ASSESSMENT OF PROFESSIONAL COMPETENCE

EXAMPLES OF VARIOUS LEVEL OF COMPETENCE IN EACH OF THE TASKS

To assist all candidates in preparation for the Assessment of Professional Competence, SAICA has made these examples (specimen answers) available, to illustrate examples of candidate responses deemed LC (limited competent), C (competent) or HC (highly competent) for each of the sections of the case, along with examiner comments (on each of the sections of the case study) on our website.

The objective of allowing candidates access to this information is to assist unsuccessful candidates and first time candidates by providing insights into what APC Examco deemed as LC, C and HC attempts to the various sections of the 2014 assessment. This may assist in preparation for the 2015 APC.

We recommend that the 2014 case study be reviewed in detail prior to reviewing examples of LC, C and HC attempts to sections. Thereafter, review the examiner's comments on each attempt and absorb this for the purposes of your preparation for 2015.

No illustrated examples of candidate responses deemed BC for each of the sections of the case study has been included. Rather examples of LC and C are provided. BC attempts would have features of both LC and C attempts but would not be distinguishable as either.

PART (a)

Assume you are an audit senior at Arthur Price Loitte & Young Inc. ('APLY')

(a)	A meeting between Mr Emgee and the management of WBP has been scheduled for 24 November 2014. Mr Emgee has a very full work schedule, and therefore has requested your assistance in preparing for the meeting. Prepare a list of appropriate questions that Mr Emgee could ask during the proposed meeting to elicit additional information to be used to determine whether APLY should accept the audit engagement.

Highly competent

Integrity of the client

1 Have you had any conflicts with your current auditors at FGH regarding their opinion on the financial statements of WBP at any point?
2 Is there any legal action pending against WBP on the basis of poor ethics?
3 Company's compliance with laws and regulations/involvement in irregularities, management's commitment to sound governance, etc
4 Reasons for replacing previous auditors other than Oikos deal?

Independence of the Auditor

1. Are you aware of any potential relationships between APPLY and WBP's staff
2. Will you be requiring any additional advisory or accounting service that might impact on the firms independence?

Communication with previous auditor (FGH)

1. Will WBP be willing to grant APLY permission to communicate with the WBP audit team at FGH?
2. Have WBP informed FGH of their intention to terminate their contract and seek new auditors for 2015? If not, when does WBP intend to do so?
3. if you have already notified the previous auditors of their termination, are you aware that you have 40 business days to appoint a new auditor?

Client ability to pay audit fees

1. Based on WBP's current financial position as per the management accounts, do you believe the company will be able to afford APLY's audit fees as they will be significantly higher than that of FGH?
2. Based on the fact that WBP also intends to purchase a new particle board plant, will the company be able to afford a new auditor?

Audit Evidence

1. Based on the potential strike action due to wage disputes, how would this impact our audit, e.g. access to audit evidence, assistance at stock counts, etc.?
2. Is WBP willing to grant APLY access to sufficient appropriate audit evidence to support our audit? (Previous auditors audit files, etc.)

General

1. We noticed that the board of directors and associated committees are not comprised in line with King Code III and that you intend to change the company governance structure. Will you be requiring our advisory services in that regard?
2. Will you be requiring any non-assurance services from APLY?
3. We have checked all your directors and shareholders for any relations with APLY that could compromise our independence and found no instances. Are you aware of any conflicts of interest between WBP and APLY?

Skills and competence of APLY team

1. How many APLY team members can you accommodate on your property?
2. Is there any task or training you wish to expose our audit team to, to facilitate their understanding of your operations?
3. Will WBP be willing to allow APLY to engage the use of experts to assist in our audit work?
4. Will WBP be formulating an internal audit function?
5. What deadline are you looking at for the financial statements?
6. The finance department seems overworked when drafting the financial statements, which could result in material human errors. Would WBP be willing to grant APLY permission to appoint a quality review partner?

Candidate identified the majority of key questions be asked including integrity of client, independence, contact with FGH, procedural issues re change of appointment, engagement risk etc. (Coverage).

Candidate also displayed good insight by identification of the following issues lifted assessment from 'C' to 'HC'

- APLY's audit fees are likely to be higher than FGH
- Impact of strike action on audit
- WBP's non-compliance with King III
- Absorption of pre-released information (labour strike, Oikos acquisition etc.)

Competent

List of questions for the management of WBP:

- Does your Memorandum of Incorporation require an audit to be performed on an annual basis?
- Does WBP have a limit in terms of what can be spent on the audit?
- Does the company have access to funds that can be used to supplement cash resources?
- Will you be willing to give us permission to discuss the company's prior audits with the predecessor auditor?
- Do you require assistance to get the accounting ready for audit or tax related matters?
- Is the audit committee prepared to approve any non-audit services that may be required?
- Are there any non-audit services that you want us to provide you with?
- Have you approached FGH to discuss the possibility of using APLY staff on the 2014 financial statement audit?
- Are you prepared to pay for the time spent by our audit team to assist FGH with the 2014 financial statement audit?
- Are you prepared to facilitate a meeting between APLY and FGH to discuss the possibility of using APLY staff on the 2014 audit?
- Is the audit deadline always 15 January of the next year?
- If you decide to acquire Oikos, will we be required to audit Oikos together with the WBP group?
- Are you aware that we can only be appointed as auditors once FGH has resigned as auditor of WBP and a valid vacancy exists in terms of s91 of the Companies Act?

Candidate had reasonable coverage of the relevant aspects to consider, but omitted questions related to independence and client integrity. However, almost all listed questions are valid and relevant. Does not have to be a perfect list of questions to be competent!

Limited competent

- As per the minutes of the Board meeting, the audit committee was tasked with evaluating internal controls over finished goods inventory. What other areas of the business is there concern over the adequacy and appropriateness of controls?
- May we please obtain consent to communicate with the current auditors, FGH?
- Land and Buildings has not been depreciated in the current year. Is the building fully depreciated? If not, what is the policy on depreciation?
- Given the decline in profits, we're also concerned about the recoverability of our fees. Will the firm be able to settle the outstanding amount as it becomes due and payable?
- From adjusting the board structure, it does not appear that WBP is in compliance with King.
- The entity invested significant amounts in new plant and machinery in 2010 and 2011, but net profit has declined. Is the entity considering impairment of plant and machinery.

Candidate gave insufficient relevant questions. All the questions, with exception of the contact of previous auditors relate to aspects that will be considered for risk of material misstatement at financial statement and assertion level. Not necessarily aspects you would consider in accepting the client or not. Missing out of critical areas such as client integrity, potential independence issues, engagement risk questions, non-audit services that might be required, and procedural appointment issues, therefore only limited competence displayed.

PART (b)

Assume you are an audit senior at Fisher Goetsch & Hegarty Inc. ('FGH')

(b)	Review workpaper W123 relating to the audit of the provision for rebates and prepare your review notes for the attention of A Junior, a trainee accountant who has recently started working for your firm after passing his CTA examinations.

Highly competent

E-mail
To: A Junior
From: Your Senior
Date: 15/12/2014
Subject: W123 – Review Notes

Morning A Junior

I hope you are keeping well.

I have reviewed your document W123 and raised some review notes. Please have a look at them.

When I arrive at the client, we can sit together and go through them so I can explain to you in detail what we can do and for you to ask questions. Not everything can be explained in a review note and this discussion will be beneficial.

Thank you so much for your hard work thus far. Provisions are generally a complex section, yet you did a wonderful job. Keep it up.

See you soon at the client.

Thanks and kind regards
Your Senior

List of review notes to be addressed (W123)

1. With regard to your point under planning that there is no need to consider the system of internal control, could we please rephrase this to consider and include the following:
   - According to ISA 240, management override of controls is regarded to be a significant risk;
   - Provisions are subject to estimates and judgements and thus are always considered significant risk.

   As a result of the above, we need to obtain an understanding of internal controls around provisions (as we have to obtain this for all significant risks according to ISAS).
2. Can we please add the prior year amounts as well so we can have a look at the movement and obtain movement explanations from management for large movements? You can base large movements on whether the account moved with 10% or is more than 10% of materiality.
3. Can we also please add a high level comparison of provision amounts to revenue and debtors as they are linked? Increase in debtors means they are not paying timeously and so conditions of rebate agreement may not be met, thus resulting in a lesser provision – yet the provision increased, so why is this?
4. Did you consider if the treatment is in line with requirements of IAS 18, IAS 37 and CC 09/06? If not, can we please add this as we can compare the different elements of the rebate transaction and see how they should be treated according to the standards I mentioned above? (Basically, we need to ensure revenue is appropriately decreased by the amount of the provision on date of sale.)
5. Can we add how we calculated our sample size?

6 I see some customers have the same name but different customer numbers (e.g. Mica Kitchen and Rand Timber). Could you please follow up on these?
7 Can we please document more info regarding the invoice (e.g. invoice number, date, customer)? This is done so if anybody has to re-perform the test it is easily determinable.
8 Can we please add which columns contain formulas? This is easier for review.
9 The difference of R892,50, although immaterial, is not expected as we are performing a recalculation. Could you please document why after following up?
10 With regards to tickmark / comment {g}, did we verify the date of the agreement is applicable to the 2014 financial year?
11 Can we corroborate tickmark {h}? Enquiry is unfortunately not sufficient for this. Maybe select a quarter and obtain all invoices for the customer for that quarter. Agree the total of the production volume per invoice to rebate agreement to determine if the requirement is met.

Candidate identified most of the key issues, although not a perfect list of review notes (e.g. failed to question materiality assumptions),

Candidate displayed good tone and guidance in communication to the audit trainee.

Candidate also displayed good insight by identifying:

- Suggested analytical review procedures
- Identified that certain customers had multiple accounts

Competent

Review notes: Provision for rebates

1 The objective is quite vague. Please can we clarify what we are testing and what risk we will be addressing? E.g. the purpose of the workpaper is to test the provision for rebates is not materially misstated, through considering risk of understatement / incorrectly calculated / not in line with a contract or policy.
2 Please can we reference to the materiality calculation to support the balance of R2 million used.
3 Please note, internal controls are assessed if we are taking a control reliance approach or if the balance we are testing is considered to be a significant risk (in which case we will test design and implementation).
I do not agree that we include documentation on internal control; perhaps we could consider renaming it. Please discuss with me if unsure. Thank you.
4 Materiality is based on qualitative and quantitative factors; as such I believe our conclusion on the provision balance as not being 'particularly' material should be amended.
Please consider: Provisions are generally believed to include management estimates which are subject to management bias, hence from a qualitative perspective balance may be material, even if it is less than R2 million.
In addition, performance materiality is more widely used to determine if a balance is material or not, as it takes into account the potential for misstatements.
Please have a read through the scoping document, it should clarify things, and discuss with me. I know the principle might be a bit tricky considering you are still new to auditing.
5 Please can we add more detail to the rebate summary, such as:
- Which customers have rebate agreements
- Are rebates linked to payment of the balance (as I believe they are)
- How does management estimate the likelihood of a customer paying within payment terms and hence qualifying for a rebate

Per the testing, it appears a rebate is raised on every invoice; if a customer does not qualify for a rebate, how is it this treated?
6 Can we please do a sample calculation and determine a sample size accordingly (sample table). This will support the sample tested. However, I imagine we may have tested additional samples – please document an

appropriate rationale for this, e.g. Additional testing performed to obtain greater audit assurance, through the introduction of unpredictability.

7. Tickmark {h}: Enquiries with management is not sufficient audit evidence, please can we corroborate this, through inspecting actual volumes vs volume targets. Thank you.
8. Can we consider performing a high level reasonability check to assess the provision, i.e. Compare prior year provision to the actual rebates paid out. Please discuss with me, to determine if possible and if information can be obtained from management.
9. Considering you are fresh to the auditing profession, this is a good effort. If you still feel unsure of any comments raised, please discuss these with me. I will be happy to help☺.

Candidate clearly understands the audit of rebates and risks and covered most of the issues. Also displayed good communication skills.

Candidate however missed too many obvious questions to be considered HC e.g. work on payments of rebates, further work on R892.50 error.

Limited competent

Preparer: A Junior
Date: 14/11/2014
Working paper reference: W123
Reviewer: Audit Senior – FGH
Date: 14/12/2014

- Overall, good presentation and layout of the working paper.
- There are some shortcomings which you need to address, as listed below:
  - Based on the auditor recalculating, consider including column subtotals, as this will enhance the presentation of the schedule.
  - Have you read through the accounting policy specific to provisions and any disclosure as presented in the notes to the financial statements and are you comfortable that there is adequate disclosure given?
  - Please document the reasons why there is an audit difference of R892,50 relating to PMB cupboards; what is management response regarding this?
  - Have you considered extrapolating the difference of R892,50 relating to PMB cupboards on the entire population? What is the error rate and is it material?
  - Have you included this R892,50 difference in the schedule of unadjusted audit differences in the event that management does not want to adjust for this difference so that we can consider this difference as part of the aggregate unadjusted errors?
  - Where is the evidence to support tickmark {d}? Have you inspected the general journal to ensure that the date of sale to the customer corresponds to the date on which the rebate was recorded?
  - Have you performed analytical review procedures to ensure that
    1. the movement in the provision year-on-year is in line with the trade receivable balance and sales?
  - Given that we are not testing controls around accounting for provisions, it is important to increase the sample size in order to reduce the risk of material misstatement to an appropriate level.

This candidate asked too few valid questions to be deemed to have competently completed the task. Audit manager/partner would probably require the task to be redone.

PART (c)

Assume you are the newly appointed financial accountant at WBP

(c)	Draft an e-mail to Mr Alexander, as requested by Mr Hawkes in his e-mail dated 18 November 2014, in which you explain in layman's terms the reasons for the possible impairment and how this would be calculated in principle.

Highly competent

Email
From: Me
To: Mr Alexander
CC: Mr Hawkes
Subject: Possible impairment and relating calculation: PPE

Good day

I trust this email finds you well. In response to your email enquiring about the reason for the impairment and the underlying calculation, I have included a brief explanation below, on behalf of Mr Hawkes.

Impairment

- The accounting standard on impairments (IAS 36) specifically requires an entity at the end of each reporting period to assess if there are any indicators that an asset might be impaired.
- Such an indicator, identified per the standard, includes any adverse changes in the market / economic environment in which the entity operates or in the market to which an asset is dedicated.
- Hence WBP's inability to generate profits, despite significant capital investments in new plant and machinery in 2010 and 2011, coupled with a deteriorating return on assets, has been identified as an indicator that PPE may be impaired.

Impairment calculation

- The accounting standard sets out clear guidelines in determining an impairment loss.
- It suggests that if a possible impairment is identified, the recoverable amount of the asset should be estimated.
- The recoverable amount is determined as the higher of:
  - Fair value less costs to sell the asset
  - Value in use which is an estimate of the future cash flows the entity expects to derive from using the assets (see Mr Hawke's impairment calculation).
- The value in use appears to be the most suitable method, as the entity has no intention to dispose of PPE and such a calculation would provide the most relevant and fair recognition of PPE and its valuation. However, to comply with standard requirements, the fair value less costs to sell has been determined.

Ultimately the assets carrying (book value) will be compared to the value determined above to assess if an impairment is necessary (i.e. if carrying value exceeds value of PPE which is expected to be realised, an impairment will be necessary).

I trust you will find this in order. If you have any additional concerns or questions, please do not hesitate to contact me.

Sincerely
Me

This candidate's response was crisp, to the point and understandable by a non-accountant. The reference to a practical example of an impairment trigger at WBP and his boss' workings elevated this to HC.

There were also many other HC examples where the candidates explained what impairment meant, in English without getting too technical in reference to the standard. Made it easy to understand for anyone that might not have any accounting background, with a lot of application to WBP

Competent

TO: Mr Frik Alexander
FROM: Stan Hawkes
SUBJECT: Explanation of impairment
Date: 19 November 2014

Dear Frik

IFRS can be quite daunting and seems like another language at times! Therefore I have broken down how an impairment works in order to make the reasons behind the impairment and the logic behind my calculation clear.

From an accounting perspective, when we include an asset on our balance sheet we expect to generate a level of economic benefit from this asset and this essentially drives the value of the asset. As we use the property, plant and equipment, the value will depreciate and eventually at some point it will be sold / replaced with new equipment or if it can no longer be used it will be scrapped.

In terms of IFRS, the property, plant and equipment should not be carried at a value more than its recoverable amount. The property, plant and equipment can eventually be recovered, so to speak, by either using it in our operations to generate cash flows and profits (economic benefit) or it can be sold. Therefore if the current carrying value of the property, plant and equipment (which is the cost of acquiring the property, plant and equipment less the depreciation to date) is greater than the economic benefit it can generate or the amount it can be sold for, then its 'true value' is not being reflected and the property, plant and equipment need to be reduced to reflect its recoverable amount.

It is important to note that the recoverable amount is the higher of:

- Fair value less the costs of disposal, which will be the price received to sell the asset
- Value in use, which is calculated as the present value of the future cash flows expected to be derived from the property, plant and equipment.

Therefore the amount of the impairment will be the carrying amount of property, plant and equipment less the recoverable amount as discussed above, and will be recorded as an expense. Please note that if the carrying amount is lower than the recoverable amount, no impairment is necessary.

I trust that this explanation has provided clarity on impairment and my calculations. Please let me know if you required further assistance.

Kind regards, APC Candidate

This candidate explained the concept well without referring to details of the accounting statement. Candidate missed explaining why there are impairment triggers but still found competent due to the clarity of expression.

Limited competent

From: The Financial accountant of WBP on behalf of S Hawkes — Wednesday 19/11/2014, 08:45 am
To: Mr Alexander
CC: Stan Hawkes
Subject: Re: Fwd: Impairment of PPE

Dear Mr Alexander

I trust this email finds you well.

As per your request to Mr Hawkes, please find below my response to your query regarding the reason for the impairment and the logic behind the impairment calculation; i.e. how it would be calculated in principle.

Reason for impairment

- In terms of the International Financial Reporting Standards (IFRS) framework, all assets (like property, plant and equipment) must be reflected on the balance sheet at their carrying amounts.
- The carrying amount is defined as the cost of the asset less accumulated depreciation and impairment. The carrying amount should therefore be a reflection (in Rand amount) of the value the company expects to realise from using that asset in its operations. This expected value to be realised is referred to as future economic benefits.
- In the case of WBP's property, plant and equipment (PPE) asset the future economic benefits that would be derived from the sale of the inventory that is produced by the PPE.
- Therefore the carrying amount must equate to the future economic benefits.
- There may be instances in an asset's useful life where it is no longer able to provide future economic benefits to the value of the carrying amount.
- For example if a piece of equipment gets damaged, it will no longer be able to operate and produce output as it did in its undamaged state. It will produce less output and therefore create less future economic benefit. The damage will have impaired the asset's ability to produce output as expected.
- The damage will cause a drop in value of future economic benefit which causes a difference in value between the carrying amount of the asset on the balance sheet and the actual benefit that can be derived from using that asset in operations.
- The IFRS framework states that all information presented on the face of the financial statements must be relevant as well as be a faithful representation of the company's financial standing and performance, i.e. the financial information must be complete, neutral and free from error.
- With the aforementioned principles in mind, it would not be a fair representation to present assets on the balance sheet at an amount which doesn't reflect the future economic benefits as this misinformation would not be relevant to users of financials.
- It is therefore imperative to reduce the carrying amount of the asset to reflect the future economic benefits.

I trust this information has been useful to you.

Please do not hesitate to contact me if you require further assistance.

Have a good day further.

Kind regards,
The financial accountant of WBP

This candidate’s response is unclear and fails to explain how impairment calculations generally work.

It also creates the impression that impairments occur only because of damage to PPE. Impairment triggers are far wider than that.

.There is also no application to the actual situation at WBP – this answer could have been written for any impairment situation.

PART (d)

Assume you are the newly appointed financial accountant at WBP

(d)	Draft an e-mail to Mr Hawkes in response to his request for a review of his impairment workings per his e-mail dated 18 November 2014.

Highly competent

To: Stan Hawkes
From: Financial Accountant
Sent: Wednesday 19 November 2014 at 11am
Subject: Re: FWD: Impairment of PPE

Dear Mr Hawkes

I hope that you are well. Thank you so much for your kind words. I am loving it already here at WBP.

I have scrutinised your calculation. I just have a few comments that I think you should consider.

Please see attached a document with my comment (Attachment 1)

I have already responded to Frik's email about the impairment and have copied you on the mail.

Hope this helps. Please let me know if you have need further assistance in finalising the calculation and I will gladly assist.

Kind regards
Financial Accountant

Appendix 1

The following are some aspects that need to be considered in the impairment calculation:

1. It seems as though we have performed a calculation for the entire balance of PPE – both land and buildings and plant and machinery. IAS 36 requires us to consider each individual asset and consider the indicators separately. The recent valuation of the buildings showed a market value of R25 million, so it is clear that the buildings are not impaired.

   There are clear indicators that the plant and machinery may be impaired. This includes adverse market trading conditions, performance behind budget, reduced selling prices etc.

   Based on the above, I think that the calculation should be for the plant and equipment only, as this is the asset for which impairment indicators exist.

   You would include buildings only if the recoverable amount of the plant alone cannot be determined as it does not generate independent cash flows, and forms part of the a larger cash generating unit. I do not think that this is the case; I think that we can reliably estimate the future cash flows that we expect from the plant'; as the plant is not dependent on the cash flows generated from other assets.

2. **Growth Rate**

The growth % has been applied to both sales and operating costs. This may not be a valid assumption, given the current situation of ever increasing costs.

If we analyse the current situation, sales have increased by 3.91% in 2014 (2013 increase: 8.2%) while cost of sales and expenses have increased respectively by 8.68% (2013 11.23%) and 6.17% (2013: 9.29%)

Therefore, I feel that the growth percentages in your calculation should be applied to sales only. These percentages assume that the 2014 growth trends will continue. I think that this is appropriate and we should be conservative in our estimates.

A different growth percentage should be applied to the cash outflows from operations. This could range between 6% and 10% given the current electricity costs and fuel increases – our largest operating costs. We should also consider providing for additional maintenance costs in the latter part of our forecast, as the plant reaches the end of its useful life.

To support our estimates, we can look at our 5 year forecast and compare it to our cash flow projections to see if our projections are reasonable. I am sure that the auditors will do the same.

3. **Finance Costs**

Finance costs should be excluded from the calculation as it is taken into account in the discount rate. Including finance costs in the cash flows amounts to double- counting.
This will result in lower value in use.

4. **Tax**

IAS 36 explicitly requires that tax be excluded from the estimated cash flows, therefore this needs to be removed. Both the cash flows and discount rate should be pre-tax

5. **Discount rate**

IAS 36 requires the use of a pre-tax rate, therefore the adjustment for the tax saving should be removed.

The prime rate is currently 9.25% and has increased from 9% in July.

The discount rate should reflect the time value of money, the risks specific to the asset, and the return that investors would expect to generate form the asset. IAS 36 notes that discount rate should be independent of how the entity has financed the asset. In our case we financed the asset by means of an instalment credit agreement with an interest rate linked to prime. Using this discount rate would not be appropriate.

I think that we could use our weighted average cost of capital (WACC) as a suitable rate. This rate takes into account the time value of money and the weighted average of the returns required by investors. We would not need to risk adjust this rate, as the risk specific to the asset (e.g. maintenance costs) would be taken into account in the cash flows.

6. **Forecast period**

A 10 year forecast period is used. This should correspond to the estimated useful life of the asset.

7. **Sale of asset**

Include the expected cash flows from the sale of the asset at the end of its useful life in the cash flow projections.

8. **Fair value less costs to sell**

As per my above discussion, this should be the fair value less costs to sell of the plant only (not the buildings). As the market value of the buildings is quite high, using the aggregate of the fair values for the plant and building may result in an incorrect recoverable amount.

The candidate was courteous in criticising the boss and kept the email short by using an attachment for the comments. There is no regurgitation from IAS 36. The comments made are applied to WBP specifically (i.e. not generic) and show broader insight into the company. What was impressive was the identification that land and buildings should be assessed separately from plant and equipment, questioning the revenue and cost forecasts and discussing current business challenges in South Africa (electricity & fuel price increases).

Competent

From: Joe Soap
To: Stan Hawkes
Date: 19/11/2014
Subject: Re: Impairment of PPE

Dear Stan

Thanks for the opportunity to assist you with the impairment testing of the PPE. I have scrutinised your workings, as requested, and compared it to the relevant accounting standard, i.e. IAS 36. Please find my comments bellow:

- The calculation states that the expected cash flows are based on the long-term turnaround strategy of WBP. IAS 36 para 33(b) states that estimates should exclude inflows or outflows expected to arise from restructuring or from improving or enhancing the asset's performance. I believe we should rather base the expected cash flows on base projections from the most recent financial budget.
- We are using 3% (initially) as the anticipated growth rate in expected cash outflows. Considering increasing fuel and electricity costs and a current inflation rate above 6%, perhaps an anticipated growth rate in expected cash outflow of 6% would be more appropriate.
- The calculation currently deducts finance costs and tax from the expected yearly cash flows. IAS 36 para 50 states that future cash flow estimates shall not include cash outflow / inflows from financing activities or income tax receipts or payments. This should therefore be excluded from the calculation.
- We are currently basing the calculation on ten years' projections. IAS 36 para 33(b) states that the forecasts should be based on a maximum of five years, unless a longer period can be justified. We should probably decrease the forecast period to five years, unless you have a valid justification in mind.
- There is currently no cash flow projections beyond the period covered by the forecast based on steady / declining growth rates, as per IAS 36 para 33(c). We should calculate a terminal value at the end of the forecast period based on steady declining growth rates and include it in the forecast.
- IAS 36 para 55 provides guidance on the discount rate to be used. Our calculation needs to be amended as follows to be in compliance with para 55:
  - The discount rate should be a pre-tax amount. Currently we are deducting the tax saving from the discount rate.
  - We are currently using the SA prime rate les 1% as the discount rate. The discount rate should however reflect the time value of money and the risks specific to the asset. A more appropriate rate would therefore be the weighted-average cost of capital for a similar asset.
- We may require an independent third party valuer / assessor to provide a fair value less costs to sell of the PPE.
- The higher of the value in use and the fair value less costs to sell is currently being compared to the total PPE balance. The land and buildings may be disaggregated for purposes of impairment testing. The plant and equipment (R82 550 at 2014) should be subjected to impairment testing and should therefore be used as the book value.

Please let me know if I can assist with any of the calculations or if you need further clarification. Thanks for taking me on at WBP. I am really enjoying it here.

Kind regards
Joe Soap

This candidate's response was good as it identified most of the technical errors in the value in use calculation. Could have been HC if he/she had discussed the need to exclude cash flows unrelated to PPE and relook the forecast cost increases. Some comments that are specific to the WBP situation could also have moved this to a HC.

Limited competent

From: John Doe
To: Mr Hawkes
Date: Tuesday
Subject: Review of possible impairment calculation

As requested, find my comments regarding your impairment loss calculations.

General comments
The general approach you followed is absolutely correct. Using the NPV of future cash flows to derive the value in use is the most logical calculation to follow.

The recoverable amount being the higher of value in use and fair value less costs to sell is also correct.

From this we then see that the current value as per financial statements are lower than recoverable amount, thus no impairment.

Specific items

Growth rate of an initial 3%
The growth rate of sales @ 3% seems to be a fair estimate that should be able to be obtained. We saw a similar increase from 2013 to 2014 financial years.

Giving a similar estimate to the expected outflows, seems not to be possible. Even with our long-term turnaround strategy where we reign in controllable costs, there seems to be too many other costs that are sky-rocketing, for this to be a viable estimate.

These costs include, but are not limited to:
Wages – labour unions are demanding 12% and with the possible threat of strike action, which is something we can't afford; we will struggle to keep these expenses as low as possible.
Fuel costs – with the continuing unrest in oil supplying countries, combined with ever increasing exchange rates, fuel costs are likely to continue its upward trend.
Electricity costs – we have seen increases of 30% year-on-year and with the parastatal continuing to struggle to keep up with demand there seems to be no end in sight.

I feel, we need to be realistically re-evaluate the growth rate, especially in the short-term.

Expected finance costs

These seem to be a correct estimate. Even with the possibility of increasing interest rates, the bulk of these interest expenses are derived from instalment sale agreements entered into in FY2010 and FY2011. They differ in length between 5–7 years. With the huge capital outlay done in FY2010 & FY 2011, we should not need for further outlays unless we are expanding and thus these amounts should continue to be lowered.

Cash profit:

We have seen a trend of customers delaying payment more and more. From 2012 to 2014 the debtors payment of gone from 45 days (see calc 1) to 60 days (see calc 2). This is a trend that seems difficult to stop. I would thus suggest making an adjustment to the predicted profit, before arriving at the cash profit.

Discount rate used

The discount rate used should not just be the market-related interest rate. When calculating discount rate, one must use the company's cost of capital. This includes expected shareholders' returns as well. Not all financing comes from loans, we must thus revaluate this figure to make compensation for shareholders' returns.

Fair value less expected selling costs

A revision of the market prices used for this amount must be made. There is a big difference between this amount and both the value in use and current book value. Further enquiries must be made to ensure this amount is correct.

Conclusion

The correct model for calculation was used, but I do feel we need to re-evaluate some of the assumptions made as this could have a material effect on whether an impairment is needed, especially as the expected selling cost is considerably lower than book value.

Let me know if you agree with my recommendations and whether you have any further questions.

Good day
J. Doe.

Calculations

1 $\frac{\text{Debtors}}{\text{Sales}} - \frac{30\ 990}{188\ 529} \times 365 = 60$ days

2 $\frac{\text{Debtors}}{\text{Sales}} - \frac{20\ 831}{168\ 960} \times 365 = 60$ days

Unfortunately this candidate failed to identify the many technical errors made – cash flow forecasts should be limited to 5 years, finance charges excluded, pre tax cash flows and discount rate. It is important to ensure the basic issues are addressed first. Suggesting that turnaround benefits are okay to include and debating the finance charge rate indicated that competence in impairment calculations is not present.

PART (e)

Assume you are the newly appointed financial accountant at WBP

(e)	Draft a report on behalf of Mr Hawkes in which you critically comment on the Oikos valuation performed by The Edge Capital Advisors. This report is to be distributed as part of the Board agenda pack for its next meeting.

Highly competent

Report (draft)
(for discussion purposes only)

Report on the Oikos valuation performed by Edge Capital Advisors

Prepared by: Financial Accountant
Date: 19 November 2014

Introduction
The purpose of this report is to critically evaluate the valuation of Oikos Building Supplies (Pty) Ltd performed by Edge Capital Advisors for consideration of the Board of Directors of WBP (Pty) Ltd.

Comments on the valuation
The valuation has been performed on the free-cash flow model. WBP will be acquiring a controlling interest in Oikos. This valuation model is most appropriate as it focuses on key drivers of value and the operations of Oikos. This model is forward-looking and a good indicator of the value of the firm.

The valuation performed by Edge Capital contains cash flow projections for only two years, with growth forecasted into perpetuity after the two year period. Using a longer forecast period, such as 10 years, or even 5 years will be more appropriate for the valuation. Cash flows for the next 5 years are expected to be reliably forecasted, while the business is expanding and growing. It is not reasonable to assume that the growth rate after only 2 years will continue into perpetuity.

It is recommended that Capital Edge revise their valuation to include a forecast period of at least 5 years.

Comments on the projected cash flows
- EBITDA has been forecasted to grow at 35,9% in 2015 and by 23,96% in 2016. This might not be appropriate. The advisors may have been optimistic about profits given that EBITDA for 2014 declined by 10,48%. Further, considering the inflation rate in South Africa of about 6% and the long-term growth rate of the business of 2%, the forecasted EBITDA seems extremely overstated, considering that there are no immediate plans for expansion or a turn-around strategy. (Capital expenditure is fairly constant.) It is recommended that Capital Edge revise their EBITDA projections to be more conservative. Consideration can be given to whether Oikos has been able to meet their budget in prior years.
- Capital expenditure is forecasted to remain at R1,8 million. Consideration must be given as to whether this is reasonable. If Oikos is in its initial stages of its life-cycle (growing and expanding), the forecasted capital expenditure may be too low. Insufficient information is available regarding Oikos's future expansion plans.

Comments on the discount rate

The three month treasury bill rate has been used to estimate the risk free rate. The risk free rate should essentially be a long-term yield. A three month bill rate is therefore inappropriate. It is recommended that Capital Edge revise the risk free rate to a 10-year bond yield rate in South Africa.

Betas of listed companies such as Cashbuild, Illiad and KayDav Ltd have been used to determine the beta for Oikos. Some of these companies may not be the most comparable to Oikos. Oikos is focused on the distribution and retail of wood products. This is very similar to KayDav Ltd who has the same operations on a larger scale. Cashbuild is a distributor of all building materials and not just wood-based products. Therefore instead of using an average of the betas of the companies, it is recommended that only the beta of KayDav Ltd be used, as the other betas may distort the beta calculation.

In addition, the average beta has not being adjusted for Oikos. Certain adjustments are required to the beta of the listed entities to take into account that:

- Oikos is a small company, and has a higher risk that would result in an increased beta.
- Oikos is unlisted. Its shares are not marketable resulting in a higher risk and higher beta.
- Oikos may be dependent on key management, resulting in a higher risk and higher beta.

It is recommended that the above factors be taken into account in arriving at a risk-adjusted beta.

The discount rate used to present value the projected cash flows is the cost of equity. As indicated by Capital Edge, Oikos has gearing. The discount rate used should take into account the return required by all investors (debt-providers and equity providers) and should be a weighted average of the two. It is recommended that the weighted average cost of capital for Oikos be used in the valuation.

Comments on valuation

A perpetuity growth rate of 2% has been forecasted. This appears to be reasonable considering the long term fluctuation rate.

The advisors have neglected to add the value of cash on hand of Oikos of R899 000 to the value of the firm.

It is unclear why the equity value has been discounted by 25%. This needs to be investigated further.

Comments on reasonability checks

The net asset value has been obtained from the books at September 2014. The valuation is performed for the year ending November 2014, and therefore, the net asset value should be updated for November.

The fair value/NAV calculation uses the 75% fair value of Oikos of R66 755 000. This is incorrect, as it should use the total equity value of R89 000 000 to test for reasonability. It is recommended that the advisors update their calculation in this regard.

In the earnings multiple reasonability test, the advisors have failed to adjust Oikos's profit after tax in order to obtain a maintainable earning amount. Once-off, non-recurring items must be removed as they are not indicative of the future earnings of Oikos. These adjustments would include profits on sale of PPE, impairments lawsuits and other non-recurring items.

The average PE multiple of listed Companies has been used. Again KayDav is the most comparable company and the advisors should use its P/E ratio only. The other less comparable companies are distorting the average.

There are clear errors in the valuation and the advisors should revise their estimates and calculations to provide a more accurate fair value of Oikos.

This was a highly impressive response by an entry level CA. In fact, this response would have impressed most boards of directors and experienced investment bankers.

Competent

From: Joe Soap (on behalf of Mr Hawkes)
To: The Board of WBP
Date: 19 November 2014
Subject: Evaluation of the Oikos valuation

Dear Board Members

In response to the valuation of Oikos Building Supplies (Pty) Ltd ('Oikos') performed by The Edge Capital Advisors, I submit the following comments.

- The assumptions made for revenue growth for the forecasted period of 2015 and 2016 seem overstated. Revenue is forecasted to grow at 15% from 2014 to 2015 and 2015 to 2016. Revenue only grew by 4.9% from 2013 to 2014 and with the current anaemic economic growth in South Africa and the trends in the industry it seems as if a 15% growth forecast is optimistic.
- The growth assumptions for EBITDA also seem overstated. EBITDA fell by 10.5% from 2013 to 2014 and a growth in perpetuity from 2016 of 2% is assumed. It is therefore highly unlikely that EBITDA growth rates of 35% from 2014 to 2015 and 23.9% from 2015 to 2016 are accurate.
- The tax paid is consistently less than the taxation expense from 2013 to 2016, which indicates there is a build-up of a tax liability that should be investigated further.
- The future forecasted cash flows are being discounted at the cost of equity. The weighted average cost of capital should be used when calculating an enterprise value. Currently the cost of debt is being ignored.
- The betas used do not appear to be correct because of the following:
  - Cashbuild and Iliad's unlevered and levered betas are exactly the same, which cannot be as it is stated that Oikos has gearing. Therefore the unlevered beta would have to be adjusted higher by Oikos's Debt to Equity ratio to get to a levered beta.
  - The beta of Cashbuild is very low and should possibly be excluded as it could be considered an outlier.

  The above mentioned leads to a very low cost of equity of 8.94%, which should be adjusted higher.
- The valuation states that 25% is deducted because they are related parties. This should not be included in a free cashflow model. All the risks should be included when calculating the average cost of capital. This will usually not include the fact that they are related parties.
- With regards to the PE multiples of similar companies used, it appears that Iliad Ltd should be excluded as it is clearly an outlier and is skewing the average PE.

  The new average PE will be [(13.8 + 12.4)] 13.1. The fact that Oikos is much smaller and unlisted (i.e. it shares lack marketability) warrants a 25% discount from the average of KayDav Ltd and Cashbuild's Ltd.'s PE multiples.

  13.1 x 75% = 9.825

  Oikos's valued PE multiple of 11.4 is therefore higher and this should perhaps cause the valuation to be lowered.

  The aforementioned comments could lead to significant adjustments in the valuation of Oikos and should be clarified before any further steps in this deal are taken.

  Joe Soap

This candidate missed some issues in the valuation model but clear evidence of competence.

Limited competent

To: Board members
From: Mr Hawkes
Date: 19/11/ 2014
Heading: Review of Oikos Valuation by The Edge Capital

The report is based on the valuation that was done on Oikos for potential investment for strategic purposes of WBP. The valuation was done based on free cash flow method and the report is basically for review of the valuation and it will cover the method used, workings and recommendation. The valuation was done on 100% stake in Oikos and is based on Cash flow Principle. Valuation is for November 2014.

Review Notes

Valuation Method

- Valuation was done based on Free Cash Flow method which is estimated for 2015 and 2016. This is subject to errors and subsequent may differ with estimates.
- The period of estimates is only for 2 years (2015 and 2016) and may not be enough to form a judgment.
- This method takes in to account only cashflow whereas a company has a lot of transactions which are vital but non cash e.g. refer the revaluation amounts which are non cash items.
- Cashflow is dependent on the company needs of the period, this method does not eliminate those unusual cash items which are not to recur in the future.
- Business is likely to have future revenue treatments which should be taken into account when performing valuations and free cash flow is the limiting factor in this regard.
- There are risk factors which have to be filtered in to get to a pair of value, it may range from company, business or security risks but WACC only takes into account Equity and debt risk.

Workings

- Cash flow workings appear correct and final cost, debits repayments and dividends have been added back.
- Present value of free cash flow, terminal value and debt appear to be accounted correctly to free cash flow.
- WACC has been correctly calculated at (6 + 0,42 x 7) = 8.94%.
- The discount value of 8% due to related parties should be justified or supported with detailed explanations because 25% is material.
- The same apply to reasonability test which is result in free cash flow method out of NAV by 21%. This is material difference which must be explained.

Conclusion and recommendations

- The Edge Capital advisors should consider other valuation methods like price earnings due to the following
  a) Price earnings eliminates abnormal earnings and expenses.
  b) It takes into account the risks and opportunities associated with the company.
  c) There is an expected drop in PE from 11,4 to 7:7 and this may mean that Oikos has been overvalued using free cash flow.
  d) PE method weight average past profits in case of uneven performance to reflect a bigger picture and as you can see Oikos profits are expected to increase from R5 857 000 to R8 682 000.
- Valuation should be done in both free cash flow and PE methodology and assess the picture.

Regards

An Accountant

This suggestion that forecast free cash flows should include non-cash flow items was concerning. Unfortunately, this candidate missed the majority of technical flaws in the valuation model. There were too many factual inaccuracies. The allegation that the forward PE multiple was declining because the FCF valuation was too high indicated a fundamental misunderstanding of valuations – forward multiples are lower than historic PE's because of increasing profits and not necessarily FCF flaws.

PART (f)

Assume you are the newly appointed financial accountant at WBP

(f)	Prepare a memorandum to Mr Hawkes in which you identify and discuss five key reasons why it may not be appropriate for WBP to pursue an investment in a particleboard plant.

Highly competent

Confidential Memorandum

To: Mr Hawkes
From: F. Accountant
Date: 19 November 2014
Subject: Particle board plant

Dear Mr Hawkes

I have considered the investment in the particle board plant and in my opinion the following are 5 important reasons why it may not be deemed appropriate to invest therein:

1. High start up costs

There is substantially high start up costs in the particle board production plant. As we are already experiencing cash flow problems this will increase pressure on our liquidity. The cash injection from Baywatch is also unlikely to cover the start up costs as a new production plant for PG Bison recently cost them in the range of R1,3 billion.

Furthermore, the example of William Tell who had to liquidate shortly after opening a new production plant. William Tell, being a listed company, would be more likely to have easier access to financing and yet they could not survive. They also received a government grant for the plant. It is thus very concerning whether we will have sufficient cash resources for such a plant.

2. Well established competitions

There are 3 well established producers in the market. These distributors may enter into a price war with us and due to us being new and our current low profitability we may not be able to compete.

Furthermore customers may be reluctant to change suppliers to us due to good relations with current suppliers.

3. Scale and access to raw materials

As CS explained, scale and access to raw materials is key in this part of the industry. Due to high fixed costs it is not worth it to operate on a small scale. However, there may not be sufficient demand for us, especially in the early years, to operate on a higher scale where it is profitable.

Access to raw materials may be costly and difficult and result in us losing a competitive advantage as most competitors own their own plantations.

4. Electricity costs and availability

The rising electricity cost as well as access to electricity (due to Eskom possibly introducing load shedding again) could be detrimental to this business as the manufacturing plant is so heavily dependent on electricity.

5. Exchange rate

The weakening Rand exchange rate will also affect this as production plant will be imported. Based on the quotes received the machinery will cost in the region of R75 million – R130 million. This could result in significant forex losses or hedging costs.

Furthermore it is more likely that the German machine be purchased (as the other machine only has a 60% comparable capacity and due to the scale as explained in point 3). This will expose us forex losses due to the Euro strengthening.

What was impressive about this attempt was the integration of research during the pre-release period. The reference to what transpired at William Tell was insightful. Very few candidates picked up on this. Mentioning how much PG Bison had spent on their investment in a particleboard plant was also evidence of pre-research. All points raised were valid.

Competent

MEMORANDUM

From: Yu Man
To: Mr Hawkes
Date: Today at 11 am
Subject: Particleboard plant

5 key reasons why it is not appropriate for WBP to pursue an investment in a particleboard plant:

1. It may result in the loss of a key director, Chris Sutton.
   - Sutton founded WBP in 1990 and is the CEO of WBP today.
   - Even if he doesn't leave, there may be a dispute and this will affect the staff morale and future of the company.
   - Production operations are known to have a high level of management participation; thus a bad attitude from top management will only further dampen WBP's future.
   - It may result in a loss of shareholding as Sutton's owns 40%.
   - This may lead to a significant decrease in share price.

2. Tight supplies of new materials
   - WBP does not have their own plantations
   - Competitors have their own plantations, thus making it harder for WBP to compete
   - Results in dependence on suppliers
   - Thus WBP may not get wood chips at the best prices and in limited delivery time.

3. Substantial initial capital investments
   - This will lead to debt financing together with increased finance costs.
   - This will thus place profits under pressure.

- The cash injection from Baywatch won't be able to fully cover the costs of the plant from Germany or China.

4. Highly competitive market
   - The market is dense and dominated by highly established competitors.
   - These competitors have economies of scale, which WBP may not have and it may take long to get to that point.
   - This is a new unfamiliar market to WBP.
   - Competitors immediately have a competitive advantage against WBP.

5. Increased costs
   - Rising electricity and transport costs will reduce WBP's profitability further.
   - More fixed overheads and fixed costs will be incurred.
   - Previous investments of WBP saw no returns and thus it is questionable whether these increased costs will be covered by revenue.
   - The market success factor is delivering a low cost, high quality product.
   - WBP's success in this regard is questionable.

The first two points raised were set out in the pre-released information. These were valid points and certainly worth mentioning. The remaining issues raised was well thought through, a good answer!

Limited competent

Memorandum

To: Mr Hawkes
From: APC Candidate
Date: 19/11/2014
Re: Investment in particle board plant

Dear Mr Hawkes

In response to your request, I have identified and discussed 5 key reasons why it may not be appropriate for WBP to pursue an investment in particleboard plant:

1. This is not in line with the strategy – it does not contribute directly to the vision, as it won't improve market share directly.
2. There are numerous environmental issues associated with particleboard market, such as emission to the air, water waste, hazardous material, solid waste, noise.
   This will result in significant increased costs to manage the above and is subject to legal and regulatory compliance.
3. WBP may not have the necessary experience to implement and manage a particleboard efficiently
4. Probably loss of co-founder and CEO. This occurred in a competitor industry and this firm is now in business rescue
5. At the moment formaldehyde emission is very relaxed in South Africa compared to the rest of the world. This may become stringent in line with global regulations.

Regards,
APC Candidate

Only one valid point was raised by the candidate.

Candidate over emphasized the environmental impact.

Not sufficient explanation given for points raised.

PART (g)

Assume you are the newly appointed financial accountant at WBP

(g)	Draft notes to Mr Sutton on behalf of Mr Hawkes in which you explain, with reasons, the accounting effect WBP's implementation of the long-term share incentive scheme would have on its financial statements, including any taxation consequences. Illustrate the effect, for the financial year ended 31 October 2014 only, on each relevant line item of the statement of comprehensive income and the statement of financial position, assuming the scheme was implemented on 31 October 2014.

Highly competent

Draft Notes to Mr Sutton

Please find below the explanations and analysis of the accounting and taxation effects of the long term incentive scheme.

Giving due consideration to the fact the incentive scheme proposed and implemented by WBP was modelled on a similar scheme implemented by Tsogo Sun (All information obtained from Tsogo sun Circular published in 2014 regarding their incentive scheme) I find it necessary to start off by analysing the key differences or similarities between the two schemes, as well as an analysis into Tsogo Sun's treatment of these shares.

Tsogo Sun granted a loan which was interest free and with no fixed terms of repayment (the 'executive loan facility' to the value of R200m) to certain directors of the entity to enable them to acquire shares in Tsogo Sun which were reserved for them by SABSA.

The Salient terms of the incentive are similar to that of WBP as per all the current information at hand. However, the vital difference is that Tsogo Sun does not have a specific clause which obligates them to buy-back the shares from beneficiaries in the event of termination of employment or death. WBP does have such clause requiring a buy-back, and as such the accounting treatment will differ.

Tsogo Sun concluded that the economic substance of the loan facility is the granting of an equity settled option on ordinary share and a once-off IFRS 2 charge was accounted for at the value (valued using Black Scholes) of the option.

Tsogo Sun also disclosed the transaction as a post reporting period event as per IAS 10 given the fact that it was decided post year end. However, due to the fact that the scheme was implemented on 31 October, there are no IAS 10 impacts on WBP's financial statements.

The accounting of the incentive scheme in WBP's books can essentially be broken down into two components, namely the loan advanced and the buyback of the shares on death or termination of employment.

These components will thus be discussed separately.

Loan Advanced

As per the definition stated in IAS 32, a financial asset is known to be: "a contractual right to receive cash in future."

The loans advanced to staff can thus be classified as a financial asset as the company has a right to receive the cash on termination of employment or death. The loan receivable would thus be recognised at present at its fair value,

and subsequently measured at fair value since the loan is not held to receive any contractual cash flows in the form of interest.

Consideration should also be given to IAS19 in accounting for the interest free portion of the loan. If the interest rate on the loan is below market rate, fair value will be less than the value of the loan. Thus the initial difference would be an employee benefit.

The IAS 19 effect is calculated as the difference between the interest paid and the interest received. Since the loan carries no interest the net effect on IAS 19 is NIL and thus not required for further consideration.

Shares

In terms of the guidance as per IFRS 2, a share based payment arrangement is an arrangement between the entity and another party (including employees) that entitles the other party (SH, NR and middle managers) to receive cash or other assets of the entity (WBP) that are based on the price of the equity instruments (shares of WBP)

Due to the fact the loan granted will be based on the value of the equity instrument, a share based payment arrangement exists.

Thus under the classifications of IFRS 2, it would be necessary to consider whether this is an equity settled or cash settled transaction.

As previously mentioned, WBP has a specific obligation to buy back the shares on event of termination of employment or death. This will be done at fair value or the higher of fair value and the initial acquisition price respectively. Due to the fact that the contractual obligation which arises in this context is linked to the price of WBP's own equity instruments, this arrangement would be classified as a cash settled transaction (as opposed to Tsogo Sun due to the key difference)

Due to the fact that there are difficulties in estimating the vesting period (until death or retirement) as per paragraph 32, the vesting is immediate. Hence a once off expense for IFRS 2 is recognised immediately.

The liability shall be measured at the fair value at each reporting period with reference to the value as per valuations performed.

On event that there is a termination of employment or death, WBP will be obliged to buy back the shares and the loan becomes immediately repayable to WBP.

Thus, the entire amount of the loan receivable will be reversed at the initial fair value of the loan due to the repayment by beneficiaries.

With regards to the shares, the IFRS 2 liability will be reversed at the fair value, with a corresponding decrease in bank balance. The bought back shares will be accounted for as Treasury Shares since they will no longer be active in the market.

Refer to attachment B for an illustrative effect on the financial statements.

Since it is only required to comment on the implications of the long term incentive scheme on WBP's financial statements, the following tax considerations will be considered only for WBP and not the employee receiving the benefit.

Deferred Tax

SARS would not allow a deduction for the buy back of shares as it will be seen as capital in nature as it not directly linked to the production of income.

Hence the tax base would be the carrying amount less the deductions in future which would be NIL. Thus the carrying amount would equate the tax base and the resultant effect on deferred tax would be NIL.

Thus item would however appear as a reconciling item in WBP's tax rate reconciliation as it is a permanent difference.

S11 Tax deductions

The incentive scheme would not yield a deduction for WBP as no expenditure has actually incurred in terms of the interest forfeited.

Deemed dividend S64 (E)

Consideration is given to the possibility of a deemed dividend due to the interest free loan granted.

A deemed dividend arises by virtue of a share held in the company if the following conditions are present:
- Debtor is a person other than a company
- Debtor is a resident AND
- The debtors is a connected person (by virtue of a shareholding greater than 20% as defined)

Due to the fact that parties are not connected persons (10% resultant shareholding), there is no deemed dividend.

VAT

The granting of an interest free loan would be taxed in the hands of the recipient as a fringe benefit in terms of the seventh schedule. As such, the granting of a fringe benefit is a deemed supply for WBP as per the VAT act.
Thus we will consider the VAT effect.
As the deemed supply relates to finance costs which are VAT exempt, no output VAT is payable by WBP on the fringe benefit.

Donations Tax

As per S54 of the Tax Act, the granting of an interest free loan by a lender may constitute a donation. The definition of 'property' includes any right in or to property. If no provision is made for interest (as it in this case with the interest free loan), no inherent right to interest. In such a case there can be no waiver of any right to interest and no donation will arise.

Since the loans provided are interest free as per the agreement, no donations tax arises.

Even though S54 does not apply, it may be argued that this may lead to a deemed donation as per S58. S58 stipulates that if property is disposed of for an inadequate consideration, it may be deemed to be a donation. However, if the loan is repayable on demand, it would be practically impossible to calculate a value.

Since there is no fixed term of repayment on WBP's loan, no donations tax is levied.

Loan to employee

No Income tax implications.

S24J

Not applicable since it is not an interest bearing instrument

I trust that you will find the above in order.

A Candidate.

Attachment A

31 October 2014

DR	Loan Receivable	10 200 000	
	CR Bank		10 200 000

Issue of loan to shareholders

DR	IFRS 2 Expense	4 200 000	
	CR IFRS 2 Liability		4 200 000

Revaluation of IFRS 2 liability to fair value

On Settlement

DR	Bank	10 200 000	
	CR Loan Receivable		10 200 000

Repayment of loan

DR	Liability	(Fair value of liability)	
	CR Bank		xxxx

Repurchase of shares on death/termination of employment

DR	Treasury Shares	xxxx	
	CR Transactions with owners reserve (equity)		xxxx

Buy back of shares before cancellation

DR	Equity/Capital	xxxx	
	CR Treasury Shares		xxxx

On cancellation of shares repurchased

DR	Transaction with owners reserve	xxxx	
	CR Retained earnings		xxxx

Release to retained earnings

Attachment B

Statement of Comprehensive Income

IFRS 2 expense	4 200 000

Statement of changes in Equity

IFRS 2 Liability	4 200 000
Loan Receivable	10 200 000
Bank	(10 200 000)

*Note that this is simply an extract and not drafted in appropriate format

The candidate displays excellent research into Tsogo sun (a very clear trigger that many candidates did not appear to research much).

Structure is excellent and language is clear making the answer easy to understand.

Illustration is good too.

Candidate is one of the few who noted that the tax should only be assessed from the perspective of WBP and did not waste time discussing all other tax implications.

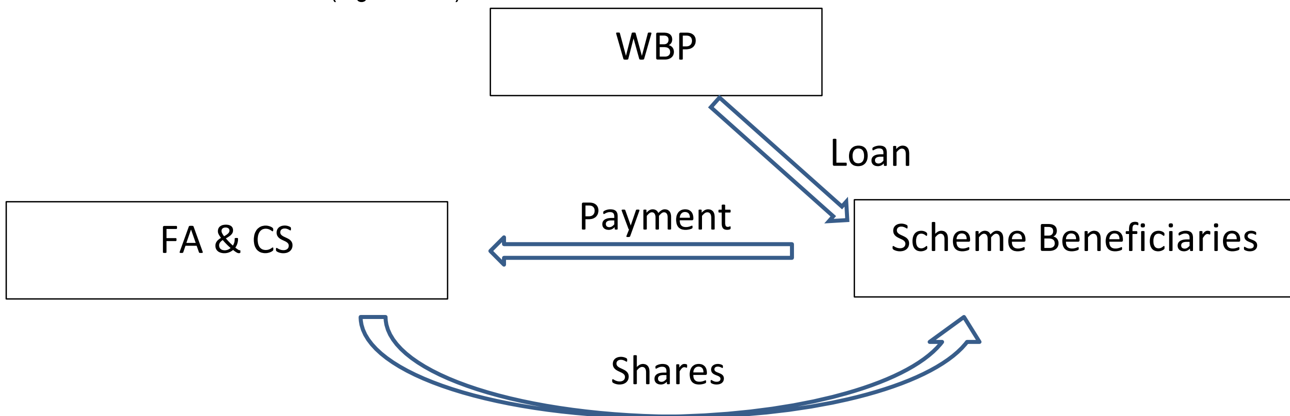
Competent

To: Mr Sutton
From: Mr Hawkes

Draft notes regarding the implementation of the long-term share incentive scheme and the impact thereof on the financial statements

Accounting implications

Structure of the scheme (legal terms)



The principles of accounting however propose that the substance of a transaction be considered rather than the legal form. In substance the scheme beneficiaries are receiving shares in WBP on condition that they remain in the employment of WBP, through an interest free loan.

The scheme therefore meets the definition of an equity settled share-based payment in terms of IFRS 2

The scheme therefore meets the definition of an equity-settled share based payment in terms of IFRS 2, as the entity receives goods or services as consideration for its own equity instruments (shares).

In terms of IFRS 2, equity-settled share-based payment transactions with employees are measured with reference to the fair value of the equity instruments granted.

Based on the valuation performed by Magnus Uber of Valuation Excellence, the fair value of the transaction is R 4200 000. The following journal will therefore be raised to account for the initial recognition of the scheme:

DR	Payroll (P/L)	4 200 000	
	CR Equity-settled Share Based payment reserve		4 200 000

The loan will have to be measured separately at fair value in terms of IAS 39, as follows:

DR	Staff Loans	10 200 000	
	CR Bank/Interest bearing borrowings		10 200 000

(102mil x 10%)

(Please note that any reduction in the share price will raise an indication of possible impairment of the staff loans, as the beneficiaries will be required to settle the loans at a value higher than they will receive as compensation for the sale of the shares, and may therefore not be able to settle the loans in full).

Tax

For tax purposes, the legal form of the transaction is considered. The loan to the employee is therefore the transaction in question for tax purposes. As this is a capital transaction, there are no income tax consequences with regard to the loan, the fact that the loan is interest free creates a taxable fringe benefit for the employees, but as the amount has not been included in the employees PAYE calculations on 31 October 2014 (salaries assumed to be payable on 205 November 2015), there will be no increase in the PAYE liability on 31 October 2014.

The Fringe benefit equal to the value of the loan multiplied by the official interest rate will however need to be taken into account in determining the PAYE of the scheme beneficiaries going forward (ie. R10200 000 x (5.75% +1 %) = R688 500 aggregate fringe benefit.)

Impact on the Financial Statements

Figures as at 31 October 2014: Statement of Financial Position

	R'000 Prior to Share Scheme	R'000 Scheme	R'000 After Share Scheme
Assets			
Trade and other receivables	30 990	10 200	41 190
Cash and Cash equivalents	203	–	203
(Cannot be funded out of cash reserves, therefore increase in long-term interest bearing borrowings)			
Equity and liabilities			
Equity			
Equity-settled share-based payment reserve	0	4 200	4 200
Retained earnings	99 697	(4 200)	95 497
Liabilities			
- Interest bearing borrowings	21 905	10 200	32 105
(Non-current refer to above)			

Statement of Comprehensive Income

	R'000 Prior to Share Scheme	R'000 Scheme	R'000 After Share Scheme
Administrative expenses (through payroll costs)	(7 910)	(4 200)	(12 110)
Operating profit	8 599	(4 200)	4 399
Profit before tax	5 723	(4 200)	1 523
Income Tax expense (current)	(1 631)	-	(1 631)
Profit for the year	4 152	(4 200)	(108)
Total comprehensive income for the year	4 152	(4 200)	(108)

As can be seen from the above calculations, WBP will show a loss from the implementation of the share incentive scheme, and the liquidity ratios of the entity will decrease (increase in proportionate liabilities compared to increase in proportionate assets)

The candidate illustrated the accounting well and also differentiated between substance (accounting) and legal form (tax).

The basic points were dealt with in a simple manner, making it easy to understand.

Good comments on the impact of the share scheme and the use of a diagram is a good technique.

Limited competent

DRAFT NOTES

From: Mr Hawkes
To: Mr Sutton
Re: Implementing the long term share incentive scheme.

Assuming the scheme was implemented 31 October 2014, FA and CS shareholding will drop to 35% each from 40% each.

There will be no changes to issued share capital.

One share at 31 October 2014 is worth R2 053,94 (102 697 000 / 50 000 shares).

10% R102 697 000 = R10 269 700 (The 10% fair value at 31 October 2014 – grant date).

FA and CS will each need to be paid out R5 134 850 cash.

There is only R203 000 in the bank of WBP so WBP will need to source finance for the payout.

A loan will be incurred by WBP for the value of the shares at 31 October 2014.
(Debit loan to scheme beneficiaries)
(company owes scheme beneficiaries).

The debit loan in the company is interest fee and will therefore constitute a deemed dividend.

The amount of the dividend is the market related interest rate (repo rate + 1% = 6,75%) less interest paid to the company which is nil.

The dividend is deemed to be paid on 31 October 2014 (last day of financial year end).

This is a dividend in specie. This means the company is liable for dividends tax.

Since the day the scheme was implemented is the same as the financial year end, no deemed dividend is incurred.

In future years 15% the value of the loan must be paid to SARS.

There are also fringe benefit implications in your personal name. From 31 October 2014 to 28 February 2015 you will need to include this in your personal calculation.

I am more than happy to assist you with this.

Illustrative effect

31 October 2014

Statement of comprehensive income	- No effect
Statement of financial position	
Non-current assets	
Loan to scheme beneficiaries	10 269 700

EQUITY	-
<u>Current liabilities</u>	
Loan to shareholders	10 269 700

Until paid out of bank.

Please note, the Black Scholes valuation is for November 14, but IFRS values the option at grant date (i.e. 31/10/14).

In subsequent years an employee benefit expense must be accounted for, and a share based payment reserve must be created and adjusted for annually. This is calculated based on scheme beneficiaries who decide to sell their shares, leave WBP or die.

This candidate failed to read the required task, which indicated that he/she should assume that the scheme was implemented on 31 October 2014, the last day of the financial year. The scheme was for certain shareholders to sell 10% of WBP's shares to select employees at R10.2m. The candidate failed to read this and worked out his/she's own valuation of R10.269m.

This was a poor attempt for many reasons including:

- No discussion of the loan (financial asset, need to present value because it is interest free)
- There is no deemed dividend as the scheme beneficiaries are not connected persons
- There is mention of share based payment expenses in subsequent years without any discussion or reasoning. The comment on the calculation is correct as share based payment is not calculated based on who decides to sell their shares.
- There is no structure making it difficult for a non-accountant to understand.

PART (h)

Assume you are the newly appointed financial accountant at WBP

(h)	Ms Moonsamy, the Human Resources Manager of WBP, showed you the anonymous letter dated 18 November 2014 received from disgruntled employees and requested your impartial comments as a newly appointed staff member. Prepare a memorandum to Ms Moonsamy in which you comment on the issues raised in the letter. Assume that you have all the relevant information with regard to the proposed long-term incentive scheme.

Highly competent

Memorandum
To: Me Moonsamy
From: Newly Appointed Financial Accountant
Date: 19 November 2014
Subject: Prepared Long Term Incentive Scheme

It is with reference to the anonymous letter which was received by you on 18 November 2014, from "disgruntled employees" that I write the attached. You have asked for my comments on the issues raised in the letter, which are addressed below:

Firstly the employee talks about the incentive scheme of which they have become aware.

Up until the date of this letter, the scheme had not been approved by the Board. It was approved on the same day in which the letter was received, who could have discussed this confidential matter with employees "unaffected" by the scheme before it had Board approval.

WBP intends to advance an interest free loan to directors and a select few middle managers, and it is rumoured that these loans will not have any fixed repayment dates! We find this completely unfair, unethical and inflammatory.

The employees need to understand that the share scheme is not a "traditional" share scheme. In a traditional share scheme the directors and managers would have been granted shares at a "predetermined price". These shares would have been vested after 3 or 5 years had they hit certain performance targets.

However in the proposed scheme, the directors and managers are paying for the shares upfront. This implies that should the share price fall below the "predetermined price" they would lose money. This incentivises the directors and mangers to Act in the best interest of the company, as if the value of these shares drop, they lose considerably, as the loan is payable irrespective.

The flip side of this is that the morality of the transaction may not have been thoroughly thought through. Even though processes at WBP are highly automated, manual labour is still used quite extensively.

The launch of this scheme coincides with the company WBP engaging with the union on salary increases for 2014/2015.

The increase sought was 12%. Given the type of worker and level we are dealing with it may be difficult for them to understand the dynamics of the share scheme vs a 12% pay hike demand.

I would suggest we start consulting with the union representation which may be more open to our discussion and explanation of the proposed scheme.

<u>Employee states WBP ignoring vast majority of workers and handsomely reward select few.</u>

It is unfortunate that the share incentive schemes do not offer top executives more rewards. However companies want to align the interests of management with those of shareholders. There is no better way of doing this than by making them a holder of the shares.

<u>How can WBP introduce a scheme which will have no risk for a few employees and ignore the rest of us?</u>

There are risks of the new scheme to the employees. As explained above, share value could decline. They would need to repay the loan if they resigned or were retrenched, etc. In addition to that, they would be paying fringe benefits tax on the interest free loan; this may or may not be matched by dividends they may or may not receive on shares.

The employees do however feel excluded as the policy was discussed and decided on without their valuable input, which may have changed the scope of the scheme and possibly the implementation.

However it has been approved by the Board of Directors and now just requires shareholder approval. The exclusionary policy could be discussed with shareholders, but in WBP's case the BOD are its shareholders.

<u>There is nothing fair and ethical about the way you treat your staff</u>

Being disgruntled can lead the employees to do many silly things. Strike action being one, lock outs another or even vandalism. WBP should consider the exclusionary policy effect on the current financial position of the company, and with its decline, whether it would be worth it. A portion, no matter how small, of the shares could appease the masses.

<u>How on earth can WBP now afford to lend money to executives and managers, when it has money problems? It sounds as if you guys have never heard of corporate governance and company law!</u>

The employee is quite ahead of her grade. The cash problem at WBP is quite glaring. We have working capital problems, meaning that we are not generating enough cash as we have increasing debtors levels, extended debtor days, increasing inventory levels and shrinking cash reserves.

Before the Board took the decision to grant the loan and approve the scheme, the solvency and liquidity of the company should have been considered. This was not done and could possibly be a contravention of the Companies Act.
WBP could need to borrow funds to pay the shareholders for the stake they selling to the scheme. With an ever declining Positive Balance Sheet the finance may be declined.

If WBP borrows the funds, would it pay interest on the borrowed funds? The answer is a resounding Yes.

The deductibility of the interest charge in our financial statements could be in doubt as it would not have been incurred for productive reasons. This implies and ever increasing tax bill.

How will WBP meet its repayment obligation on the loan to the fund providers?

<u>Some salary increases and additional benefits such as housing and cell phone allowances would buy you tremendous loyalty and dedication.</u>

The employees are indicating that their needs are not excessive. We would need to revisit this scheme from many perspectives and one would be the consideration of "other" employees.

Additional considerations not covered by the letter would be:

National Credit Act – The loans total more than R50 000 and would need to comply with the NCA.

The King Code is being contravened as Niall Rice will receive shares, whereas in terms of King Code non executives may only receive directors fees, as this may impair his independence.

You need to consider the impact on lower level employees and engage the Board on this issue before it is submitted to shareholders for approval.

Thanking you

Whilst not the best English, this candidate displayed a balanced view on various issues. The insight into how disgruntled employees may feel and the need for the WBP board to attempt a compromise was refreshing. Most candidates dismissed employees' claims and demands as unrealistic.

Other impressive features of this attempt:

- Recognised that there may have been an informational leak;
- Identified the poor corporate governance (non-executive receiving shares)
- Discussed the financial implications for WBP in some detail
- Discussed the alignment of interests between scheme beneficiaries and WBP
- Recognised that WBP did not have the funds to advance the R10.2 million loan, and if it borrowed amounts, interest may not be tax deductible

Competent

To: Ms Moonsamy
From: Financial Accountant
Date: 19 November 2014
Subject: Long term incentive scheme

Dear Ms Moonsamy

Please refer to my comments below on the issues raised by the disgruntled employees in relation to the long-term incentive scheme.

Based on all the information that I have received on the terms of the scheme, I feel that the employees' concerns relate to aspects of the scheme that the employees do not understand. They seem to be comparing the scheme to other long term incentive schemes normally given to executives of big listed companies.

The employees need to understand that the scheme is actually far less generous than most other executive incentives – even despite the fact that the loan is interest free and has no fixed repayment date.

The employees claim that the scheme has no risk to the beneficiaries. This view is misguided. On the contrary, the beneficiaries are exposed to a decrease in value of WBP. If the value of WBP drops at the time when the employee leaves the Company, then they would have to pay the company the difference between the value of the WBP shares at grand date and at the time when they leave the company. In normal share schemes, employees are not exposed to a decline in value. This scheme is rare in that the employee is exposed to downside risk of the share option.

It is true that they have an advantage over ordinary investors in that they have been able to access the loan up front, but this loan can only be used to buy shares in WBP and has to be repaid.

The employees need to also understand that even though the loan scheme has no repayment date, it is still repayable when the employee leaves the employment of WBP or dies. So it must be explained to the employees that the money has not just been lent to the executives – it is repayable when they leave and it can only be used to buy shares.

The beneficiaries would also have to pay fringe-benefits tax on the loan, which may or may not be matched with the dividends they receive on the shares.

Employees must be reminded that WBP still fully promotes transparency and has been completely transparent to employees and the media about the scheme.

Employees must also be reminded that the scheme has been introduced to align the interests of management with that of key shareholders – management will face negative financial consequences if they fail to add value to the company. Adding value to the company will not only benefit shareholders, but employees as well, as improved profits mean that there are more resources to improve employees' salaries and other benefits.

WBP is currently involved with negotiations with labour unions with respect to salary increases for employees.

The employees are correct that WBP has been experiencing a declining trend in profits and reduced profitability. Their concerns about where WBP will get the funding to lend to directors is therefore valid and should be explained to them.

This candidate argued the issues clearly and identified the key financial issues associated with the scheme. The alignment of interests and the need to reassure employees was also commendable. However, the answer lacked the breadth and depth of the HC candidate above.

Limited competent

Memorandum to Ms Moonsamy commenting on the issues raised in the letter.

Memorandum

From: Financial Accountant
To: Ms Moonsamy
Date: 19 November 2014
RE: Comments on letter from disgruntled employees

Dear Ms Moonsamy

As per your request please see my comments on the issues raised by the disgruntled employees.

Granting of the loan

- The granting of the interest free loans will not result in a cash flow for the company thereby not affecting the cash flow of the company.
- All the incentive scheme is effectively doing is transferring shares from the current shareholders to scheme shareholders.
- The shares of WBP are not traded on the JSE therefore the actual purchase of the shares and granting of the entry is a book entry.
- The only derived benefit that the scheme beneficiaries obtain is a share of ownership and possible income from dividends.

Current situation for disgruntled employees

- It must be understood that the current economic conditions cannot support double digit wage increases.
- However with the possible investment from Baywatch, the company will have the funds to create additional benefits for staff – possible allowances may be built with salary and wage packages.
- Employees must understand that the directors of the company could have followed the due process with regards to the Companies Act and Corporate governance.

Conclusion

I trust the above comments assist you.

Financial Accountant

The candidate did not address the majority of the issues raised in the address the other issues raised in the disgruntled employees letter. The task required an unbiased discussion of both “sides of the story” which was not addressed in this response. The candidate failed to display the breadth and depth which the task required. The statements that the loan was a book entry and there were no financial implications for the company illustrated that the candidate had failed to grasp the scheme, despite this having been clearly explained in the pre-released information.

PART (i)	
Assume you are the newly appointed financial accountant at WBP	
(i)	List, with reasons, six key initiatives you would expect WBP to begin implementing in order to enhance business sustainability. This list is for your personal use as a reference document in preparation for your attendance at the forthcoming strategic think tank of WBP regarding business sustainability.

Highly competent

Key sustainability initiatives that WBP should implement

1. Improve Corporate Governance

At present we have a poor balance of power on the board with director disagreements and exertion of power by the chairman. Furthermore in the absence of properly structured board committees, a company secretary, formally documented policies, terms of reference, risk processes and stakeholder interaction processes, there is increased risk of non-compliance with laws & regulations, inappropriate/insufficient monitoring and mitigation of business risks , and weakening of stakeholder relationships.

Improvements based on King III good practice, but not necessarily adopting King III as we are not listed and it is costly, will significantly contribute to our sustainability through numerous benefits.

Such benefits include:

- Improved balance of power on the board resulting in more informed, better decision making
- Improved transparency and accountability
- Improved performance management therefore goal congruence
- Improved risk management
- Improved compliance with laws ®ulations
- Improved shareholder relationships.

2. Integrated reporting

Implementing integrated reporting process will have the following impacts that are essential to our sustainability:

- improve stakeholder relations, including investor and employee confidence to support
- Focus management on long term value creation and a sustainable focus rather than short term gains.
- Allow management and stakeholders to better understand the importance of the link between our long term strategy and success
- Allow management to better track their progress and strategic goals
- Increase managements understanding of risk and opportunities facing the business
- Assists management in monitoring potential breaches of compliance with laws and regulations.

3. Stakeholder relations

The importance of improving stakeholder relations is paramount, especially considering our reliance on suppliers, our desperate need for liquidity and potential strike action.

Relations with employees are most relevant at this point. We need to implement more effective channels of communication with employees and unions, so as to avoid strike action and our employees feeling "ignored".

The initiative should include:

- Regular staff meetings and progress reports
- Celebrating employee contributions through recognising an employee of the month and involving all employees in overall performance bonuses.
- Management to be more sensitive in negotiations and not shut down demands immediately as unreasonable.

4. **Working Capital management**

We have serious concerns about present liquidity issues. This requires immediate attention in order for us to continue as a going concern.

Such actions required include:

- More active monitoring of costs, cash levels, debtors payments, debtors credit terms, inventory management by management.
- Management need to meet more frequently to discuss these issues to a strategy to improve liquidity.

5. Improved risk identification, monitoring and mitigation

Better risk identification, monitoring and mitigating by management and the board is fundamental to long term value creation and sustaining economic pressures and demands. We need to respond to our risks or we will not be able to continue operating and achieve sustainability.

6. Strategy

We need to come up with a strategy in response to the pressures that we are experiencing, or it is likely will not remain a going concern. Management need to decide whether we intend to move up or down the supply chain into particle board manufacturing or retail or whether we will attempt to our-ride the recession.

This strategy must further include managing our resources, both personnel and supply effectively to achieve sustainability.

Our environmental and social impact and strategy must also be considered.

The candidate displayed good breadth in their answer. The response firstly shows that the candidate is able to differentiate between the concepts of "sustainability" which is in essence the "triple bottom line" and secondly the broader issue of business sustainability, being business survival. The task required candidates to identify the drivers of business sustainability and to suggest business improvements. The response above, answered both these requirements - the candidate clearly identified the risks to business sustainability and made feasible business improvement and/or suggestions for innovations to improve business sustainability. The business improvements suggestions and innovations go beyond just addressing the triple bottom line concept of sustainability and display a good amount of depth.

Competent

1. Cost Cutting
   WBP's current cost management is poor and eating into profitability. If management does not manage and cut costs the business will not be able to bear the impact and will not be sustainable

2. People
   WBP's staff are currently very unhappy. A satisfied work environment is crucial to the sustainability of the business. WBP needs to implement new policies and strategies to ensure the general staff are inspired. Increase social responsibility such as more common and larger investments in the community (e.g. the soccer club sponsorship) will attract new customers and also lead to sustainability

3. Environment
   WBP needs to assess its current impact on the environment as well as how it can benefit the environment around it. A business can only be sustainable in a sustainable world.

4. Risk Management
   The current risk register is too generic and does not appropriately quantify the likelihood and impact of the main risks as well as how they will be mitigated.

   If WPB does not implement proper risk management the entity will not be sustainable as the uncontrolled risks could lead to its downfall.

5. Integrated Reporting
   Integrated reporting is a key tool in managing business sustainability. It gives the entity and all users' greater access to and transparency of information. It helps identify focus areas to ensure better allocation of resources in order to ensure a sustainable business.

6. New Strategy Implementation
   WBP's current state of affairs is a very concerning matter. The board has been considering 2 different strategic approaches and it will be important for the entity to start with the implementation of the new strategy in order to maintain and enhance profitability and ensure a sustainable business.

Firstly, the candidate addressed the task – provide six initiatives to address the business sustainability issues which WBP is exposed to. The response from the candidate firstly addressed more than the sustainability issues (which would include integrated reporting, people & environmental issues), with the candidate identifying that business sustainability would require WBP to improve its risk management and reduce its costs. The candidate provided a good mix of sustainability as well as other business sustainability issues. The candidate's response is however not highly competent – although the response displays the breadth required to be competent, the candidate's response is very limited on the depth dimension. Had the candidate added more insightful commentary in respect of the initiatives to improve business sustainability, then their response would be deemed to be highly competent.

Limited competent

Six key initiatives that WBP should implement to enhance business sustainability

1. They can improve management systems and internal processes.

   Once WBP tracks and assesses the performance, you can identify areas where by you can do better, e.g. potential productivity improvement and cost reductions.

2. They should give the responsibility to a specific board.

   They can ensure that the audit committee is responsible for sustainability and thus they can take ownership and responsibility for business sustainability, as well as for the reporting thereof.

3. They should identify their risks, and ensure their risk register also mitigates their risks.

   They should ensure that their risk register is complete and that they also assess the risks and ensure that someone takes responsibility thereof.

4. They should make sustainability part of their mission and vision.

   They should ensure that all of the employees are aware of it and it also part of their day to day activities.

5. WBP should identify their strengths and weaknesses.

   It is possible that during the reporting process you discover that some issues are not as well managed as you first thought. Thus the board should ensure that strengths are embraced, weaknesses are reduced/limited and risks are managed appropriately at WBP.

6. Have in-house waste reduction and pollution teams.

   Sustainability and awareness thereof can be fun, if you can innovate your own business and give employees material of economic, environmental and social trends it is already a step in the right direction.

This candidate would not have impressed with most of these suggestions at a strategic think tank. There was a strong trigger in the pre-release information about business sustainability and we would have expected candidates to research annual reports of listed companies and in particular, Masonite and KAP (PG Bison) to establish what their sustainability initiatives are. In addition, because of the trigger in the pre-released information, we expected candidates to identify initiatives specific to WBP.

The initiatives regarding SWOT analysis, establishing a risk register, improving systems and developing a mission & vision statement listed by the candidate are all valid business initiatives. However, this list is generic to any business. There was limited evidence to suggest that the candidate applied his/her mind to WBP's business. What candidates need to have displayed is evidence of pre-research done of relevant annual reports in the industry.

This attempt would have been a pass in the ITC however, in the APC, we expect application to the scenario, addressing relevant industry and business specific issues.

The candidate could have redeemed himself/herself by listing say 3 or 4 generic initiatives with specific reference to WBP. The context of a strategic think tank required candidates to think of at least one initiative that would have impressed his/her new employee.