Assessment of Professional Competence
November 2016

Information on the day

żinga Fashions (Pty) Ltd documentation		
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DOCUMENT E

EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT

From:	Harry Mnisi
Sent:	Wednesday, 16 November 2016, 05:39 AM
To:	Financial Accountant
CC:	
Subject:	Current and deferred tax: Sale and leaseback

Hi

I need your assistance please. One of the outstanding matters in the financial statement preparation process is the sale and leaseback transaction and the tax computations. I played around with the deferred tax consequences of the sale and leaseback so that I can incorporate it into the draft deferred tax calculation for the auditors. With all my current work pressures, I do not have time to get it perfect right now, and would appreciate your input. Please also check my calculation of the base cost of the building for CGT purposes – I am not sure if I used the most appropriate basis. I cannot get the deferred tax proof to work yet!

In my calculations I've used a lease term of ten years as we are definitely not certain that we will be renewing the lease. We might be moving offices in the long term. I used a discount rate of 5,5% per annum (nominal), as this is a fair estimate of the interest we would have paid on a bank loan to finance this particular transaction.

I forgot to mention this to you previously, but there is some additional information that might affect the numbers: before we sold the head office building, its residual value had always been estimated to be equal to the carrying amount, and the auditors agreed based on the information that was reasonably available at the time. However, during the sale and leaseback negotiations we did some market research and it came to light that other office buildings in the same area and the same age as ours will be at the end of the lease term, currently sell for around R58 million. That is in today's money terms, so I think we were lucky to negotiate a guaranteed residual of only R70 million, considering that property prices in the area generally grow by about 2,5% from year to year! I am also aware that the lessor did not incur any costs to secure the lease.

I attach my draft workings for your review. Just comment on any errors or omissions – we can finalise the correct workings later.

Thanks in advance.

Regards
Harry

Email attachment

Draft żinga deferred tax calculation and deferred tax proof: Sale and leaseback

żinga Deferred tax workings FY2016					
	Carrying amount	**Tax base**	**Temp diff.**	**Rate**	**DTax asset/ (liab)**
	R'000	**R'000**	**R'000**	**%**	**R'000**
Building	65 500	–	65 500		(17 719)
Historical carrying amount	58 866	–	58 866	28,00%	(16 482)
Revaluation	6 634	–	6 634	18,65%	(1 237)
Finance lease obligation	(59 006)	(8 876)	50 130	28,00%	14 036
					(3 683)
					All in P/L

Calculations

	R'000
Calculation 1: Historical carrying amount: Building	
Cost (see calculation 3)	58 866
Depreciation 1 August 2016 to 30 September 2016 (residual value exceeds carrying amount)	–
	58 866
Initial measurement is lower of fair value and present value (IAS17) – therefore present value	
Calculation 2: Revaluation of building	
Fair value	65 500
Carrying amount (see calculation 1)	(58 866)
	6 634

		R'000	R'000	R'000	R'000
Calculation 3: Finance lease obligation					
Period (months)	120				
Monthly payment (R'000)	(200)				
Residual value (R'000)	70 000				
Discount rate (annual)	5,5%				
Present value (R'000)	58 866				
Amortisation		**Pmt**	**Interest**	**Princip.**	**Balance**
1 August 2016					58 866
31 August 2016		(200)	(270)	70	58 936
30 September 2016		(200)	(270)	70	59 006
		(400)	(540)	140	

Tax base: A finance lease is an 'instalment credit agreement' per the VAT Act, therefore section 23C of the Income Tax Act determines that the rental deduction be reduced by – (Lease payments current period ÷ Total lease payments) x VAT amount

	R'000
Therefore for FY2016 {[(200 000 x 2) / (200 000 x 120)] x (73 500 000 x 14/114)}	150
Therefore for all periods beyond FY2016	8 876

	R'000
Calculation 4: Gain on sale of building	
Proceeds on sale	73 500
Carrying amount derecognised (at latest revaluation)	(60 000)
Gain on sale of building	13 500

	R'000	
FY2016 current tax consequences and deferred tax proof		
Movement in deferred tax liability account	(3 683)	
Permanent differences	Nil	
Temporary differences		
Capital gain on building sold – previous revaluations realised [60 000 000 (calculation 4) – 19 900 000 (base cost) x 66,6%] =	26 707	OCI
Capital gain on building sold [13 500 000 (calculation 4) x 33,4% non-taxable portion] =	(4 509)	P/L
Interest on finance lease obligation	(540)	P/L
Depreciation	–	P/L
Section 11(a) rental deduction	(400)	P/L
Reduce rental deduction with section 23C amount	150	P/L
Total temporary differences in P/L	(5 298)	
28% of temporary differences in P/L	(1 484)	
Does not agree to R3 683k per deferred tax liability movement above!!!		

DOCUMENT F

EMAIL TRAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT

From: Harry Mnisi
Sent: Wednesday, 16 November 2016, 05:45 AM
To: Financial Accountant
CC:
Subject: RE: Internal audit

Hi

Please have a look at the email trail below, as well as the WhatsApp messages I received from Bill Marx which I forwarded to you. I would like you to draft the memorandum requested by Sally Whiteley in her email on my behalf.

Thanks
Harry

From: Sally Whiteley
Sent: Tuesday, 15 November 2016, 03:47 PM
To: Harry Mnisi
CC:
Subject: RE: Internal audit

Hi Harry

Please refer to the email from Gavin below, as well as my email of 9 November 2016.

Could you please prepare a memorandum to be tabled at our next Board meeting dealing with –

- the key considerations in deciding whether to establish an internal audit function for żinga Fashions within the next couple of months; and
- Bill Marx's suitability as a potential candidate as head of internal audit in the event that the Board does decide to appoint one.

Regards
Sal

From: Gavin Marx
Sent: Friday, 11 November 2016, 01:30 PM
To: Sally Whiteley
CC:
Subject: RE: Internal audit

Dear Sally

I know that you have asked Harry to report on the desirability of establishing an internal audit function for our company.

Refer below to the email I received from my nephew, Bill Marx, who has recently qualified as an internal auditor. I took the liberty of providing him with Harry's contact details. I think that Bill may be a good option to be our company's first internal auditor. Not only is Bill suitably qualified, but he has some very good ideas which I believe will be of great benefit to żinga Fashions.

In the interests of transparency, I thought that I should inform you of this fact.

Regards
Gavin

From: Bill Marx
Sent: Friday, 11 November 2016, 11:00 AM
To: Gavin Marx
CC:
Subject: Internal audit

Dear Uncle Gav

As you are aware, I have now completed my university studies, and I am ready to start my career as an internal auditor. From what you have told me about żinga Fashions (Pty) Ltd, it sounds like an exciting company to work for, and I would now like to take you up on your offer to assist with securing me a job at żinga Fashions.

At this stage I have the following internal audit projects in mind:

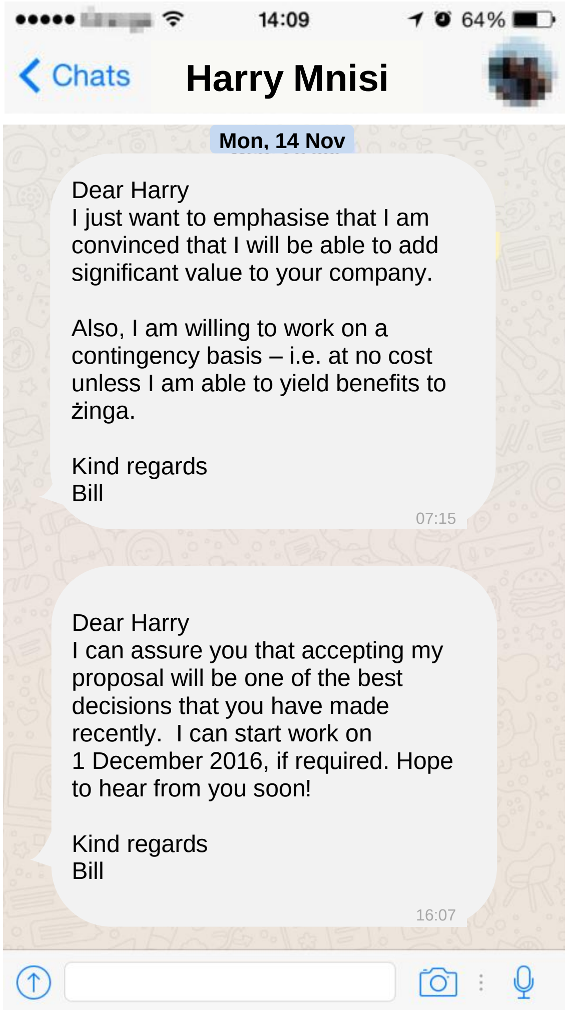
- Undertaking work in areas that will contribute to a reduced external audit fee, e.g. by evaluating the effectiveness of your company's internal control systems; and
- Detecting fraudulent conduct at żinga Fashions by establishing and rolling out a whistleblower's hotline – which will use my cell phone number, and which I am willing to man on a 24 hours a day basis. I will investigate all reported frauds, and present the findings to the CEO / CFO.

But, of course, the exact nature of my work can only be finalised following discussions with your company's executives, and once I have a better understanding of the needs of żinga Fashions.

Cheers
Bill

Email attachment

WhatsApp messages from Bill Marx to Harry Mnisi



DOCUMENT G

EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT

From:	Harry Mnisi
Sent:	Wednesday, 16 November 2016, 06:05 AM
To:	Financial accountant
CC:	
Subject:	Inventory obsolescence allowance

Hi there

I mentioned last week that I needed you to help with the preparations for the discussions with the external auditors regarding the reasonability of the obsolescence allowance for inventories. Belinda Jantjies was responsible for calculating the obsolescence allowance amount – see attached for her notes and the workings that she sent me.

Please could you review Belinda's notes and think about what additional reports we should ask Barbara Byte to extract to help us assess the reasonability of the obsolescence allowance. Also, let me know what questions we should ask Belinda when we meet with her to discuss the obsolescence allowance workings – bearing in mind that you and I will have to justify the approach and workings to the external auditors.

Thanks in advance.

Regards
Harry

Email attachment

Notes made by Belinda Jantjies on some of the inventory obsolescence allowance amounts

1 I computed the inventory obsolescence allowance at 30 September 2016, which amounts to R7 850 769, as follows:

1.1 For żinga Stores: The allowance was determined as 25% of the cost of all inventory held for longer than six months. This was based on the inventory balance in the '180 days or more' column in the inventory age analysis at 30 September 2016.

1.2 For H&S Stores: A report was generated from the inventory management system listing all instances where items were sold below cost in October 2016. The difference between the total of the selling prices and cost prices per this report amounted to R340 456, and this was used as the amount for the inventory obsolescence allowance.

I am satisfied as to the clerical accuracy of these workings.

2 żinga Fashions uses a 'state of the art' inventory management system that incorporates strong programmed controls and contains all data pertaining to the company's inventory and all transactions relating to inventory. As such, the system is capable of generating a wide variety of inventory-related reports.

3 Barbara Byte, our Chief Information Officer, has indicated her willingness to assist you to extract those reports that you deem necessary for your investigation. Please provide her with a detailed description of the reports that you require and she will extract these for you. Be clear on exactly what you require, otherwise you may end up with meaningless information!

4 The following reports have already been extracted:

4.1 Details of inventory balances at 30 September 2016 and at 30 September 2015; and

4.2 The inventory age analysis at 30 September 2016 and at 30 September 2015 for each division.

5 Other relevant operations-related information:

5.1 Different sizes of a particular clothing item do not sell equally well – i.e. even though a particular clothing item may sell very well, a retail outlet can be left with a large number of very large or very small sizes of the item.

5.2 For each size of a particular item of clothing, a unique stock-keeping unit (SKU) code is maintained on the inventory management system. For each SKU code, full particulars of the inventory, including its unit cost, the quantities on hand at each store, and the season for which it has been purchased (e.g. summer 2017 or season neutral) are recorded.

5.3 żinga Stores is well known for its 'end of season' sales, where all stock for the past season is marked down by amounts ranging from 25% to 75%.

DOCUMENT H

EMAIL FROM HARRY MNISI TO REFILWE MAPOE

From:	Harry Mnisi
Sent:	Wednesday,16 November 2016, 06:15 AM
To:	Refilwe Mapoe
CC:	Financial Accountant
Subject:	Tweets

Hi Refilwe

My daughter referred me to some tweets made by Gavin Marx on Twitter recently. I logged onto Twitter and can confirm the following posts were made by Gavin. They are still on Twitter:

> So bored in the board meeting, blah blah … only interesting thing is the talk of our possible JSE listing and maybe an acquisition before then
> - Gavin Marx (@Gavżinga) November 7, 2016
>
> You know you live a boring life if you aren't nervous about others looking at pictures on your phone – I just have photos of models wearing żinga clothes lol
> - Gavin Marx (@Gavżinga) November 12, 2016
>
> #FeesMustFall getting boring. It's amazing how often these protests start just before university exams
> - Gavin Marx (@Gavżinga) November 14, 2016

Refilwe, I am not sure these tweets are appropriate? What should we do as a company?

Regards
Harry

PS: I have copied our Financial Accountant on this email as I think the younger generation may provide some different insights into social media.

DOCUMENT I

EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT

From:	Harry Mnisi
Sent:	Wednesday, 16 November 2016, 07:35 AM
To:	Financial Accountant
CC:	
Subject:	Revenue ratios

Hi

I need to calculate relevant revenue ratios for FY2016, together with comparatives, and discuss these at our Board meeting later this month. The context is that our directors want to review our historical revenue growth and evaluate where our growth has come from and what strategies to follow to address any issues.

You would have seen the revenue breakdown per year in which stores were opened in the PowerPoint presentation to First Regional Investment Bank – see particularly slide 12. I have attached some additional information that I have extracted from our management information system, which may be useful in calculating relevant revenue ratios. Assume that the attached information is accurate – our management information system provides detailed and valid data!

Please prepare a memorandum on my behalf that I can distribute to the Board. The Board prefers concise memorandums that summarise the key issues. The memorandum should deal with the most relevant revenue ratios together with commentary on these numbers.

Bear in mind that we did not close or renovate any stores in FY2016 and FY2015. Also, we did not open any new stores in FY2013.

Regards
Harry

Email attachment

Revenue information extracted from our management information system

	FY2014	FY2015	FY2016
Number of stores open at the start of the year	70	74	86
Unit sales	**’000**	**’000**	**’000**
Stores opened pre FY2014	3 958,6	3 998,2	4 018,2
Stores opened in FY2014	106,6	214,3	212,1
Stores opened pre FY2015	4 065,2	4 212,5	4 230,3
Stores opened in FY2015		327,5	641,9
Stores opened pre FY2016	4 065,2	4 540,0	4 872,2
Stores opened during FY2016			128,9
Total unit sales for the year	4 065,2	4 540,0	5 001,1
Average sales price per unit	**R**	**R**	**R**
Stores opened pre FY2014	145,25	154,69	165,68
Stores opened in FY2014	144,47	153,86	164,78
Stores opened in FY2015		154,00	164,93
Stores opened during FY2016			164,09
	%	**%**	**%**
Overall annual change in average unit selling prices	5,5	6,5	7,0
Average revenue per store	**R million**	**R million**	**R million**
Stores opened pre FY2014	8,2	8,8	9,5
Stores opened in FY2014	7,7	8,2	8,7
Stores opened in FY2015		8,4	8,8
Stores opened during FY2016			7,1
Increase in revenue			
Stores opened pre FY2014		43,5	47,2
Stores opened in FY2014		17,6	2,0
Stores opened in FY2015		50,4	55,5
Stores opened during FY2016			21,1
Total increase in revenue for the year		111,5	125,8

DOCUMENT J

EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT

From:	Harry Mnisi
Sent:	Wednesday, 16 November 2016, 07:45 AM
To:	Financial Accountant
CC:	
Subject:	Growth strategies

Hi

With regard to that presentation to First Regional Investment Bank which I forwarded to you last week, please go to section 9 (slide 17). I know that I am going to be asked by the other directors which of the growth opportunities we should prioritise. All those initiatives and opportunities look good but we have to focus on those that will deliver the most long-term value to our shareholders and focus on them first.

Please prepare a brief memorandum (for my attention only at this point in time). In it, rank the seven growth opportunities per the First Regional presentation from 1 (highest priority) to 7 (lowest priority), together with your reasons for your assessment.

We also need to be cognisant of the major trends in consumer behaviour and retailing. What are two of the major trends (apart from those implicit in the seven growth strategies above) that żinga needs to be aware of and adapt to? Please include some brief notes in the memorandum on this aspect.

The document does not have to be too formal – feel free to use bullet points to explain your rationale.

Thanks
Harry

DOCUMENT K

EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT

From:	Harry Mnisi
Sent:	Wednesday, 16 November 2016, 07:59 AM
To:	Financial Accountant
CC:	
Subject:	Cost of sales

Hi again

You will recall our earlier discussion where I mentioned to you that Sally and I are wondering whether our GP% is actually comparable to that of the listed groups, because they might be including certain income and expenses in different line items. I re-read IAS 2 yesterday and I am not sure that I agree with all of the principles from a management decision making and control perspective.

I have three specific issues:

(a) **Storage costs –** IAS 2 states that we should exclude these from the cost of inventories. That makes no sense from a management decision making and control perspective. Our business is seasonal and we need to order and store large quantities of products every couple of months. The cost of storage is inextricably linked to the cost of merchandise – to include these costs in other operating costs would not be reflecting the true cost of our merchandise.

(b) **Inventory write-offs** – IAS 2 requires us to include the obsolescence allowance, inventory write-offs and shrinkage in the cost of inventories expensed. To my mind, inventory write-offs are the result of poor planning by the fashion buyers. So why should sales be punished for higher inventory costs when the fashion buyers made the mistake? I would prefer to reflect inventory write-offs as a separate line item in other operating costs in our monthly management accounts. Also, inventory write-offs are so easy to manipulate from year to year – we can vary our procedures for identifying slow moving inventory and achieve a different GP%.

(c) **Royalties** – IAS 2 states that royalties paid to our foreign suppliers (we have numerous licencing agreements with foreign brands) be included in the cost of inventories. Royalties are paid when we sell products and not when we order and store merchandise. If we do not sell the merchandise, we do not pay royalties. I think we should reflect royalties paid as a selling expense in our management accounts.

I would like your thoughts on where żinga should reflect the above costs in our monthly management accounts. Obviously we will need to comply with IFRS for our financial reporting purposes but we do not have to manage our business using illogical principles.

Please could you double check that I have interpreted IAS 2 correctly for the above three items.

Thanks once again! I'm sure things will get quieter as soon as the audit is done.

Regards
Harry