included in the taxable income of the non-executive director who will be taxed on it with reference to the sliding scale for individuals.

If any of the NED become non-residents BK will have to withhold PAYE from the amount paid to the NED and pay this tax over to SARS.

The candidate considers other taxes, for the director (which wasn't necessarily required) and for BK. On top of that further insight is shown regarding potential tax considering if the directors become non-residents.

5. Solidarity Fund

You are correct when stating that contributions to the Solidarity Fund (donations as it is a gratuitous disposal of money) can be deducted from you PAYE calculation but it is limited to a percentage. The Solidarity Fund was established to combat the spread of the COVID-19 virus and thus a tax benefit were granted to motivate South Africans to make a contribution to this fund.

The normal deduction for donations in the PAYE calculation were 5%. However this amount has been temporarily increased to 33.33% of the employee's remuneration for 3 months or 16.66% for 6 months.

It is of utmost importance that this donations that you and Katleho made will be included in your IRP 5 and that the Solidarity Fund issue you with a s18A receipt in order to qualify for this extended tax benefit.

The PAYE to be withheld from your salary will be calculated on the balance of remuneration, which is remuneration remaining after deducting any donation by you. This deduction will now be calculated as 33.3% of your remuneration limited to the actual donation made as you contributed to the fund for 3 months.

At the end of the year of assessment you will also be able to deduct the donation, limited to 20% of your taxable income and not only 10% as is normal practice.

The candidate provides an excellent answer considering both PAYE and the calculation of taxable income

BK should ensure to pay PAYE over to SARS monthly.

Other taxation implications:
No donation tax will be levied on this donation made to the Solidarity Fund as it is a public benefit organisation as per section 56(1)(h) of the Income Tax Act.

The candidate considers other taxes, and correctly identifies that the donations tax is exempt.

BK should ensure to calculate the PAYE correctly taking into account the extended tax benefits.

Overall, the candidate has answered all 5 transactions correctly. Significant insight has been shown, especially with regards to other taxes and this pushes the candidate into the HC category.

Part (e)

Competent

From: Financial Analyst
Sent: 17 December 2020
To: Charles Lancome
Subject: RE: PAYE Concerns

Hi Charles,

I've provided some feedback on the PAYE treatment of each of the items in your email's attachment as well as my consideration of any other tax implications we may need to consider.
Importantly, for PAYE we have to consider the employees tax requirements for their to be an "employee", "employer", and "remuneration" as defined in the 4th Schedule of the Tax Act.

I have provided commentary on each of the items mentioned in my email below:

The candidate provides a simple, concise introduction that explains the request well.

Loan to CEO & CFO

In respect of these loans, there could potentially be PAYE implications. These loans, although interest bearing, may still be considered a taxable fringe benefit and need to be included in the definition of "remuneration" (which includes all fringe benefits).

The candidate explains well how the transactions could result in fringe benefits, which are included in remuneration and therefore impact employees' tax.

The loan has been provided by the company to the CEO and CFO. . In terms of the Tax Act, we would consider "low interest loans" to be a fringe benefit. These are loans whereby the interest charged on the loan to the employee is less than the official interest rate. The official interest rate is calculated as Repo + 1%, therefore currently at 4.5%. Importantly, the repo rate has moved significantly in the year and would have been at different levels at the various months in the 2021 year of assessment.

The candidate has done well to not only identify what, in theory, the official rate is, but also that the rate changed during the year in question.

If at any stage the interest being charged on these loans to the CEO and CFO was below the official rate (which may have been possible in the earlier month of the year when the repo rate was above 6%) then there would be a taxable fringe benefit being granted to these employees which would be the difference between the official interest rate and the interest rate being paid by the employees. In the times where this is the case, the value of the benefit (difference in rates multiplied by the amount outstanding) would need to be included in the remuneration used in the PAYE calculation. If the interest charged on these loans has always been below the official rate then Sandy would be correct in her statement.

The candidate correctly identifies the issue - the rate wasn't provided and therefore if the loan rate was below the official rate, then there would be a fringe benefit.
Additionally, the candidate clearly identifies the value to be calculated - the difference between the official rate and the rate paid.
Lastly, the candidate concludes by answering the question - Sandy is correct.

Other tax implications: BK would need to include the interest earned on these loans into the gross income of the entity under s24J. This is as there is interest on an instrument (loans) which have been issued by the company to the directors.

The candidate provides an accurate answer to another part of the task - that of providing other tax implications. Here the candidate identifies the interest income for BK from the loan, as well as the financial service being VAT exempt.

The loans to the directors would be considered a financial service as defined by the VAT Act and hence there would be no VAT charge on the interest as this is an exempt supply.

Arrangement with Financial Institution

As stated above employees need to include the taxable benefit of any fringe benefits into their remuneration for the calculation of PAYE. There is concern that PAYE has not been correctly calculated as there has actually been a taxable fringe benefit.

The loan provided by Fintab to the employees is at a total interest rate of 6.75%, being 3% borne by BK and 3.75% being borne by the employee. Currently the repo rate is at historic lows of 3.5%. The official interest rate per the tax act is calculated as the repo rate plus 1% which would mean the "official interest rate" is currently sitting at 4.5%. This would indicate that the interest rate being charged is in fact above the official interest rate. The value of the fringe benefit when this is the case is the total interest cost borne by the employer (being the 3% multiplied by the loan amount outstanding). This amount would need to be included in the "remuneration" for the purposes of PAYE.

The candidate uses the pre-research of the official rate, with an explanation, and compares it correctly to the rate provided on the day, that of the 6.75%.
There is a correct conclusion of the 3% being included in remuneration when the official rate is below the 6.75%. Then the candidate goes even further and correctly explains the value when the official rate is higher than the 6.75% of the loan, applying the facts of the transaction and using the 3.75% paid by employees.
Lastly for this part of the transaction, the candidate considers the exclusions, but once again applies the facts of the case study and concludes than the R3000 limit will likely not apply.

Furthermore, previously where the official interest rate was above the interest being charge on the employee loans (ie January or February 2020 when above 6% repo rate), there would still be a taxable fringe benefit for the employee. The value of the fringe benefit would be calculated as the difference between the loan amount outstanding at the official interest rate, less the amount outstanding multiplied by the employees interest rate (3.75%). The difference would be the cost being borne by the employer and would be considered "remuneration" for the purposes of PAYE. However, if the total loan amount does not exceed R3000 or if these loans were acquired to fund studies then there would be no value applied to these loans. However, you have mentioned the loans are up to R60k and hence would likely be included.

<u>Other Tax Consequences</u>

The payment of the interest in respect of these loans should be looked to have a deduction claimed under s24J if the interest is incurred in the production of income. For the item to be in the production of income there needs to be a direct link between the expense that is being incurred and the income earning operations of the entity. As BK's income earning operations are the farming of land to produce avocados for sale for profits, and the related expense is the interest expense on loans provided to farmworkers who work on within these income earning operations we can conclude there is a close enough link for the expense to be considered in the production of income. Hence, we would be able to deduct the interest expenses incurred from our taxable income.

> The candidate once again considers other tax implications, this time correctly considering the 3% interest paid by BK for taxable income, as well as the nature of the transaction being a financial service and hence exempt for VAT purposes.

As states above, the provision of loans is considered a financial service in the VAT Act which is an exempt supply and hence the interest will have no related VAT charged on this. Therefore, we will have no output or input VAT related to these payments.

<u>Tax Consulting Services:</u>

> This transaction was the one transaction that was new on the day, although the fringe benefit should have been researched during the pre-release.
> The candidate correctly identifies the fringe benefit and then goes into a discussion as to the value thereof. Regarding the value, it is debatable whether the no value rule applies and hence the discussion provided is relevant.
> Lastly, as the candidate considered there to be a value, they continue and provide further application using the R120,000 from the information on the day.

This fringe benefit would be considered a Free or Cheap service provided by BK to the senior management employees. This would be a free service as you have stated BK pays the R120,000 due to the consultants for their services provided. For this excluded from being a free or cheap service it would need to be provided to senior management at their place of work for the better performance of their duties. Although this is provided at their place of work, it cannot be said to directly better the performance of their duties as this is being done to benefit BK by ensureing they have completed and paid tax returns accordingly.

This could be excluded from being a fringe benefit if this was a service provided to be benefited by the senior management at the place of work for a recreational purpose. However, you have stated that the senior management are required to utilise this service and hence it could not be considered for recreational purposes as it is a term and condition of their employ. Finally, this does not meet the last exclusion requirement of being a place of recreation providided for use by employees in general.

As we have not met any of the exemption requirements of a free and cheap service, this tax consulting service would in fact be considered a taxable fringe benefit. The value place on this service would be the cost to the employer in rending the service of R120,000 - which would need to be split appropriately between the senior management individuals in proprortion to their respective usage. As this is a fringe benefit it would be included in the "remuneration" for PAYE purposes and hence this has been incorrectly treated.

Other tax consequences:

The services received, if provided from a VAT vendor (the tax consultants), would be a taxable supply and BK would have been charged output VAT. BK produces avocados for export or local sale. Both of these are zero rated taxable supplies, and hence we are in the production of taxable supplies. As these are services used by the senior management who take a managerial position over the company in general, we would be able to claim input VAT on the fee. This would be 15% of the VAT exclusive fee amount.

Once again, the candidate goes further and provides other tax consequences, this time the input VAT to be claimed onthe tax consultant invoice. They correctly consider that if the consultants are registered for VAT, then input can be claimed, as well as correctly providing how to calculate this amount.
For normal tax, the candidate incorrectly concludes that the amount is not deductible, but this doesn't detract from the correct VAT treatment above, the correct other taxes for the other transactions, nor the fact that other taxes were considered.

For normal tax purposes we would need to determine whether this expense was incurred in the production of income for BK to claim a s11(a) deduction. This once again requires a clear link between the income earning activities of BK and the nature of the expense being incurred. As you have provided in your description it appears that the tax services do not add to the income earning capabilities of the senior management nor relate directly to the income earning operation of producing avocados and farming. Thus, I do not think we would be able to claim the related deduction.

Directors Emoluments:

We need to determine if the non-executive directors are "employees" as defined. An employee is any person who receives "remuneration". If an individuals is an "independent contractor" the amounts earned by independent contractors have been excluded from the definition of remuneration and hence no employees tax is required.

We'd have to look to see if these are independent contracts, and apply the statutory test.
The amounts paid to non-executives are fees for board meeting preparation and board meeting attendance.
The preparation for board meetings is not required to be performed at the premises of BK per the statutory test.
Furthermore, the manner in which hours are spent on board preparation are not supervised or controlled by BK.

We'd need to make a conclusion on whether they are independent contractors based on the common law test by applying the grid to get a dominant impression of whether these non-executives would be considered employees. I have listed a few key consideration from this grid below
- Payment to the directors is on a set rate and is not dependent on output or performance (employee)

- The director is obliged to render the service personally to BK, not able to hire others to perform (employee)
- Instructions/Supervision in terms of when meetings will take place and the need to prepare is usually directed by BK (employee).
- BK may dismiss the non-executive director on notice should services not be being performed or any other contractual item identified.

For the directors' emoluments, the candidate correctly considers independent contractors, but unfortunately is incorrect in their conclusion. Non-executive directors are specifically excluded from the definition of employees in terms of Binding General Ruling 40. Or the candidate could have gone through the definition of independent contractors and applied it correctly.

From the above factors it seems to appear that the non-excutive directors are in fact employees as they do not seem to be dominantly impressed as a independent contractor. As such the amounts paid to these directors would be considered remuneration and should have PAYE implications.

Other tax consequences:
These directors fees would be considered salaries and wages which is not an enterprise as defined in the VAT act. Hence this would not incur any output VAT and consequently no input VAT.

The candidate concluded incorrectly on the employees' tax consequences, and therefore the VAT is incorrect. However, based on their conclusion regarding the directors' independent contractor status, the VAT follows.
Regardless, the normal tax consequence is correct and applicable as an "other tax implication".

From a normal tax perspective the fees are incurred in the production of income and would be allowed a s11(a) dedcution

Solidarity Fund Contributions:

When calculating PAYE, we take the balance of remuneration and apply this to the tax tables.
The balance of remuneration is after we factor in deductions for the S18A contributions to public benefit organisations. Normally this deduction is limited to 5% of the "remuneration" of the employee, however, as you have correctly stated the President has changed this to increase it to be an amount of 33.3% of 3 months' remuneration from April to June.

The candidate has correctly concluded on the PAYE effects of the Solidarity Fund contributions, making the assumption it comes from pre-tax salary. There is a slight confusion as to the 33.3% allowable deduction versus the 33% contribution, but the candidate has indicated their understanding, which is correct.

As a result when calculating the amount of PAYE we need to pay, we would take out remuneration, less any dedcution for amounts contributed to pension or provident funds which can be dedcuted in terms of S11F with an applicable limitation. Finally, we would deduct the contributions made to the Solidarity Fund limited to 33% of the remuneration for that month. As we are contributing 33% of our after tax salary to the Solidarity Fund it is likely we would be allowed a full deduction of the contribution made before calculating our PAYE.

FINAL ITEM:

The candidate has gone through a discussion on NOCLAR that wasn't necessarily relevant for this task. However, as they have worded it an appropriate manner, it doesn't detract significantly from the overall answer

On a final note I need to bring to your attention the fact that the above information you have provided me may indicate non-compliance with laws and regulations, namely the income tax act in terms of the employees tax calculations. As a CA in business, I do have a responsibility to uphold integrity and honesty and professional behaviour. The non-compliance with the income tax act is illegal and could result in fines or penalties from SARS.

I would ask if you could please provide all the prior years PAYE submissions we have on file so that I can investigate these further and review the significance of the potential non-compliance. If possible could we arrange a meeting to discuss the incorrect calculations and potential impact on BK as well as procedures that we can implement to rectify these errors. I think it may be of our best interest to involve a tax specialst to assist with the calculations and determine the significance of the prior period and current period errors. Are there any activities we have put in place to

Lastly, the candidate therefore correctly answered 4 of the 5 tasks, including the tax consulting (on the day information), only getting the directors wrong, as well as providing a multitude of correct other tax implications.

eradicate these?
I hope the above has helped in your request and please let me know when you are able to discuss the potential non-compliance threat.

Kind regards,
FInancial Analyst.

Limited competent

To: Charles Lancome
From: Financial Analyst
Sent: Thursday 17 Dec
Subject: PAYE Concern

Hi Charles

Thank you for the query. I hope that my explanation will be of value

I will provide my view on whether we are correctly treating the PAYE on these employee related transaction, and also comment on other tax implications.

Please find my response to your mail

The first part of the required was to answer all of the transactions. This candidate has attempted all five transactions, albeit not accurately.

1. Loans to CEO and CFO

This transaction was the only transaction that changed on the day. While the transaction was

This candidate identified that there is a potential taxable fringe benefit; that of a low interest loan, by applying the information in the pre-release that was strongly triggered.
The information provided did not indicate the rate of the loan and therefore this transaction lent itself to an applicable theory discussion. The comment of "if" in this solution is therefore valid in this circumstance. In addition, during the pre-release period it should have been researched that the official rate of interest changed significantly during the year. The candidate correctly identified that the official rate is the repurchase rate plus 100 basis points.
The candidate also highlighted the value of the fringe benefit accurately, but could have gone further and indicated how the official rate changed during the year.

Paragraph 2(f) 10A and 11 of the Seventh Schedule means that a taxable benefit shall be deemed to have been granted if a debt has been incurred at either no interest or at a lower rate in comparison to the official rate of interest, being the repo rate plus 100 basis points

If your interest rate is lower than the official rate then you will be taxed on the interest difference between the two rates

2 Arrangements with financial institutions
Paragraph 2(g) and 12 of the Seventh

Using the pre-release research, the candidate partly identified the taxable fringe benefit for transaction 2, the arrangement with the financial institution. There was an absolute statement that there was a subsidy, although the use of "if" doesn't provide further clarity.
However, there is a technical error as a subsidy is not a payment to the employer. It is the payment by the employer to the third party.
The candidate should have identified during the pre-release period that the repo rate changed during the year and therefore this taxable fringe benefit could have been either a subsidy (when the sum of the rates paid by the employer and employee - the 3% + 3.75% were in excess of the official rate) or a low interest loan (when the sum was less than the official rate).
The value of the fringe benefit should have also been provided, which for a subsidy would have been the 3% paid by the employer, and for the time of the year when the benefit would have been a low interest loan, the difference between the official rate and the 3.75% (rate paid by the employee).

Schedule means that a taxable benefit shall be deemed to have been granted if the employer has been paid any subsidy in respect of the amount of interest or capital repayments payable by the employee in terms of any debt. The full amount of the subsidy in respect of any debt is subjected to the deduction of employees tax.

3 Tax consulting services

Paragraph 2(e) and 10 of the Seventh Schedule means that a taxable benefit shall be deemed to have granted if any service has at the expense of employer been rendered to employee and that service has been utilised by employee for his private purpose.

However, no value shall be placed on any services rendered to employees at their place of work, for better performance of their duties, and as a benefit to be enjoyed by them at their place of work.

Thus these tax services won't be tax benefit for the employees

4 Directors emoluments

Firstly, the candidate does not conclude on whether or not the non-executive directors are employees. There was enough information to come to a conclusion.
Secondly, non-executive directors are not employees and are seen as independent contractors. Independent contractors were specifically triggered during the pre-release.

In the case of non-executive directors a distinction must be drawn between true independent and those who are deemed to be employees. The distinction is abed on whether or not any amount paid meet the definition of remuneration in the Fourth Schedule to the income Tax Act.

An non-executive director should be added to the companies payroll if the fees meets the definition of remuneration. This will be the case if they render services mainly at the premises of BK where they are paid.

Solidarity Fund contributions
The Solidarity Fund is seen as a public benefit organisation, and therefore the contributions can be deducted from your remuneration, in line with the requirements of the Fourth Schedule to the Income Tax Act. Normally, this deduction is limited to 5% of your remuneration. However, this limit was increased to 33.3% of your remuneration for a period of 3 months (You and Katleho donated for 3 months and therefore this is applicable to you) if the donation is made through Bk's payroll.

It was not clear from the information whether the contributions were from pre-tax or post-tax salaries. Therefore the candidate's answer provides a valid argument.
The other option would have been to consider the 20% deduction under s18A in their taxable income calculation (rather than the 33.3% deduction from remuneration for employees' tax).

Therefore, the full deduction that you and Katleho made can be deducted from your remuneration in each of the 3 months in determining your employees tax payable. Please note, that the deduction in respect of your PAYE will only be deductible if the
following is done:
The donation must be made through the payroll process (deducted from your salary) –
and BK must have paid the amount over to the Solidarity Fund on your behalf.
The Solidarity Fund must issue a section 18A receipt to BK, showing the full donation amount
This donation amount must reflect on your IRP5.

Part (e)

I hope you find the above in order

Throughout the answer there is no consideration of the other taxes, which was specifically requested as part of the task. There were many options available within multiple other Acts, from s11(a) in income tax, to VAT, Donations Tax and dividends withholding tax.

Overall the candidate only addressed 3 of the 5 transactions correctly. Two of which related to pre-released information. Additionally the candidate did not address a part of the task, being the other tax implications.

Kind Regards
Financial Analyst

TASK (f)
Respond to Charles Lancome's email, which is contained in document F, regarding the new sales agreement with Supreme Brands.

Highly competent

From: Financial Analyst
Sent: 17/12/2020
To: Charles Lancome
Subject: New sales agreement with Supreme Brands

Hi Charles,

Not a problem about coming back to me on this. I have included my views on the positives and downsides of the sale agreement with Supreme Brands; hedging and other relevant factors in the attachment below.

Please do not hesitate to call me should you require any clarification.

Kind regards

Financial Analyst

Attachment

> This is a pleasing comment that acknowledges the context of the original agreement, and thus recognises the uniqueness of this as a new agreement.

The sales agreement with Supreme Brands (SB) is going to need a lot of thought. As you told me last week, we could have been in a better position the last time they offered this in the FY19 year as we received higher prices outside of the agreement. However, I aim to discuss the considerations BK management need to assess before management decide to accept or reject the offer.

Part (f)

Positives and Drawbacks

The candidate provides considerations for most if not all the **core** issues for the positives and downsides of the agreement.

In addition, the candidate illustrates **exceptional application** in each of the points raised by using detailed facts regarding the context of BK and its operations (such as BK's financial position, BK's business cycle timing, the avo industry trends, this contract compared to prior etc.)

On multiple occasions in the table provided there is no doubt that the point is **specific to that of BK** and not a generic consideration for forward sales agreements.

The points raised provide depth and insight to to the response and are also not long winded. Charles would gladly read through this and find much benefit for the sake of deciding on the agreement.

There are also no invalid points or problematic statements made in the table, which highlights the professional competence of the response.

Positives	Drawbacks
BK would have certainty around volumes and price in Euros to be received upfront and thus this would make it easier for BK to plan from a financial perspective. This would protect BK from decreases in the volatile avo price.	As SB are buying a large portion of our avos, they are asking for a discount. As seen in FY19, it was more beneficial price wise not to go with SB's offer as the market provided better pricing and thus higher margin per carton. Volumes were not impacted by the price either as BK still exported 2 171 tonnes, whilst SB would have only bough 1 152 tonnes.
We will not need to look for more buyers, which is a lengthy and expensive process, as a large portion of exports will already be accounted for	There is however additional default risk associated with this as SB will receive all the avos before paying the last 50% of the transaction price
Our cash balance at FY20 year end was extremely low at R160k. We thus desperately need a large cash inflow and if SB can provide 1 372 711 euro (50% deposit) upfront. As we have limited sources of funding (with the Land Bank not being able to provide for more than half of their client's need), this could be a great source of financing. This can be used to pay expenses, but also expand the farm as we will buy the 20 hectares and are looking at a possible guacamole processing plant	From a working capital perspective, BK has a very long collection period already and the working capital cycle is high at around 71 days. If we enter into this agreement, we would have the benefit of cash uprfront but would have 8 and a half months of no cash inflows from one of our largest clients and this could further cash strap us.
BK would likely be selling all its volumes of avos as SB would take a large proportion of avos and thus reduces the risk of obsolete stock and assists in the recovery of costs associated with these avos	Price precedent may be set now as SB would be used to getting the avos at cheaper rates and thus would not be willing to pay more
BK can develop a stronger relationship with SB and this can assist with long term partnership and long term set cash flows which can assist in our planning. The relationship will also help ensure that SB does not purchase from the suppliers from Peru who are continuing to gain market share in Europe	It is not clear if SB will reimburse the CIF costs. If not, this is a large cost for us to bear. We would thus need to ensure that this is clear in the contract.

The hedging considerations are adequate from the candidate here. They:
- show an understanding of the principle of hedging (and removing uncertainty)
- show accurate understanding of the favourable and unfavourable movement in the Rand with respect to BK and thus shown a good understanding of the forex risk. (They state that a strengthening Rand is unfavourable for BK)
- indicate a high level understanding of the nature of the Rand to Euro over the long run
- provide a view on whether BK should hedge that aligns to their application points raised.

The candidate could have shown more depth and application to the significance of the risk to BK, but on balance their treatment of this part of the required was sufficient.

Hedging our Euro Exposure

Although we would have a fixed price in Euros with this contract, we are not sure what our exchange rate to Rands will be. This can only be certain if we hedge the exchange rate by using a forward exchange contract. The risk for BK is that the exchange rate strengthens. As the Rand is fundamentally a weak currency, in the long run we expect that the rand would depreciate even further to the Euro. It thus may be wise to hedge a portion of our cash flows to have certainty around how much we will earn in Rand terms and leave a portion unhedged as to gain from any further depreciation in the Rand.

Another option to consider is a currency option. This would give BK the option to exercise if the exchange rate strengthens and would cost us a certain premium for this option. It may be beneficial to investigate this.

From a management perspective, there are some key 'other considerations' raised here that add value to the response. These considerations provide the necessary big picture awareness to help assess the nature of the agreement.

Capacity constraints, customer demands, (with possible reputation impacts), key customer risks, and weather dependency are all key areas of concern to be highlighted. The manner of how they have been highlighted also clearly aligns to the circumstances and facts of BK, which accentuates the application of the answer.

Other factors to consider regarding providing a significant portion of produce to SB

1. Will we be able to meet the demand of our local customers? We had local sales of 53% of total produce in South Africa last year. If we cannot supply for the demand of local supermarkets, they may go elsewhere and we would lose the local market we have worked hard to gain.
2. Will we be able to meet the demand of our other international customers such as Albert Heijn? We have worked hard to create strong relationships with these importers and this could be lost instantly if we cannot supply their demands.
3. If we cannot supply the demand of our local and international customers, our reputation could be negatively affected as we will lose the trust of customers.
4. There is significant concentration risk associated with this as a significant portion of our sales will come from SB. If we lose SB as a client next year, we will have to quickly find new buyers as our current importers may have already replaced us.
5. There is a risk that we have a terrible harvest and that we may not be able to meet the pre-agreed volumes and thus not be able to meet the forward sales agreement terms and could be sued for breach of contract. By not entering into such an agreement, we only sell what we produce.

A well-constructed executive summary of the facts is again pleasing to read and cements home the essence of the question and essence of what Charles is looking for.

Overall, I believe the risk outweighs the benefit at this level. It may be beneficial to enter into an agreement for a lesser portion of our produce as to not be expose ourselves to the risks as discussed above. In this way, we would have certainty around a smaller part of our revenue but would still be able to meet the needs and keep the relationships with our other customers hereby meeting our objective to create a sustainable supply chain (as we are in the supply chain of our customers).

The overall impression of this answer was very distinct. The manner that each point was applied to BK as well as to the information provided on the day of the assessment was differentiating in this response.

It would be noted that the hedging aspect of this answer was not exceptional, but certainly satisfactory. However, while that component could be argued to be a 'C' in isolation, the rest of the answer lent strongly to an HC candidate.

Competent

From: Financial Analyst
Sent: Thursday 17 December 2020, 9:10 am
To: Charles Lancome
Subject: New sales agreement
Attachment: Thoughts on new sales agreement

Hi Charles

I trust you are well

Please see attached my thoughts on new sales agreement including advantages and disadvantages of the agreement as well as whether we should hedge our Euro exposure and other relevant factors.

The candidate has correctly framed the crux of the task here.

- The positives and the downsides of entering into the arrangement.
- Whether BK should hedge our euro currency exposure.

It is noted that the task did explicitly ask for 'other relevant factors that BK should consider before entering into this commitment'. However these considerations could be dealt with in the 'advantages and disadvantages of the agreement'.

Please let me know if you need anything else.

Kind regards
Financial Analyst

Attachment: Thoughts on new sales agreement

Pros

The most obvious pro of such an agreement will be that BK will be protected against any downside movement in the Avo price.

> This is a core reason to enter the agreement and works in the candidates favour to mention it upfront to emphasise its importance.

This is very relevant as the price of Avo's has been extremely volatile over the past 3 years. This is also due to the large effect the weather plays on the supply side of Avocados that effect the price drastically.

> Good application to the industry provided here, which allows the point to be well applied and not generic in nature.

Another factor that should be considered is that the price of Avo's has been very high in both 2020 and 2019 as compared to 2018. 53% higher in 2019 and 47% higher in 2020 vs 2018. This may result in price decreasing in 2021 depending on demand and supply.

> Further application provided based on the risk of price fluctuations, supporting the importance of price being fixed.

As we know now already what a large part of our revenue and cash balances will look like, we can start to budget and determine if we have enough cash or whether we will need to obtain another loan if we want to increase operations like open the guacamole plant.

> A good point has been raised regarding the predictability of revenue and cash flow from the agreement.
>
> The application of this point to BK's context is also well executed here regarding their possible guacamole future capex decisions and corresponding funding.

Cons

The other side of the coin will be ofcourse if prices go up we will be stuck in the contract for a substantial part of our produce.

> This is of course valid and the candidate does well to not repeat the application already provided.

The average price of 4kg carton exported was 13,5 euros in 2020 as in the info you send last week. The committed prices are much lower in each of the months except for August and October. But October also only has about 9380 kg committed which is the smallest of all the months.

> This is a good application point to have mentioned given that it deals with the information provided on the day with respect to the new agreement.

We currently have a very low cash balance as at 30 September 2020. It is less than the current portion of our loans. The 50% upfront fee paid to us in March 2021will help a lot with this.

Another good application point that links the characteristic of the agreement (upfront 50% payment) to the context of BK (low cash

We will also be able to use a large part of this funds for the proposed guacamole project. We wont need to increase our debt and finance cost if we use the cash received.

This is a repeated point, which is redundant in the answer and decreases the professionalism of the response.

The ZAR is currently trading at very high levels to the Euro. As 50% of the cash is received in March 2021, the ZAR will most probably still be trading at current levels due to the ongoing Covid 19 pandemic. This we will probably receive a better exchange rate than selling each month a portion of our Avo's in the market

This point is probably more important to deal with in the context of the hedging decision as the timing of the agreement (in terms of exchange rate timing) is not as core as the other points raised.

However, the point is not completely invalid as it does understand that the agreement may allow BK to receive cash flow in March with a speculatively high Rand to Euro exchange rate.

As avocados are produced between September and may in Europe (in the info you send me), we will be omitting to selling a large part of our produce during the season when prices are generally higher. We may therefore be committing to prices that are too low.

This is not a very accurate point. The pre release info states that BK's European customers prefer Hass avos, and these are harvested by BK between May and October.

This period aligns to the forward sale agreement and there is no real option to time the Hass avos differently.

We will only receive the last portion (50%) in November. The zar might by then have recovered to pre Covid 19 levels.

This is also not a very accurate point. The possible downside is simply that there is exchange rate risk in the deal. That could have been much more clearly stated

Due to all the uncertainly in the market due to Covid 19 and lockdown, having some certainty in regards to price and volumes to be received in the future, can definitely be a positive to the company. This is especially true if demand drops due to consumers being cash strapped in a depressed economy.

The candidate has again recognised the context of BK and the industry - being COVID and a limping economy - while raising a core consideration of locked in sale volume and price.

Its possible that SB might default on the remaining 50% of the amount due. this is especially relevant during Covid 19 if SB might not be able to unload or sell due to a lockdown or decreased demand due to lockdown.

It is a good consideration to consider the credit worthiness of the counter party of the agreement. The application of this in relation to COVID makes it an even better point.

Our best prices are received in the European market. As we will export a substantial portion of our produce under one European importer, our revenue might increase compared to previous years. This is relevant as our % exports decreased from 53% in 2018 to 47% in 2020.

The point of BK having their best prices in the European market is not a given and so that statement is not perfect. However, the thrust of this point does show good understanding that volumes offshore are decreasing and that this agreement allows for further growth there. This shows good application again.

If we do not manage the cash we received upfront correctly, ie paying out large dividends, we might later experience liquidity issues as we only receive the rest of the cash in November.

This point would have been unhelpful if it just stated that 'there may be a cash management risk for BK because they receive the 50% upfront.'

The reason this point is better is because it links it to the dividend decision, which is part of the BK business model as it stands.

Having said this, the point is still quite weak given the lack of clear evidence that BK wont be able to manage the upfront cash flow.

Other considerations:

Even though this was not specifically mentioned in the email body, this is encouraging to see the candidate specifically deal with the other 'big picture' considerations.

A good consideration is the remaining capacity of our harvest after committing to this agreement. This has been pointed out here at a high level.

The candidate has also indicated an important consideration regarding the consequence of not fulfilling other obligations as a result of this agreement.

1. We will be selling a substantial part of our produce. Using the info you send me last week, I calculated that we roughly produced 1 1550 000 cartons(420 hectares * 11 ton/hectares/4). This figure will include the avo's of lesser quality and does not even take the rejects/by product into account. Thus we will need to determine how much Avo's we need to fulfill any other contracts we might have(if any) to avoid legal cost due to contract

breaking.

2. In addition to the above, we might also lose other customers (both export and local) if we can not supply them with Avo's during the 2021 year. Other suppliers may fill this gap.
3. The volatility of supply due to adverse weather conditions may further decrease the amount of Avo's we have on hand.
4. We should also consider if Supreme Brands will contract with us again in 2022 as they might drop us leaving us with an oversupply of Avo's and other suppliers that might not want to do business with us anymore due to the points raised above.
5. Due to large parts if our stock being committed, we may lose out on new markets being available such as South east Asia or the USA. This may lead to us later struggling to gain a foothold in these markets

The other considerations mentioned above are all brief, but all very important in the eyes of management as they look at this agreement in relation to the whole business going forward.

Hedging our Euro exposure

Historically, the ZAR has been weakening against the major hard currencies for the past few decades.
As we receive revenue in Euro's and pay for our expenses in ZAR, this has been a massive advantage for us.
Currently the ZAR is trading at all time highs (especially a month or two ago). In the short term this might mean that the ZAR will continuo to strengthen against the Euro. This can lead to use Foreign exchange losses on monetary assets (debtors) as well as receiving less cash in ZAR than we would have if the ZAR did not strengthen.
In the short term it might be to our benefit to hedge our Euro exposure by entering into a forward contract to protect us against a strengthening rand. This will be especially relevant if we enter into the sales agreement with SB since 50% of the cash will only be received in November 2021.

The candidate has shown good considerations in the hedging decision.

The candidate has:
- looked at the trend of the currency to provide a view on the forecasted movement.
- shown accurate understanding of the favourable and unfavourable movement in the Rand with respect to BK and thus shown a good understanding of the forex risk. (they state that a strengthening Rand is unfavourable for BK and could result in losses)
- applied the risk to the facts of the agreement (50% upfront) to add insight to the extent of the risk faced
- provided a view on whether BK should hedge that aligns to their application points raised.

The candidate could have shown more depth and application to the significance of the risk to BK, but on balance their treatment of this part of the required was sufficient.

We should also obviously take the cost of entering into the forward exchange contract into consideration.
There might be cheaper methods of hedging our selves such as currency futures or options.
In the long term though I do not advise in hedging ourselves against a strengthening rand.

Overall, this candidate has confirmed their professional competence in the task by:
1. Showing a good understanding of the nature of the forward sale agreement to the extent that a strategic decision can be made.
2. Showing a good understanding about what drives a decision to hedge foreign currency risk to the extent that the end user would be more informed on what to think about in the hedging decision.
3. Showing good application in the answer by linking the commentary back to the facts and circumstances of BK and the industry it is in.

The answer has some issues and imperfections but those are acceptable given the answer as a whole.

Limited competent

To: Charles Lancome
From: Financial Analyst
Sent: Thursday 17 December
Subject: New Sales agreement with Supreme Brands

Hi Charles

Thanks for the interest in my thoughts on business activities

The candidate has briefly listed positive and downside aspects of the agreement. They have also responded, in part, to the hedging decision regarding the Euro exposure in the agreement.

While the required was addressed to some degree, the answer was inadequate because of a lack of due depth, application and explanation. Charles, the end user of this answer, would need to ask multiple follow-up questions based on the high level nature of the points provided.

This indicates a lack of professional competence, given the significant trigger that was provided in the pre release information.

Sometimes in business we need to take some risk.
This is one on those situation

Part (f)

I personally think it is a good business move.
For me the positives are:
1. We build long-term relationship with customer.

- Why would this long-term relationship necessarily be established? Is the relationship not perhaps based on the performance that BK provides in the agreement?
- This agreement is with Supreme Brands, which is already an existing long-term client. So, this agreement does not necessarily achieve this positive point.
- Thus, this statement appears generic and not applied even though there may be good considerations hidden in the statement.

2. A part of our revenue is already determined. That put some stability in the profit and loss

This is true and a good aspect of the agreement to raise. However, Charles would still be left asking:
- Why is having pre-determined revenue such a positive thing for BK, given its industry?
- Do we have any idea how much of our annual revenue will be pre-determined by this agreement?

3. Smaller portion of our produce need then to find customers

This is an unclear statement and also seems to repeat the same point of securing income above. - If one secures income in advance, it by implication means that the remaining stock 'needs to find customers'
Candidates need to be clear in the explanations to insure that their points are being made.

4. We can do long-term planning on our cold chain movement

Charles would again be asking how this point is a positive aspect of the deal.
BK could, at any stage, do long term planning for its temperature sensitive avos. They could do that regardless of this agreement. So what is meant by this point?
How is BK more able to plan better for cold storage just because of this deal?
The amount of stock that is harvested in BK cannot be influenced in the short term and this agreement is to be executed in the short term. Thus, the cold storage needs are not more easily planned because of the agreement.

The negatives will be:

1. There is always risk of foreign currency if we don't apply hedge accounting

This is a problematic statement that is fundamentally inaccurate. The risk of foreign currency has nothing to do with the hedge accounting treatment, but to do with foreign currency exposure in the business without any form of hedging policy.

Of course, stating that there is foreign currency risk in the agreement would have been valid, even though BK already has foreign currency risk based on it being an exporter.

2. We are at risk to loose out on higher EUR selling price, but the reverse also apply

This is a major the downside of the agreement. - By locking in to the Euro price for the avos, BK will not be able to capitalise on the upward movement in the avo price.

Again, there was lacking application as to indicate whether this was a likely outcome given the avo industry and the volatile avo prices.

3. We are committed to sell x-amount of produce, and our produce is weather dependant

This is true, but not fully explained.
- Why is being weather dependent significantly noteworthy for BK, given its history?
- What are the consequences here regarding BK's commitment where they are dependent on uncontrollable factors?

Essentially, Charles would not have been made aware of the significance of this risk after reading the response.

Regarding our euro currency exposure

Candidates were explicitly asked to address the question of whether to hedge the Euro exposure of the sale agreement. It was good that this candidate specifically addressed the issue as many candidates completely left it out of their response which would have indicated a lack of competence.

1. we don't have a natural hedge there fore we are at risk if the ZAR strengthen against the EUR
2. There are good data available to foresee the bandwidth of EUR movement in the near future
3. Using that data we can calculated at what range we must cover EUR inflows

4. There a lot of part forward, stop order, participation option available the hedge the risk on EUR currency

After reading the response RE whether or not to hedge, Charles would not be much more informed after reading this response.

The candidate has provided glimpses to some considerations around the forecast of the currency movement and some practical alternatives to implementing hedging, but has failed to provide a coherent analysis for the decision of 1.Hedge OR 2. Do not hedge.

The point of this aspect of the task was not necessarily about how candidates concluded, but how they went about the considerations to arrive at the conclusion.
In this case, the candidate has not shown depth in their understanding of BK's foreign exchange risk in this agreement (which is the underlying reason behind the hedging decision).

Also, any guidance or information regarding **how** to hedge was acceptable, but not the main issue. They issue was the **why or why not** BK should hedge.

Overall, the required also asked candidates for 'other relevant factors we should consider before entering into this commitment'.

These considerations were ones that related to some of the uncertainties that BK may have to deal with if they were to accept. These are the kinds of considerations that management would appreciate as they are always interested in the big picture.

This aspect of the task could have been included in the positives and downsides in the response, but in this answer there was a clear lack of these big picture considerations.

I hope you find the info in order

Kind Regards
Financial Analyst

TASK (g)
Respond to Charles Lancome's email with regard to the guacamole initiative.

Highly competent

Task G: Guacamole Project Evaluation
To: Charles Lancome
From: Financial Analyst
Date: 17 December 2020
Subject: Guacamole Project Considerations

Good day Charles

This is so exciting! I don't know about you, but I love guacamole! Especially with Eggs Benedict and mayo! I will definitely be great if we can invest in the production of guacamole, but let us first consider the financial viability and the other qualitative considerations to ensure that the project will be a step in the right direction. (Refer to the Excel for corrections only - I did not re-do the entire calculation)

Let us start with the option of selling our waste avocados:

1. NPV calculation

1. How did you determine the increase in the number of waste avocados? I understand that we expand with 20ha every year but does this automatically yield 20,000 extra avocados per year?

> The candidate correctly questions that the quantity of pack-outs should not correlate with the expansion of the area under cultivation. As BK has been investing in more sustainable farming methods (ie. the fertigation systems), the quantity of pack-outs should reduce over time?

2. The price increase is lower than inflation which is a bit of a down-turn. How did you determine the percentage increase per year? Is this maybe per a contract?

> While the candidate seems to compare the annual projected increase in the selling price of the pack-outs to the outsourced customer being less than the inflation rate, the value in the candidate's interrogation lies in questioning whether the increase is in line with the outsourcing agreement.

3. Should we not maybe include the transportation costs to transport the waste avos from BK to the owner of the processing plant, or will they pay for it?

> Questioning whether all relevant costs have been identified and correctly included is indeed part of performing the task Charles gave to the candidate on the day. The candidate is quite correct in identifying that would be incurred.

4. Will this contract end after 5 years or continue into the future? If the selling of waste avocados will continue we should consider including a terminal value to account for the project value in the future by increasing the last year's cash flow with future growth and divide it with WACC minus this growth. The present value of the terminal value should be included in our current year.

Part (g)

While it is unlikely that the outsourcing agreement would be a permanent feature, it would not be wrong to question whether the arrangement would extend beyond five years. The candidate suggests using a perpetuity - this would be correct if the agreement were to result in recurring cash flows. Otherwise one would extend the capital budget and bring in the additional cash flows over a finite period.

5. Are there no other costs associated with the selling of the waste avocados? Should they not be packed into boxes to be transported, electricity costs, storage costs, etc?
6. How did you determine the discount rate used? It is usual practice to make use of the WACC of BK - this can be calculated by using the interest bearing loans and equity and weighing them in accordance with their market value and cost.

It would be correct to use the weighted average cost of capital as point of departure in calculating an appropriate discount rate. It would be even more correct to suggest adjusting this rate for the difference in risk which each of the two options would have for BK.

7. I calculated a NRV of R14,154.75.

Charles indicated that his Excel skills are a problem! The candidate correctly scrutinised the calculation of the net present value (we will forgive the candidate for referring to the NRV here rather than the NPV), and correctly identified that it should be R14,154.75 (in R'000).

2. Additional qualitative factors

1. The biggest advantage of selling the avocados is that it saves us an initial investment due to the fact that we do not have to acquire the machinery to process the avos to guacamole.

The candidate correctly identified that this alternative would not require the same CAPEX investment as the organic growth strategy (alternative two below), would.

2. In the background information you stated that we have a significant portion of harvested avos that are not suitable for export or local sales. Selling these avocados will increase our revenue and help us to use a by-product of our production.

This is indeed correct to consider using the by-product to generate additional value.

3. No funding need to be obtained to purchase a HPP machine.
4. BK will have minimal risk with this option - we basically just sell the avocados and then we are free of risk. The only risk that we might have is the non-payment of the customer.

The candidate correctly identifies that this is the less risky of the two options for BK - it would have been value-adding here to justify using a different discount rate on these grounds.

5. The selling of the avocados will immediately provide extra cash flow for BK.
6. There is also disadvantages to just selling the waste avocados - we are not using an opportunity to grow and keep up with the competitor's trends and if we sign a contract for a specific amount of waste avos and we did not produce so many in that month it may cause us to take some of our good / saleable avos and give it away as waste for a much cheaper price.

Good higher order thinking being displayed here - should any shortfall arise in the quantity of pack-outs, in order to avoid a legal risk, BK would need to sacrifice "good avos" - an opportunity cost would indeed arise for BK.

What about the in-house guacamole manufacturing?

3. NPV calculation:

1. We will probably have to buy a High Pressure Processing Machine - as this is the machine our competitors use to process guacamole. As per my research these machines go for about R30 million - so your R25 million seems to be appropriate.

This is superb insightful commentary. The candidate during the pre-release researched the manufacture of guacamole and correctly identified that HPP machines are used. The candidate's research allowed them to question the reasonability of the budgeted CAPEX expenditure.

2. The cost of the warehouse of R2 million might be a little low if we are planning to buy the warehouse. As per my knowledge it will rather have to be a big warehouse.
3. Where did you obtain the sales value for guacamole from? It seems to be a lot more than selling the avocados to a third party - is this reasonable?

The candidate's probing of the capital budget for the in-house manufacturing option correctly led the candidate to question why the selling price of the guacamole is so much more than the selling price of the pack-outs. The candidate could have concluded here that if correct, this would indicate that the in-house alternative could create far more value in the longer run.

4. It seems like we used an increase of 4.5% in both NPV calculations for the sales and the processing costs. Are this appropriate? We should consider conducting more research on the matter.

The candidate correctly questioned why the sales revenue and processing costs change at the same rate. The candidate could have further indicated that processing costs appear to be purely variable - highly unlikely to be the case.

5. Depreciation was appropriately excluded from the NPV calculation but the tax benefit of the depreciation should have been included in the NPV.
6. On which percentage did you calculate the taxation? It does not appear like 28% of the difference between the sales value and the processing costs.
7. I think it may be appropriate to include residual value for the plant as I believe we will be able to sell the plant for something.
8. Will the production of guacamole end after 5 years or continue into the future? If it will continue we should consider including a terminal value to account for the project value in the future by increasing the last year's cash flow with future growth and divide it with WACC minus this growth. The present value of the terminal value should be included in our current year.

As mentioned earlier, the candidate's comment here would be valid if the guacamole project results in recurring cash flows into the future. One would however probably require some CAPEX in future to replace machinery/equipment.

9. s11(e) allowance does not seem appropriate - the process will be one of manufacturing and section 12C should be considered. As we will probably purchase new unused equipment a 40:20:20:20 allowance will be applicable. Thus R10,000 , R5,000 x 3

Part (g)

The candidate correctly identifies that a S12C allowance should apply.

10. Section 13 allowance for the warehouse is appropriate.
11. The appropriateness of the discount rate should be evaluated as discussed above. The rate should be adjusted for the specific risks of the project.

Good - yes one should differentiate between the risks which the two alternatives would expose BK to, in setting the discount rate for each alternative.

12. I calculated a NPV of R69,534.87.

4. Additional qualitative factors:

The advantages and disadvantages of in-house manufacturing of guacamole should be considered before making a decision on which option is best.

Good - yes one should differentiate between the risks which the two alternatives would expose BK to, in setting the discount rate for each alternative.

Advantages	Disadvantages
1. BK will be creating new jobs with inhouse manufacturing. This will address the issue that AAWU raised that local communities are not uplifted by BK. Training to use new technologies will definitely uplift the community. Good thinking here - particularly given BK's commitment to being socially responsible!	1. The initial investment in the HPP technology is very high. BK will have to obtain funding for this machinery.
2. BK will get a competitive advantage if they are able to put their name on a good quality guacamole product.	2. BK has limited knowledge of manufacturing processes and might have to employ engineers and technicians to work on the machines if they cannot train their own employees to do so.
3. This will be in-line with the sustainable growth strategy that BK is trying to follow as we will be using all the food produced to produce an eatable version and not throwing away avocados.	3. High costs of training employees to work with the technology.
4. BK is financially stable and will be able to get additional loans for funding of the HPP technology or even pay it out of retained earnings.	4. The growth will be significantly slower than just selling the avocados.

Good breadth of thought displayed here - yes, the funding required is a relevant consideration - it is correct to identify the current capital structure providing "head room" for the use of additional debt funding.	
	5. BK will bear the risk of the project not working out and losing a substantial amount of money spent on it.

As you can see there is much to consider before deciding on which project would be the best to continue with. Usually the project with the highest NPV will be chosen (in-house manufacturing) but qualitative factors should also be considered.

I think we should go and re-look at the NPV calculations and take into account the considerations I have listed and once we recalculated the NPV and met with the board we can make a decision on which project will be best.

While the task did not expect a final recommendation being made with regard to which alternative is more feasible, the candidate displayed a high degree of competence by pulling it all together here and providing a recommendation regarding the feasibility of two alternatives.

I hope this answers your questions.

Kind regards
Financial Analyst
Please consider the environment before printing this email - we are striving to be more sustainable!

Part (g)

Having reviewed the candidate's response to Task G we concluded that it was a highly competent response. Firstly, the candidate displayed an ability to think analytically by interrogating the cash flows provided. The candidate correctly questioned **both quantity and price** in unpacking the revenue figures provided for both alternatives, and provided **valid concerns** relating to the context within which BK operates.

Secondly, the candidate **correctly addressed the technical issues/concerns** pertaining to each of the two respective capital budgets provided. There were a number of technical issues that should have bothered candidates on the day of the assessment. We are of the opinion that this candidate **correctly identified <u>and unpacked</u>** a number of these issues. Good coverage of the technical issues was achieved. Furthermore, the candidate confirmed their competence on the task by having identified the Excel errors made by Charles in his Excel models. This included correcting the error Charles had made of including the taxable profit into his calculation of the net cash flow.

Thirdly, the candidate provided good and at times insightful commentary relating to the qualitative (non-quantifiable) decision-relevant factors to consider in arriving at a final decision here.

Having addressed all three aspects of the task in a well-thought through crisp manner (the candidate did not dump any irrelevant comments in the process of responding to this task), we would come to no other conclusion than that this candidate displayed qualities of a highly competent candidate in their response to this task.

Competent
To: Charles Lancome From: Newly Qualified CA Subject: Guacamole Initiative Dear Charles Lancome I am happy to help you with your request, please see attachment where I provide you with my comments. Please do not hesitate to contact me f you have an questions Kind regards, Newly Qualified CA ATTATCHMENT Guacamole Initiative NPV High Level Thoughts 1. The period for each of the decisions is 5 years. What is this based on, for example is this the useful life of the manufacturing plant, as this is the depreciation period then it the period does make sense. However, this may not be the case for the contract with the producer, it is likely to be shorter as a business may not be keen to sign a 5 year contract. So we need to calculate the Capital budget for the number of years that this contract will be. Because the Capital Budget NPV's will now not be comparable, we should then subsequently calculate an annualise net present value. Off take NPV Good thinking on the part of the candidate! It is correct to question why the capital budget covers a five-year period. The outsourcing alternative should be evaluated, as the candidate indicates, over the term of the contract with the off-taker of the by-product. The candidate then impressed us technically by indicating that, should the term of the two capital budgets differ, the NPVs would need to be converted to an annual equivalent. 2. The number of waste avocados is growing at a rate of 20 000 tones each year. This is most probably because of the expected growth in the 20 hectrers under cultivation that BK has been growing by. However, we need to determine if this is reasonable, as BK has invested in the fertigation system, which may improve the health of the avocados. This may result in a decrease in the number of waste avocado that we can supply.

Part (g)

The candidate interrogates the quantity related aspect of the capital budget impacting on the cash inflows. The candidates quite correctly, in the context of the implementation of the fertigation system, questions the constant 20 000 tonnes being achieved each year - this should reduce if the fertigation system is effective.

3. The selling prices of the offtake are expected to consistently grow at approximately 4,5%. Did we determine the base R10 from the contract with the processor? The growth of 4.5% may be too much we need to consider if it should be closer to inflation, as inflation is currently 3.3% so we need to consider a growth rate that's close to that.

Two impressive aspects to the response here - does the selling price per kilogram tie up with the off-take agreement entered into with the 3-rd party, and the annual increase in the selling price is compared with the inflation rate using the current inflation rate for comparative purposes.

4. The taxation payable is only calculated as 28% of sales, however we need to consider the tax consequences of other costs that we may incur i.e. transportation costs that we may incur to deliver the avocado or any other deductable relevant costs.
5. No relevant costs were considered in the NPV calculation, we need to consider what relevant costs are as a result of entering into this contract i.e. transport costs to deliver.

The candidate questions whether the capital budget is complete - why have transport costs been omitted? A further example of a possible omitted cost is the labour cost referred to below.

6. I noticed that you have not included any labour costs to pick the avocado, or grade them, this is correct as these are not relevant costs as they are incurred in the normal course of producing avocado.
7. Discount rate of 10% may not be correct, we need to discount at a discount rate that reflects the expected return, perhaps the WACC as this is the rate that the providers of capital would require from their investments. Then we can adjust it for any risks attached to the projecy, for this project they would be very minimal or insignificant, but the project must at least return WACC.

Manufacturing & Processing Plant

The candidate correctly identifies that this alternative exposes BK to less risk than the alternative, hence a decrease in the discount rate could be justified. Good solid technical ability being displayed here.

8. No working capital cash flows such as inventory, accounts receivable and payables have been considered. This is incorrect as before the project starts a working capital outflow needs to be invested and there will probably be necessary investments in the following years of the project

The candidate correctly queries the absence of working capital cash flows in the respective capital budgets. It is likely that the investment in working capital would be greater for this in-house manufacturing alternative.

and towards the end or at the end of the project the working capital will not be needed any more and the will be an inflow. Therefore we need to consider in the Capital budget all of these inflows and outflows in working capital. This would need to be considered from the beginning i.e Year 0

9. No scrap value has been considered for the plant, even though it is fully depreciated for us, it is possible that we can get a scrap value in the market, we need to consider if this is not the case and include the amounts as inflows at the end of year 5 and consider any tax recoupments and CGT as a result.
10. <u>The tax calculation:</u>

11. The operating profit is used as taxable profit before capital allowances. This may not give us accurate results as not all the costs we incur will get a tax deduction as this is accounting operating profit, therefore we need to consider the tax line by line.

> The candidate correctly identifies that no proceeds from sale of the machinery at the end of the five-year period have been included in the capital budget. Again, a good solid technical aspect being highlighted here.

12. S11(e) allowance has been claimed for the machinery. it is likely that the we will be able to get a 12 C deduction as it is owned by us in the process of manufacture of avocado, and as this is our first time in the business it is likely our first time using it. We just need to determine if it is new and unused as this will determine whether we get the normal (20% per year if not new) or the accelerated deduction (40/20/20/20 if new and unused)

> Further evidence of competence - the candidate correctly identifies that a S12C allowance should have been claimed here. The candidate correctly indicates that the machinery will be used in the process of manufacture - and not in an agricultural context, which some candidates suggested in their responses.

13. You have correctly deducted a 5% deduction for section 13 for the warehouse as it is a building used in the process of manufacture
14. We need to consider if the VAT has been deducted in the cost of the machine and warehouse as we are able to claim VAT at the standard rate for these item.
15. The sales value increase at 5% each year, this is similar to the projected number of waste avocado. As mentioned this may not be the case of constant increase due to improvements from production of avocados. In addition the sales value should also grow at a real and inflation rate. The price growth percentages should also be considered. As the price should also grow at at least inflation of 3.3% which should also affect the rate of growth in sales value.

> The candidate probes the growth in the sales revenue. Had the candidate done this by probing selling prices rather than sales revenue at the total level.

16. The costs also increasing at the same rate. I would expect us to start benefiting from learning curves in the 3 or 4th year thus decreasing costs, in addition the current rate of inflation is 3,3%. I would expect a lower rate. However to be prudent, lets not change this percentage.

> The candidate correctly interrogates the change in processing costs and queries why this is the same rate of change as seen in sales revenue.

17. The same discount rates are used for both projects but they carry different risks. We need to adjust for this as the WACC to reflect the risk of the project with WACC as the base. As this project is riskier the providers of capital woud require a higher return, thus this needs be reflected as an increase in the discount rate.

Qualitative Factors to be considered for each decision

Offtake

18. We need to consider the reputation of the producer we will be working with, are we able to rely on that they will honor their side of taking the guacamole at set delivery dates.
19. The offtake is less riskier than the processing plant as it requires no real capital investment. Which is better because we currently are experiencing liquidity problems due to decreases in cash, this option may be a good solution to our cash problem, considering that the packout avocado would require little or no further processing and is already grown and therefore np further costs, except maybe transport costs.

Good strategic thinking on the part of the candidate - no further processing costs would be incurred - only potentially transport costs in transporting the waste to the off-taker.

20. We need to consider who the risk of making guacamole from avocados that are damaged by fungus will lay on as some but not all may have been damaged as a result of this, as this avocado may be harmful and result in legal costs and reputational damage. Or as part of our agreement BK would have to do this testing before delivery

This is a key risk - the safety of the final product is dependent on the waste being safe - this is indeed a very important risk in the industry, hence a very relevant consideration.

21. The offtake agreement will result in no risk of not recovering costs and making losses unlike the processing plan.

Processing Plant

22. The board is worried that the avocado market will soon be saturated and filled with competitors which will result in decreasing revenue or limited growth. This decision will actually help us diversify before this happens, so if we make this decision now by the time this happens we would've have improved and developed our product instead of doing it later (if we do the offtake).

Appropriate to consider the timing of the proposed project and to question the competitive environment and how "full" it is.

23. Where will we get the funding? Currently B is cash strapped and the Land bank has just been downgraded due to its inability meet it commitments, therefore it ay not be able to fund us. The next available option would be to issue equity, is this something that the board and shareholders will be happy about as it would dilute their shareholding.

While the cash and cash equivalents have declined year-on-year, it does not mean that BK cannot access further funding. Notwithstanding this comment, the candidate's response is still a sollid competent response.

24. This decision will need research and development capabilities before it is done to support the

functionalities of the steering committee which will require more cash.

25. As the country has just entered the second wave of the COVID 19 pendamic and some coutries also doing the same. It is not clear what restrictions may be placed on shipping. We need to consider that if we invest in processising plant, will we be able to export the guacamole? The processing plant may be better in this regard

Overall: Having reviewed the candidate's response to Task G we concluded that it was a solid competent response. Firstly, the candidate interrogated the cash flows provided. This was a **pre-requisite** to being declared competent on this task. This was also likely the reason for many candidates not achieving competence on the task as they did not probe the cash flows and hence did not comment on whether the inputs into the net present value calculations were reasonable. The candidate effectively questioned **quantities used** and provides a **valid concern** in terms of the impact of the fertigation systems in use in the BK orchards to the context within which BK operates. While it did not detract from the candidate's competence it would have been appropriate for the candidate to probe the selling prices used, in more detail.

Secondly, the candidate **correctly addressed the technical issues/concerns** pertaining to each of the two respective capital budgets provided. Task G required a display of technical competence – this required that candidates identify areas in which the capital budgets given lacked from a technical perspective. We are of the opinion that this candidate correctly **identified and unpacked** a number of these issues. Good coverage of the technical issues was achieved. The candidate is technically solid. Had the candidate identified Charles' Excel errors, their response would been better, remembering that Charles had hinted in his email to the fact that his Excel skills lack.

Thirdly, the candidate provided good and at times insightful commentary relating to the qualitative (non-quantifiable) decision-relevant factors to consider in arriving at a final decision here. The candidate provided an appropriate number of issues to consider – did not dump irrelevant considerations but did apply their mind in thinking around both strategic and operational issues here.

Having addressed all three aspects of the task in a robust manner, the conclusion is that the candidate displayed qualities of a *solid* competent candidate in their response to this task.

Part (g)

Limited competent

Respond to Charles regarding guacomole initiative

To: Charles Lancome
From: Financial Analyst
Sent: Thursday 17 December
Subject: Guacamole

Hi Charles

Many thanks for asking my commentary and inputs regarding your Excel spreadsheets working.

Please find some high level thoughts on the NPV calculations reflected:

> The task required to give Charles high-level thoughts on both calculations provided on the day. The view of the candidate's competence would have been positively impact had the candidate addressed each capital budget separately. Charles would not have been amused had he himself had to decide which particular alternative each of the candidate's comments is referring to.

1. Number of waste avocados kg increase by 20 000 each year. Is that in line with our hectares increase per year? What will the effect of weather and climate have on the total production of and thus waste?

> This is good probing of the sales quantity, pointing out that while an increase of 20 000 kg per year is projected, it might be influenced by the weather etc.

2. The off-take selling price per kg increase by 4.5% per year. Is that in line with the expected waste price in the next few years?

> This comment is not clear. The waste has never been sold before. Hence there is not really a current price for BK to compare it to. What do competitors do with their waste? There might not be a "market price" to compare the selling price to. The candidate should have question what the price agreed to in the off-take agreement entered into with the 3rd party is or alternatively how does the price of the by-product compare to the price of "good avos".

3. The process plant selling price starts of at 72.54 in year 1, and ends up at 73.20 in year 5. That is a much smaller increase in selling price than off-take sales. I think the model must show a similar trend in selling price or be tested in open market.

> This comment misses the fact that under the the off-take agreement BK is selling waste whereas under the 'own plant' option BK will be selling a processed guacamole. One cannot directly compare the increase in sales year-on-year between the two options. One can however compare the increase in the quantity of the by-product with the quantity of the guacamole processed.

4. Processing cost is at a flat rate of 75% of sales value. As the volumes increase per year the rate must come down because of certain fixed cost included in the processing costs

Part (g)

While fixed costs expressed at a unit level might decrease, one would expect inflationary increases in the fixed costs at a total level to occur annually?

5. There is no indication if depreciation is included in the processing cost. If it is included it will affect the taxable income calculation

A NPV calculation present values future "relevant" cash flows. Depreciation is an accounting charge, hence a non-cash flow items and as such cannot be relevant. It would have been correct to question whether or not depreciation was included in the processing costs, so that if that was indeed the case, the processing costs would need to have been adjusted to remove the depreciation charge. As depreciation never forms part of the tax calculation, the candidate was incorrect in stating that depreciation affects the taxable income calculation. S12C and S13 are the capital allowances which BK can claim in respect of the "own plant" to be developed.

6. For accounting purpose the machinery must have a rest-value build into the calculations. For tax it will be fully claimed

Typically an NPV includes the proceeds on the sale of a capital asset in the final period of the project and this is typically the residual value. Despite the term used by the candidate it seems that the candidate understands what is meant by residual/scrap value. However the reference to accounting purposes makes it questionable whether there is true understanding that NPV is derived from cash flows and not accounting values. The understanding of the correct timing is also not clear. What is meant by fully claimed? From a tax perspective proceeds a residual value might result in a recoupment or scrapping allowance and depending on the type of asset, even possibly CGT.

7. The calculation included tax which is good as it is a real expense

Some other comments for your consideration:

It is not clear to which option i.e. 'Offtake agreement' or 'Own plant' these comments relate to. As the decision-relevant issues typically differ between the two alternatives, the candidate should have addressed those relating to each of the respective alternatives, separately.

1. It will be prudent to increase repairs and maintenance towards end of projection

For which option? Probably most relevant for option 2 but it has not been made clear.

Part (g)

2. Possible COVID effect on sales needs to be build in

How? and again for which option. The off-take agreement would have a fixed price and quantity contractually agreed to so the effect of COVID on sales would be minimal at best. It is possible might possible that COVID might affect the sales demand for alternative 2 ('own plant') as guacamole is not an essential food item, and as people's incomes have been affected due to COVID it might affect the projected guacamole sales.

It is not clear what is meant by this point? There is no rental provided in any of the options.

3. Will have rental of plant have a affect on the forecast

4. It may be a good idea to run sensitivity and scenario analysis on potential IRR. These type of analyses provide useful guidance about potential returns assuming low road, base case and high road scenarios

Relevance of reference to an IRR? The NPV is to be calculated?

5. The discount rate of 10% seems quite high if compared to the current interest rate. Will financial institution budge on their risk apatite and fund the rate at a more agreeable rate?

This is a great point, but it is not clear if this is being addressed from a qualitative perspective or a criticism of the NPV calculations provided by Charles.
An investment decision is always discounted at the WACC or risk adjusted WACC of the enterprise. Debt financing options would be discounted at an after-tax cost of debt. The relevance of comparing a WACC to prevailing interest rates can therefore be questioned.

I trust my comments are useful for your analysis. Please let me know if there is anything else your require

Regards

Part (g)

Financial Analyst

Overall: Task G required three things of a candidate:

- An interrogation or probing of the cash flows provided in the two respective capital budgets.
- The identification of the various technical errors made in, or omissions from, the capital budgets provided. As Charles had indicated that his Excel skills lack, candidates should have reviewed the calculations he performed in drafting the two respective capital budgets.
- Providing decision-relevant qualitative considerations for the respective alternatives.

As mentioned in the annotations included within the candidate's response, the candidate lumps all their comments together and does not clearly indicate which of the two respective alternatives the comments relate to. A competent candidate typically isolates the relevant comments/issues pertaining to a particular alternative, as said comments/issues need to be considered with regard to only that alternative.

While the candidate did perform some probing or interrogation of the cash flows provided, the candidate's conclusions around the escalation in the sales revenue, to the extent that price influences this, are questionable given the inference that waste and guacamole prices should escalate at a similar rate. These are two very different products?

The main area lacking in the candidate's response relates to the candidate's technical understanding. The discussion around depreciation is concerning. Possibly the candidate did not express themselves properly, and should work on this going forward. The only technical issue correctly addressed out of a possible 11 issues, is the absence of a residual/scrap value for the plant and machinery. This is very concerning and is the main reason for the candidate being deemed limited competent on the task.

Furthermore, notwithstanding Charles' comment regarding his Excel skills, the candidate did not check any of the calculations performed by Charles. In a task such as this, evidence of technical understanding will always be one of the cornerstones of competence.
Finally, with regard to the qualitative issues, the candidate seems to focus on quantitative issues again. Qualitative issues are typically those issues which are difficult to quantify and as such are not addressed in the capital budget. These would normally be strategic and risk-related issues. In identifying these, the candidate needs to apply the particular context provided and highlight issues differing between the alternatives. While COVID might be relevant, it should have been factored in to the quantities used in drafting the two respective capital budgets

TASK (h)
Respond to Charles Lancome's requests for assistance ahead of the scheduled Zoom meeting.

Highly competent

From: Financial Analyst
Sent: Thursday 17 December
To: Charles Lancome
Subject: Re: Some questions
Attachment: Attachment H

Hi Charles

Overall: The candidates were asked to identify things that BK is doing right as a corporate citizen, potential threats to its corporate image and reputation including selecting three UN Sustainable Development Goals where BK can make a meaningful difference based on the nature of its business.

This candidate was able to focus on key aspects of the required and provided an excellent response that was comprehensive and concise. The overall response addressed majority of the key aspects of the three components of the required.

The candidate response is clearly communicated, providing the necessary explanation to the key aspects of the task whilst displaying understanding of the case study, research and a comprehensive assessment of the information provided.

I hope your day hasn't been too stressful, I know how meetings can take their toll.

Please see my thoughts in the attached document (Attachment H).

I just also wanted to mention a concern of mine to you. In the email you forwarded me, there some information given about one of the farm managers, Fanie Mboweni. I noted that he was congratulated on ordering some avocados from another farm to ensure we fulfilled our order to the customer. While it is important to think on your feet and solve problems, this particular instance may cause us some issues. It is one BK's values to have integrity, and act transparently. However, by labelling another farm's produce as our, we are not being straight forward and honest in our business dealings, or transparent, as our values require.

From an operational standpoint, it is also risky to us, as we do not have control on how Trichardt Farms go about the growing and harvesting process, and therefore their avocado's may not be grown in line with our values and standpoints.

It is important that we do not have any misleading packaging, not only from an ethical standpoint, but also from a legal one. Our labelling says the stock is BK produce, while it is not.
I'm sure, as you followed the CA stream in university, would agree that as CA(SA)'s we have a to also uphold the fundamental principles in the SAICA Code of Professional Conduct (CPC) of integrity and professional behaviour. As misleading packaging is a contravention of the Consumer Protection Act (CPA), this could result in the Non-compliance with laws and regulations (NOCLAR) requirements from the CPC being applicable. I, as a junior CA(SA) in business, and you (as a senior CA(SA) in business) would need to follow these steps:

1. Obtain an understanding of the NOCLAR, including what exactly the CPA notes as not allowable and the

consequences of the NOCLAR on BK and all its stakeholders

2. Discuss this further with you once we have more facts about the situation.
3. Thereafter, we can determine what further action needs to be taken, and whether the NOCLAR needs to be reported.
4. We must also document the NOCLAR with all relevant details. (The matter, any discussions held over it, what our response was and the courses of action taken and decisions made surrounding it.)

Additionally, while BK is not required to abide by KING IV principles, it is recommended. BK is not acting as responsible corporate citizen/ acting with integrity by doing this, as it is not legal to market others produce as your own.

Let me know should you require anything further.

Regards
Financial Analyst

ATTACHMENT H:

The candidate's response includes valid comments regarding the following aspects:
Identifies and explains what BK is doing as a good corporate citizen to embrace the communities as an integral part of the operations and promoting sustainable farming by:

Providing housing for employees, schooling facilities for their kids and helping develop the skills of its seasonal pickers, showing its commitment to uplifting the surrounding community.

Embracing employees as key stakeholders with 20% shareholding and facilitate the creation of wealth amongst employees.

Focusing on sustainable farming model that promotes the efficient use of water, limited application of synthetic fertilisers and pesticides and implementation of drainage systems to minimise soil erosion.

<u>What is BK getting right as a corporate citizen?</u>

1. BK is providing schools, playgrounds and accommodation for its staff. It also has set up the BK Employees Trust which holds shares in BK, to facilitate the creation of wealth amogst employees. This is in line with being a corporate citizen, as it is acknowledging that it is an integral part of the community that has responsibilities to its stakeholders (specifically its employees in this case)
2. BK is helping develop the skills of its seasonal pickers, showing its commitment to uplifting the surrounding community. Seasonal pickers are not employed year-round, and therefore by developing their skills, BK could ensure they may have employment for more parts of the year. This is in line with transforming society and the community it operates in.
3. BK has adopted the Sustainable Farming Model which promotes the efficient use of water and pesticides (specifically by implementing the fertigation system) and implementing drainage systems to minimise the soil erosion caused. This shows that BK recognises the impact on the surrounding environment and the responsibilities it has with respect to it.

Part (h)

The candidate's response includes valid comments/issues regarding the following aspects:
Identifies and explains BK's potential threats to its corporate image and reputation:

Sourcing avocados from a neighbouring farm and then representing this as BK produce grown to perfection where BK has no control over neighbours farming practices which may be unethical and environmental unfriendly and accurately links the issue to the core value of integrity and transparency.

Labelling BK's avocados as free of pesticides whilst BK promotes limited application of synthetic fertilisers and pesticides and implementation of drainage systems to minimise soil erosion is false and misleading representation in its marketing of the avocados and may impact reputation and corporate image of BK.

Issues surrounding incorrect PAYE and EAO deductions and overtime not being paid considering fair remuneration to its employees may impact reputation and corporate image of BK.

<u>Areas which could affect our reputation?</u>

1. There is an issue with the our labelling. Over above the issue I mentioned in my email, I also noted that we label our produce "pesticide-free". However, I noted that in the general background information you gave me on BK, it is noted that we use pesticides on our trees. This could impact our reputation quite extensively, for the following reasons:
   - This is a contravention of the Consumer Protection Act (CPA), which prohibits any false or misleading representation in its marketing of the goods. We could be liable for a fine, or even imprisonment. Therefore, the legal issues resulting from this could extensively damage our reputation in South Africa with our local customers.
   - Additionally, it could have a further effect in Europe where there are more regulations, often more strict that South African ones on the use of pesticides the disclosure thereof. This may damage our reputation with our European importers and cause us to lose sales from our foreign customers as well.
   - It additionally, contravenes not only our values to health and safety (of our stakeholders - customers and employees), but our commitment to that values as a corporate citizen.
2. The claims by the trade union of incorrect EAO deductions being made and overtime not being paid would contravene its responsibilities as a corporate citizen to provide a fair remuneration to its employees.
3. The issues surrounding our payroll system and the deficient controls there, as well as the incorrect treatment of PAYE are also major concerns. This could result in tax penalties and reputational damage surrounding that as well. By paying the incorrect amount of tax, we are not being responsible to the government as one of our stakeholders.

The candidate's response includes valid SDGs and explanations thereof:
Identifies and explains three UN SDGs where BK can make a meaningful difference based on the nature of its business:

Zero hunger where BK should ensure sustainable food production systems and implement resilient agricultural practices that increase productivity and production by sustainable farming model that promotes the efficient use of water, limited application of synthetic fertilisers and pesticides and implementation of drainage systems to minimise soil erosion. Furthermore, to continue embracing the fourth industrial revolution (4IR) and use data analytics to monitor crop health and to improve production yields while maintaining strict quality control to ensure consistently high standards of fruit production.

Decent work and economic growth where BK should actively seek ways in which to firstly, preserve jobs and secondly, to expand operations to create employment opportunities.

Sustainable consumption and production where BK should actively continue to ensure sustainable consumption and production patterns by sustainable farming model that promotes the efficient use of water, look at wastage and the use of data analytics to monitor crop health and to improve production yields.

<u>3 UN Sustainable Development Goals to focus on</u>

1. Zero hunger: Eradicate extreme hunger and malnutrition
    - BK can make a big impact in this goal. This is in line with our goals and values - to grow, but while being committed to sustainable farming.
    - Sustainable agriculture must come from each individual farm, and BK can strive to ensure it provides food sustainably.
    - This can also be done in line with BK's goal to incorporate innovation and the Fourth Industrial Revolution, by BK becoming more efficient and utilising those opportunities, it can provide food to all more sustainably and efficiently.
2. Decent work and economic growth
    - We can make an impact here as we employ many workers and can start making an impact with our own. BK sees employees as key stakeholders already, and therefore can ensure it makes a difference in the community it is involved in.
    - Additionally, if BK expands, this can extend to helping more people become employed and upskilled.
    - BK can promote the rights of its employees and provide them a safe and secure working environment.
3. Ensure sustainable consumption and production patterns
    - This goal is also in line with our aim to incorporate sustainable farming. We are in a position to make an impact as we hold a lot of land and can change how we use it.
    - Especially important here is the use of water. We can make a huge difference here as agriculture uses 70% of freshwater use, and of that, avocados are very water intensive. Therefore, there is lots of room for innovation and ideas on how to improve our water usage and ensure we use it responsibly.
    - We also generate large amounts of wastage (avocados, packaging and other) and can change our ecological footprint by focussing on this and how we can adjsut our strategy to minimise our waste.

Competent

To: Charles Lancome
From: Financial Analyst
Subject: FW: Some questions
Date: 17 December 2020

Hi Charles,

I have included my thoughts on the three issues outlined by Katleho for discussion. Please see attached.

Overall: The candidates were asked to identify things that BK is doing right as a corporate citizen, potential threats to its corporate image and reputation including selecting three UN Sustainable Development Goals (SDGs) where BK can make a meaningful difference based on the nature of its business.

The candidate was able to focus and addressed most of the key aspects of the three components of the required. The response is clearly communicated, providing the necessary explanation to the key aspects of the task whilst displaying understanding of the case study, research and assessment of the information provided.

Kind regards
Financial Analyst

Attachment 8:

What are 3 things BK is getting right as a responsible corporate citizen:

1. Diversity of our board composition. Compared to other industries and companies, we have decent gender representation on our board of directors. This is a good base to work off in order to contribute to growing the representation of the number of females we hire as labourers on our farm, in management positions as well as on our board. Females can be inspired to see female representation on our board. This can breed strong female leaders from within our organisation. We also have a good mix of skills and experience on our board.
2. We are directing a lot of our focus to sustainable development and incorporating 4IR technologies while maintaining the jobs of our employees
3. We have good intentions of aiming to upskill our employees through extensive training as well as providing school facilities for the families of our workers. This can breed the next generation of skills from within the organisation to create long term value for the community at large.

The candidate's response includes some valid comments regarding the following aspects:

Identifies and explains what BK is doing as a good corporate citizen to embrace the communities as an integral part of the operations and promoting sustainable farming by:

Providing school facilities for employees' kids and helping develop the skills of its seasonal pickers, showing its commitment to uplifting the surrounding community.

Focusing on sustainable farming practices by minimizing the use of pesticides, by using 4IR to improve farming practices and using 'fertigration' techniques.

The candidate's response includes some valid comments/issues regarding the following aspects:

Identifies and explains BK's potential threats to its corporate image and reputation:

Issues surrounding incorrect PAYE and EAO deductions considering fair remuneration to its employees may impact reputation and corporate image of BK.

Labelling BK's avocados as free of pesticides whilst BK promotes limited application of synthetic fertilisers and pesticides and implementation of drainage systems to minimise soil erosion is false and misleading representation in its marketing of the avocados and may impact reputation and corporate image of BK.

<u>What are 3 potential areas that could seriously dent BK's reputation as a responsible corporate citizen?</u>
I have thoroughly enjoyed my start to life at BK. However, I have become aware of a few areas that could dent BK's reputation as a responsible corporate citizen:

1. Salaries and wage processing and SARS errors:

It seems BK's salaries and wages system is a bit archaic and might need a bit of a reshuffle. I'm concerned that Sandy doesn't have the necessary knowledge of Tax Act. Her treatment of some of the items of fringe benefits in particular is not in compliance with the Income Tax Act. As such, PAYE may be being calculated incorrectly resulting in the incorrect amount being transferred over to SARS. This could result in serious penalties being charged by SARS.
The incorrect amount is also being withheld from employees salaries as a result. Therefore, we may be liable to repay employees for this portion. If not, employees could impose a class action lawsuit against BK.

2. Misrepresentation / false advertising:

It has come to my attention that our labelling of our avocados sold locally and in the export market, may contain some misleading advertising. This could also be construed as being false advertising. We claim sell avocados that are "pesticide-free and plucked by the sons and daughters of local soil". This is misleading for multiple reasons:

- I am aware that we use pesticides in our production process
- We also make use of immigrant workers as casual labour

It is therefore incorrect to label our products as such. This contravenes the Consumer Protection Act as we are in effect, lying to our customers, who may purchase our products thinking they are making an environmentally-consious decision and supporting South African industry.

Another matter of concern is the fact that an employee of ours, Fanie, has bought avos from a competitor and sold it to a client labelling it as one of our own products. Again, this is blatant misrepresentation that could have serious consequences to our reputation. Yet we seem to reward it by wanting to offer him employee of the month award As directors on the board, the King Code on corporate governance recommends setting an example and acting with integrity which includes acting in good faith. This also includes acting with transparency.
As a CA (SA) who has recently passed SAICA board exams, I am bound by the highest possible code of ethics in the CPC which requires us to comply with the fundamental principles of integrity. Charles, both you and I have a responsibility in terms of the Code to gain a deeper understanding into these transgressions. I will have to bring this to the attention of Katleho and the other board members after we engage with this a bit further. If after affording the board the chance to address and rectify the issue and the matter is unresolved, I will have an obligation to report this to higher authorities such as SAICA and the Consumer Protection Authority.

Part (h)

3. Low pay to our employees

As a core principle of ours is inclusivity, it stands against our moral principles to pay our lowest level of employees a meagre wage. Under the stakeholder inclusivity model we should strive to uplift our employees especially our labourers, on whose backs our business is built. Farm workers represent the most underpaid sector in South Africa therefore, we must strive to assist wherever we can.
I was disappointed to note that the tax consultation sessions were only pitched at senior employees instead of lower level employees who could have benefitted even more than senior employees from an update in tax knowledge.
It is issues like these which is leading to friction with our trade union.

The candidate's response includes valid SDGs and explanations thereof:

Identifies and explains three UN SDGs where BK can make a meaningful difference based on the nature of its business:

Clean water and sanitation where avocado farming is notoriously water intensive, and BK should actively seek ways to reduce its use of irrigation or recycle or do whatever it takes to minimize water consumption. There must be ways in which BK can focus on more sustainable means of water usage while limiting use of irrigation.

Decent work and economic growth where BK should actively seek ways in which to firstly, preserve jobs and secondly, to expand operations to create employment opportunities.

Sustainable consumption and production where BK should actively continue to ensure sustainable consumption and production patterns by sustainable farming model that promotes the efficient use of water, look at wastage and the use of data analytics to monitor crop health and to improve production yields.

3 SDGs BK should focus on:

- Clean water and sanitation: the production of avocados is water intensive. We must ensure that we strive to use clean water sources so that we don't pollute water given how valuable a resource water is
- Decent work and economic growth - this speaks to inclusive economic growth that we should strive for while uplifting our employees and providing decent working conditions contributing to a positive work environment for our employees
- Responsible consumption and production - we must aim to ensure our farming practices are sustainable through the use of clean energy sources, and environmentally-friendly fertilisers and pesticides in order to contribute to the sustainable development of the natural environment

Limited competent

To: Charles Lancome
From: Financial Analyst
Sent: Thursday 17 December 2020
Subject: Some Questions

Part (h)

Hi Charles

Thanks you for the opportunity to provide some thoughts on the three issues asked by Katleho.

Overall: The candidates were asked to identify things that BK is doing right as a corporate citizen, potential threats to its corporate image and reputation including selecting three UN Sustainable Development Goals (SDGs) where BK can make a meaningful difference based on the nature of its business.

This candidate was not able to focus on the potential aspects of the task and the response fell short on the coverage of three aspects of the required.

The response is limited, not concise and not providing the necessary explanations to what was required. The Candidate also displayed a lack of understanding of the case study, research and a comprehensive assessment of the information provided.

Overall, the candidate did not respond to the task appropriately and could not be competent on the task as the response was inadequate and showed limited application.

But before I give my thought.

Well done to Fanie. We need more people like him to think on his feet and look out for the company. I sure hope he will be awarded employee of the month

Back to pressing matters

The candidate's response includes the following aspects:

Identifies the inclusivity business model which embraces the communities, that BK is following a sustainable farming that promotes efficiency and that BK regards each stakeholder as an integral part of our operations but fails to be concise on what BK is doing to be inclusive and how are the stakeholders' integral part of BK operations. One would have expected to see the following:

BK is embracing inclusivity with communities by providing housing for employees, schooling facilities for their kids and helping develop the skills of its seasonal pickers, showing its commitment to uplifting the surrounding community.

Embracing employees as key stakeholders with 20% shareholding and representative on the board.

Focusing on sustainable farming practices by minimizing the use of pesticides, by using 4IR to improve farming practices and using 'fertigration' techniques.

The pressing questions:

1. What are the things that BK may be getting right as responsible corporate citizen?

Part (h)

- We adopts an inclusive business model which embrace the communities
- We follow a sustainable farming model that promotes the efficient use of natural resources
- We regard each of our stakeholders as an integral part of our operations

What are three potential areas or things that could seriously dent our reputation

Identifies that increase use of technology could have impact on community and loss of ethical environmental image if sustainable farming to applied. The candidate response does not really cover the prevalent issues that BK is faced with when assessing the case study. One would have expected to see the following being addressed as potential threats to BK's corporate image and reputation:

The issues surrounding employing illegal immigrants and paying them very low wages, incorrect employee deductions and overtime not being paid considering fair remuneration to its employees may impact reputation and corporate image of BK.

Labelling BK's avocados as free of pesticides whilst BK promotes limited application of synthetic fertilisers and pesticides and implementation of drainage systems to minimise soil erosion is false and misleading representation in its marketing of the avocados and may impact reputation and corporate image of BK.

Sourcing avocados from a neighbouring farm and then representing this as BK produce grown to perfection where BK has no control over neighbours farming practices which may be unethical and environmental unfriendly.

Avocados becoming contaminated somewhere in the supply chain between picking and finding its way onto retailers 'shelves this will result in major costs and reputational damage.

- Increase use of technology could have impact on community if they are not up-skilled
- Loss of ethical en environmental image if sustainable farming to applied

The candidate's response includes some valid SDGs and explanations thereof:

Identifies and explains decent work and economic growth where BK should actively seek ways in which to firstly, preserve jobs and secondly, to expand operations to create employment opportunities.

Identifies and has limited explanation on responsible consumption and production where BK should actively continue to ensure sustainable consumption and production patterns by sustainable farming model that promotes the efficient use of water, look at wastage and the use of data analytics to monitor crop health and to improve production yields.
Explanation provided for Good health and well-being did not address how BK can make a meaningful difference based on the nature of its business.

2. Which three of the UN Sustainable Goals must we select
   - Goal 3: Ensure healthy lives and promote well-being for all ages. We can focus on the healthy alternative that avocado and avocado by products provide to the human body
   - Goal 8: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all. We can promote policies that support productive activities, decent job creation
   - Goal 12: Ensure sustainable consumption and production patterns. We can adopt sustainable practices and integrate sustainable information in the reporting cycle

I hope you find the info handy for you ZOOM

Kind Regards

Financial Analyst

