

Examiners Comments

Assessment of Professional Competence

November 2019

OBJECTIVES OF THIS REPORT

This report has been compiled from the analysis of examiners on candidates' performance in the Assessment of Professional Competence (APC), which is Part II of the Qualifying Examination and which was written in November 2019. Its objectives are to –

- assist unsuccessful candidates in identifying those areas in which they need to improve their knowledge and/or presentation; and
- assist future exam candidates, by providing a commentary for them to use when working through this paper.

To accomplish these objectives, the report provides specific comments on each section of the case study required.

The APC consists of a single integrated case study which is based on a comprehensive real-life scenario and is multi-disciplinary in nature, in that it covers multiple competency areas.

The case study is assessed within the context of a certain baseline of technical competence (as developed through the academic programme and as assessed in both the academic programme and the ITC). The case study will also be assessed within the context of any industry, including those that are specifically excluded from ITC.

The remainder of this report is discussed under the following headings:

- Background and acknowledgement on the setting of APC November 2019
- Statistics and detailed comments by section/required

More detailed statistics can be found on the SAICA website at www.saica.co.za.

BACKGROUND AND ACKNOWLEDGEMENT ON THE SETTING OF APC NOVEMBER 2019

The Examinations Committee (Examco) constantly strives to improve its ability to determine whether candidates demonstrate a level of professional competence at entry into the CA(SA) profession. This is done by means of an ongoing process of evaluation and improvement of the way in which it commissions an appropriate case study for the assessment and decides on the evaluation of competence.

Source of the questions

Examco is a sub-committee of the SAICA Initial Professional Development Committee (IPD Committee), and takes overall responsibility for the setting of the case study.

The APC Examco decides on the industry, scenario and topics to be examined and also commissions a separate setting team, who are specialists in their respective competency area(s) and who have a good understanding of the other competency areas, to draft an appropriate case study and solution for the assessment.

The team consists of academics and members of the profession in public practice and / or in commerce and industry. Case studies are commissioned from any person the APC Examco deems to have the relevant experience and competence to do so.

In this regard, the following applies:

- Members in practice who are requested to set case studies by the APC Examco may not be involved in any way in preparing candidates for the APC (this includes formal courses and lectures and training programmes and support programmes put in place to prepare students for the APC but excludes members who perform the normal role of a supervisor, manager or partner on a client); and
- Individuals who are in any way involved in preparing students for the professional programme (this includes formal courses and lectures and training programmes and support programmes put in place to prepare students for the APC but excludes members who perform the normal role of a supervisor, manager or partner on a client) are PROHIBITED from preparing or reviewing any aspect of the case study.

Academics, former academics and/or members of the profession in public practice and/or in commerce and industry are also selected by Examco each year to assist in the external review of the case study. These external reviewers are selected based on their experience and ability.

Anyone involved in the professional programmes may not be engaged by SAICA to perform the role of external reviewer.

The involvement of such individuals as external reviewers in the assessment setting and review process is crucial for achieving the quality objective of the assessment.

Where appropriate and where possible, external reviewers are appointed for a period of at least three years as continuity is important.

The external reviewers have the following tasks:

- Review of the case study for conceptual problems and consistency in the use of terminology;
- Indicate whether the relevant case study is set at an appropriate level;
- Comment on whether the level of competence in accounting and external reporting (underpinned by the pervasive skills) is set at an appropriate level;
- Comment on whether a minimum level of competence in the remaining five specific technical competence areas and communication skills is set at an appropriate level;
- Comment on the provisional mark grid;
- Comment on whether the time limit is appropriate (assessment can reasonably be completed within a six-hour period, including reading time); and
- Comment as to whether the principles of assessment have been met.

In addition, the quality and appropriateness of the case study are monitored by at least two external sitters, who attempt each APC case study. These external sitters are required to provide the APC Examco with a formal, independent report in which they comment on the overall case study and suggested solution.

SAICA would like to acknowledge and thank all the people involved in the setting process.

An alphabetical list of all the people involved in various roles, including members of the Examinations Committee, setting team, reviewers and external examination sitters, is as follows:

Christo Landman
Ferdinand Mokete
Frans Prinsloo
Greg Beech
Gregory Plant
Janine Claassens
Keshni Kuni
Lauren van der Byl
Mandi Olivier
Marielienne Janeke

Mpumi Monageng
Nico van der Merwe
Nomonde Holomisa
Paolo Giuricich
Richard Champion
Sphiwe Stemela
Terry Moore
Tumeka Matshoba-Ramuedzisi
Zanele Mncwango
Zuleka Jasper

COMMENTARY ON CANDIDATES' PERFORMANCE IN THE APC 2019

The 2019 case study was based on a hypothetical private company namely; Oikos Property Group (Proprietary) Limited (Oikos). The feedback from various stakeholders in the process was positive. They thought the selection of the retail property industry to be topical and relatable to candidates. The Professional Programme Providers (PPPs) in particular were pleased with the multi-disciplinary integration within tasks and the single role that candidates had to adopt. There was a suggestion that the auditing of goodwill was not strongly triggered. With hindsight, the candidates should have identified the impairment trigger in the pre-release and at least prepared for an accounting type task.

It is important to note that being assessed as borderline competent (BC) in a task reflects that a candidate may have attempted the task but not quite at the level expected of an entry level CA(SA). Hence BC in a task is neither competent (C) nor limited competence (LC).

Task (h) proved to be the easiest task in the case study with the lowest LC count in the assessment. It was disappointing to note the candidates performance in the auditing tasks namely; tasks (a) and (b). Candidates generally coped well with the financial accounting tasks in (c) and (e). Part of task (e) was strongly triggered and the information on the day did not change the accounting for the tranche B shares.

Task (f) was surprisingly difficult for candidates. This task required candidates to 'think on their feet', which a significant number could not demonstrate on the day. Candidates performance in task (d) was equally concerning. There appears to be trend in that candidates could perform well in technical tasks such as the financial accounting tasks. Tasks which tested pervasive skills such as critical thinking, problem solving, and effective communication proved to be more challenging for candidates.

The senior markers again noticed a decline in the quality of responses to the 2019 APC in comparison to prior years. In particular, the following were a concern:

- Many candidates were 'writing' far too much in response to the tasks. One candidate typed over 60 pages in Microsoft Word and Excel! In real life, your immediate boss may cease reading an email response after two or three pages;
- We noticed an increasing incidence of ITC type responses particularly in tasks. Dumping theory and providing too much technical detail would not be an appropriate response in practice; and
- We noticed a decline in communication skills displayed. Many candidates were unable to express themselves clearly and articulately in writing. Spelling was also problematic.

The section below contains a summary of candidates' general performance for each part of the case study. These should be read in conjunction with the published examples of actual candidate attempts per task, based on mark team assessments of LC, C and 'highly competent' (HC) attempts.

Task (a)

Competence area	APC 2019 candidate results		
	Not competent	Borderline	Competent
Audit	24,4%	58,8%	16,8%

Pre-released information: Document C (point 3)

Information on the day: Document 1

Task: Respond to Henry Higgins's email requests regarding the assessment of the risk of material misstatement in the 'investment property' account balance.

In the pre-release information, there was an email with subject "Audit preparation" (Page 14) from Gideon Madima where he indicated in point #3, that the finance team will be expected to prepare files of evidence to support the amounts and disclosures in the 2019 annual financial statements. The external audit manager advised them to use the 'risk of material misstatement' as a point of departure for preparing these files. Indicating the internal auditors are currently undertaking the risk assessment exercise, once completed will be forwarded for review and input.

The trigger was therefore strong in terms of understanding how to assess the risk of material misstatement (RoMM) for amounts and disclosures and in addition the account balances were provided in the 2019 annual financial statements. Candidates should have revisited *ISA 315 – Identifying and assessing the risks of material misstatement through understanding the entity and its environment* in their preparation for the 2019 APC.

On the day the candidates were given the assessment done by the internal auditors on Investment Property and candidates were required to indicate if they agree with the assessment, revise the assessment if not in agreement, with detailed explanation on how conclusion(s) were reached.

Information provided on the day of the APC revealed that Oikos purchased a new shopping centre during FY2019 and the costs relating to this may have been capitalized incorrectly.

ISA 315 is explicit in that the auditor shall identify and assess the RoMM at the assertion level for classes of transactions, account balances, and disclosures, (Ref: Para. A109–A113 in the standard). ISA 315 further provides the assertions and definitions for each assertion that should be considered to assess for account balances and disclosures for assets (A), liabilities (L) and equity interest (E):

- **Existence** – A, L and E exist
- **Rights & Obligations** – the entity holds or controls the rights to the A and L are obligations of the entity
- **Completeness** – All A, L and E that should have been recorded
- **Accuracy, Valuation and Allocation** – A, L, E interests have been included in FS at appropriate amounts and resulting valuation or allocation adjustment appropriately recorded
- **Classification** – A, L and E have been recorded in proper accounts
- **Presentation** – A, L and E are appropriately aggregated or disaggregated and clearly described

ISA 315 further indicate that the RoMM for each assertion be rated High, Medium or Low. Candidates were therefore expected to reassess the risk of material misstatement at assertion level for investment property, and to conclude whether the overall RoMM for investment property is appropriate or not.

In context of Oikos the following was considered appropriate in terms of assessing the assertions for investment property:

- **Existence** – Oikos earns rental income from these properties, the size of properties are large and hence, it may be difficult to manipulate or overstate. In addition, it should be relatively easy to verify the existence of properties. The risk that could increase the risk of misstatement for Existence is the fact that a new property was acquired and the existence could be in question which based on the value of new property could have a material impact, hence Low or Medium would be acceptable.

- **Rights** – As Oikos uses interest bearing borrowings to fund the acquisition of properties, it is likely that investment property is held as security for these loans. Oikos’ financial position is strong, hence it is highly unlikely that the rights have been impaired as a result of non-payment. A factor that could increase the risk assessment is the possibility that the rights to the new property acquired had not transferred to Oikos by year end. A risk assessment for this assertion of low or medium would be acceptable
- **Completeness** – Given the magnitude of the amounts relating to investment property, it would be relatively easy to detect the failure to account for the purchase of a shopping centre. Oikos is a private company, well within loan covenant, questioning the incentive to not account or overstate investment property, regardless of the value of the properties. Low would be acceptable
- **Accuracy, Valuation and Allocation** - Given the materiality of investment property, the large increase in the account balance in FY2019, the risk of material misstatement is increased. Oikos in addition, acknowledged that the acquisition costs might not be capitalized, maintenance costs could be capitalized and VAT included with the last acquisition, influencing the accuracy of the balance. The valuation of investment properties is also subjective. The appropriate assessment of the valuation assertion should be high.
- **Classification** - Only properties are used for rental income and will satisfy IAS 40. The sale of Kasuba, could mean that we no longer consolidate Kasuba Investment Property with Oikos. Hence low or medium (if well explained what increases the RoMM) assessment would be acceptable.
- **Presentation** – There is no indication in ‘what we know’ that presentation has a risk of being materially misstated, therefore low assessment for presentation assertion.

A competent candidate would have assessed majority of the assertions for investment property appropriately, including indicating that the valuation assertion assessment is high and give sufficient detailed explanation of why valuation would be high for investment property in Oikos books.

Many candidates agreed with an overall assessment of RoMM for investment properties, which is not appropriate, as not all assertions related to the balance would be considered high.

Candidates often went beyond the scope of what was required in performing the task:

- they made up controls that could lower the risk assessment, which in this task was not considered appropriate because no information was given on the controls that Oikos has in place around the various assertions for investment property;
- they described how to go about getting an understanding of the entity and what analytical procedures to perform, which was not required; and
- some candidates also gave procedures on how to address the risks, which is mitigating your detection risk, which does not form part of RoMM, nor what was required.

Task (b)

Competence area	APC 2019 candidate results		
	Not competent	Borderline	Competent
Audit	23,7%	65,1%	11,2%

Pre-released information: Slide 16 of the PowerPoint presentation

Information on the day: Document

Task: Prepare a memorandum to Henry Higgins regarding the audit of goodwill as requested by Gideon Madima.

The concept of goodwill from an accounting perspective was strongly triggered in the pre-release information. The latter triggers are found in slide 9 (page 10) as well as in Document C point 2, where it was explained that Oikos sold a quarter of its shares in a foreign subsidiary (Kasuba LLC) and that Oikos acted swiftly with the sale but have not had time to consider the accounting implications of the sale. The pre-release information therefore strongly triggered the following from an accounting perspective:

- IFRS 10 *Consolidated Financial Statements*

- IFRS 3 *Business Combinations*
- IAS 21 *The Effects of Changes in Foreign Exchange Rates*
- IAS 36 *Impairment of Assets*

The information on the day presented candidates with the email from Gideon Madima regarding the audit procedures performed by Jill Jackson of internal audit. Gideon requested the Newly Qualified CA (SA) to prepare and send a memorandum to Henry Higgins dealing with the following:

- The continued appropriateness of the audit procedures conducted in 2018 for the 2019 financial audit considering the sale of the shares in Kasuba LLC;
- The additional audit procedures, if any, that should be performed on the 2019 audit; and
- Any other matters that the Newly Qualified CA (SA) think that Gideon Madima and Henry Higgins should be aware of.

The level of difficulty of this task was assessed as moderate due to candidates having to demonstrate the ability to adapt to change on the day and adjust to what seemed to be a task from an accounting perspective per the pre-release information, to an auditing and assurance task on the day. Candidates had to use their pre-research done from an accounting perspective to be able to answer this task competently, as to be able to adequately audit a balance, you need to understand the accounting thereof.

A competent candidate in this task presented the following in his/her response to the task:

- A discussion on the continued appropriateness of the audit procedures conducted in 2018 for the 2019 audit;
- The identification that goodwill needs to be tested for impairment and that the current audit procedures do not deal with this matter;
- Provided additional audit procedures on the impairment of goodwill clearly showcasing that the candidate understands that testing goodwill for impairment would require comparing the carrying amount of the subsidiary including the goodwill to the recoverable amount of the subsidiary, with the latter being the higher of value in use and fair value less cost to sell; and
- Noting any other valid matters such as that the sale of the shares could have resulted in Oikos losing control over Kasuba LLC, questioning the competence of the internal auditors and reliance on the internal auditors work due to them never having tested goodwill for impairment before.

Other issues that candidates could have mentioned which were deemed as being insightful include, but are not limited to, included:

- Identifying the fact that the possible loss of control would result in goodwill being derecognised, hence no impairment would be applicable;
- Questioning the competence/quality of work performed by external auditors due to them never picking up in any prior financial year that goodwill has not been tested for impairment;
- Questioning the materiality (quantitatively and qualitatively) of the goodwill amount in relation to auditing the balance; and
- Considering whether goodwill should have been recognised in the first place (i.e. business versus asset acquisitions, whether all identifiable assets and liabilities were fairly valued on the acquisition date in terms of IFRS 3 and the implication thereof on the calculation of goodwill).

Most candidates were able to competently deal with all aspects of the task except for the additional audit procedures on the impairment of goodwill. Most candidates provided high-level audit procedures such as recalculating the amount and casting managements calculation of impairment, and did not provide procedures to confirm the value in use amount and fair value less cost to sell amount. The latter would have included providing procedures verifying the cashflows, discounts rates, etc. used in calculating the value in use as well as procedures confirming the fair value less cost to sell. As a result, the majority of candidates did not display competence in this task and were either assessed as BC or LC.

Task (c)

Competence area	APC 2019 candidate results		
	Not competent	Borderline	Competent
Accounting and Taxation	19,8%	40,9%	39,3%

Pre-released information: Document C (point 1)

Information on the day: Document 3

Task: Respond to Gideon Madima's email by providing comments and questions regarding the deferred tax calculation prepared by Leonard van Dyk.

In task (c), candidates were required to critically review the deferred tax calculation that was prepared by Leonard van Dyk and to provide comments and questions for his consideration. Candidates were not required to redo the calculations, but to only point Leonard "in the right direction".

There was a strong trigger in the pre-release information to research the potential deferred tax consequences relating to the assets and liabilities of Oikos (which were included in the summarised financial information in the slides). The information on the day then presented candidates with the actual deferred tax calculation prepared by Leonard van Dyk, which included all the assets and liabilities of Oikos as included in the pre-release information. The deferred tax calculation on the day further split investment property into foreign, local rented out and local own use.

The level of difficulty of this task was assessed as moderate due to candidates having to demonstrate the pervasive skill of being able to evaluate information (i.e. being able to work through the deferred tax calculation in a systematic, analytical and critical manner) and to then respond in an appropriate and professional way to Gideon Madima's request. Candidates could, however, use pre-researched deferred tax knowledge to assist in the review of the deferred tax calculation.

A competent candidate in this task provided valid and technically sound comments and/or questions with reasonable coverage of the potential issues in the deferred tax calculation. The potential issues relating to investment properties was considered important, since investment properties represented the largest asset in the statement of financial position of Oikos.

The following were some of the potential issues in the deferred tax calculation which candidates could question or comment on:

- The accuracy of the tax base of investment properties, considering the requirements of section 13quin;
- The classification of the local own use property as owner-occupied or investment property since this will determine the expected manner of recovery of this asset (use or sale) and hence the appropriate tax rate to be used in calculating deferred tax for this item;
- The tax rate of 28% that was used to calculate the deferred tax liability relating to local properties, considering the rebuttable presumption in IAS12.51C and potential CGT consequences;
- The rate of 28% that was used to calculate the deferred tax liability relating to the Zambian property, considering a different corporate tax rate is applicable in Zambia / the potential impact of double tax agreements between South Africa and Zambia;
- The accuracy of the tax base of office equipment, considering the requirements of section 11(e) / Interpretation Note 47;
- The calculation of deferred tax on goodwill, considering that goodwill is exempt from the recognition of deferred tax in terms of IAS12.15(a);
- The correctness of the tax base of zero / deferred tax liability relating to the operating lease assets;
- The possible omission of the allowance for credit losses from the deferred tax calculation relating to trade and other receivables;
- The nature of deposits received (liability vs income received in advance) since this will affect the tax base and resulting deferred tax consequences.

Other insightful questions and/or comments included the following:

- The potential loss of control over the Zambian subsidiary, which might affect the deferred tax calculation;
- The reasonableness of the tax base of investment property considering that section 13quin only applies to the cost of commercial buildings and excludes land and fair value adjustments;
- The rate to be used for the purposes of section 11(j) relating to the allowance for credit losses (25% vs 40%);
- The potential impact of section 23H relating to prepaid expenses possibly included in trade and other receivables;
- The possibility that trade and other payables may include items that create temporary differences, e.g. accounting accruals only deductible when paid in cash.

The majority of candidates displayed a good understanding of the technical aspects encompassed in this task and also managed to raise valid comments and/or questions in an appropriate and professional manner. However, despite this task being strongly triggered, and also considering the vast number of questions and/or comments that could have been raised by candidates, a concerning number of candidates lacked the necessary coverage of valid issues. Candidates also failed to display the necessary application of pre-researched technical knowledge to the case study on the day.

Task (d)

Competence area	APC 2019 candidate results		
	Not competent	Borderline	Competent
MAF	24,4%	43,8%	31,8%

Pre-released information: Document D

Information on the day: Document 4

Task: Respond to Gideon Madima's request for your comments on his Excel workings regarding the forecast revenue and expenses of the Newco 667 property and the estimated return on investment.

Candidates were asked to respond to Gideon's request for comments on the potential acquisition of a property in the Pretoria CBD. They were not asked to perform a valuation of the investment property but to comment on the forecasts presented. Valuation was an important aspect of the potential return on investment since the entry and potential exit values would have a material impact on the IRR. However, it was beyond the scope of the task to dump and discuss valuation theory. The cap rate was strongly triggered, and candidates had the opportunity to pre-research industry cap rates and valuation practices. It was pleasing to note many candidates referring to SAPOA industry research.

The task essentially required candidates to interrogate the forecast rental income, vacancies and property expenses, and also to question the reasonability of the entry and exit property valuations. It also required candidates to identify what was potentially missing from the Excel model such as taxation and working capital. The model included loan advances, interest and loan repayments. Candidates would have been taught at university that the financing elements should be excluded from capital budgeting exercises. However, in practice in the property industry, financing aspects play a critical role in investment decisions. Hence, candidates could argue it both ways.

Yvonne Njeke, the CEO of Oikos was a 50% shareholder in the company that owned the Pretoria property. It follows that she should recuse herself from any decision making re the property acquisition.

Candidates struggled to respond to the subtleties of the task – being respectful of their boss' Excel workings whilst also being of value in the workplace. A competent response to the task should have included a rigorous discussion of the forecasts and also addressing the taxation and entry/exit valuations.

Task (e)

Competence area	APC 2019 candidate results		
	Not competent	Borderline	Competent
Accounting & Taxation	19,6%	43,9%	36,5%

Pre-released information: Document B

Information on the day: Document 5

Task: Respond to Gideon Madima's requests regarding the accounting and tax implications of the business rescue agreement in respect of Ziki's Burgers by means of an email to him.

Candidates were asked to write an email in which they summarise the likely accounting, income tax and VAT implications resulting from the business rescue settlement agreement. They were not asked to provide the deferred tax consequences. In answering this part successfully, candidates needed to demonstrate technical competence in both financial reporting and taxation; and pervasive skills to present findings in an appropriate manner for circulation to the Board. The accounting and tax implications were strongly triggered and candidates had the opportunity to research and prepare the accounting and tax implications in the pre-release period. It was pleasing to note many candidates researched the Edcon transaction.

Information provided in the pre-released information indicated that Ziki owed Oikos R3,38 million in arrears rentals, and that Oikos had raised an allowance for credit losses of R1,07 million together with a tax allowance for doubtful debts of R430 000. There was also an indication in the pre-release that the candidates' accounting and tax expertise would be most helpful.

There was then a clear trigger to research what the accounting and taxation consequences would be for both Ziki and Oikos in relation to the following:

- Swopping the outstanding debt (R3,38 million) for equity in Ziki (Tranche A); and
- A reduction of the 30% rentals in return for further equity (Tranche B).

The pre-released information also included a negative trigger not to consider the application of section 19 of the Income Tax Act, and therefore scoped out the application of the debt benefit provisions. As section 19 is applicable to the debtor (Ziki) it was clear that candidates need only have considered the tax consequences for Oikos.

Tranche A changed on the day and candidates had to respond accordingly. The revised transaction (write-off of 25% and cash receipt of 75%) was not considered a difficult transaction for both accounting and taxation and candidates were expected to be able to deal with this with ease. Candidates had adequate time to research the more difficult Tranche B transaction in the pre-release period.

In answering this part, candidates were required to provide the financial reporting, normal tax and VAT consequences for Oikos for each of the transactions which arose out of the business settlement agreement. The business rescue settlement agreement had two broad components:

1. The 75% cash settlement provided in the Information on the day; and
2. The Tranche B equity settlement for a 30% reduction in lease rentals.

For the purposes of accounting, the transactions that candidates were expected to address in their solutions were as follows:

1. The 75% cash settlement:
 - The cash settlement of the debtor;
 - The bad debts write off for the remaining 25% (either against the provision or through profit or loss); and
 - The reversal of the allowances for credit losses of R1,07 million (or less if the bad debt was written off against the provision).
2. Tranche B equity settlement for a 30% reduction in lease rentals:
 - Equity shares received as a financial asset at fair value;

- Deferred income, subsequently straight-lined through profit or loss; and
- Lease modification for the remaining lease.

For the purposes of normal tax, candidates were expected to consider the following for Oikos in relation to each of the transactions:

- Section 11(i) deduction on the bad debts written off;
- The reversal (add back to taxable income) of the section 11(j) of the tax allowances of R430 000;
- The gross income inclusion on the equity shares received for a 30% reduction in lease rentals; and
- The gross income inclusion on the remaining 70% rentals to be received.

For the purposes of VAT, candidates were expected to consider the following for Oikos in relation to each of the transactions:

- Section 22(1) input tax adjustment of the bad debts written off;
- The output tax consequences in terms of section 7(1)(a) on the equity shares received for a 30% reduction in lease rentals; and
- The output tax consequences in terms of section 7(1)(a) on the remaining 70% rentals to be received.

Most candidates displayed borderline competence in part (e). This was largely due to the integrated nature of this task and an inability to competently address the financial reporting, normal tax and VAT consequences for the various transactions.

While most candidates demonstrated competence in the financial reporting components of the task, the mark team noticed that many candidates displayed very limited technical competence and understanding in applying normal tax and VAT principles. Often candidate's solutions relating to this element of the task was incoherent with legislation being interpreted and applied incorrectly. Many candidates also failed to correctly assess the normal tax and VAT consequences on the receipt of the equity shares as part of Tranche B, despite this being strongly triggered. Often candidates only addressed the normal tax consequences in terms of the Eighth Schedule to the Income Tax Act on the subsequent sale and did not address the gross income considerations on receipt of the shares.

Some candidates simply provided journal entries for the financial reporting with no explanations. This would be inappropriate to assist in preparing the memo for circulation to the Board.

Task (f)

Competence area	APC 2019 candidate results		
	Not competent	Borderline	Competent
MAF	43,3%	35,1%	21.6%

Pre-released information: Document B
Information on the day: Document 6
Task: Respond to Yvonne Njeke's email regarding the Ziki matter.

In the pre-release information, candidates were alerted to Ziki, one of Oikos' top 10 tenants, occupying 3.4% of the Oikos gross lettable area (GLA). The following is an extract from the email in which the candidates make their first acquaintance with Ziki:

'Ziki is a fast food chain listed on the Johannesburg Stock exchange that is currently in business rescue. They are really giving us headaches, but we can't just ditch them. They are very important in the tenant mix of all the shopping malls as they bring footfall. It would also be difficult to replace them.'

The information on the day then informs candidates that the meeting of the Ziki creditors has already taken place. An amended version of the business rescue plan has been approved by the creditors of Ziki which will see Oikos receiving a

cash dividend of 75 cents in the rand for the outstanding lease receivables and a 12% equity-stake for reducing the rentals to be charged to Ziki for the next three years. The task involves candidates identifying the key factors which should have been considered prior to voting on the business practitioner's proposal.

Candidates had been triggered to consider the accounting and tax implications of the original business rescue practitioner proposal, and had been sensitized to the Ziki saga. Task F required candidates to display the ability to "think on their feet" in coming up with relevant factors. As indicated above, these factors should have been key factors, implying that candidates should have identified key strategy, risk management and financial management factors. Candidates would have convinced the assessors of their competence on this task by identifying an adequate number of key factors. Sadly, as indicated by the statistics provided above, only 21.6% of all responses were considered competent. The main reason for this disappointing result is that candidates did not provide an adequate list of factors. The focus of the task was to identify factors "in the now" and not factors which in future might be relevant. In this regard, for instance, the tax implications resulting immediately from the acceptance of the proposal and not the future CGT liability, are relevant.

Many candidates only regurgitated the details included in the extract from the pre-release information included above, without adding much further. This is clearly a limited response. A competent candidate would have however addressed a number of the following issues:

- Questions what the root cause(s) of Ziki's financial distress are.
- Suggests reviewing the business rescue plan prepared by the business practitioner – does the plan address the issue(s) identified in bullet one above? Hence, what is the likelihood of the business rescue being successful? What is the track record of the business rescue practitioner?
- Do any other proposals exist other than that of the business practitioner and what do such proposals entail?
- As Ziki brings footfall to the Oikos shopping centres, the closure of Ziki would result in a loss of footfall negatively affecting the business of the remaining tenants and ultimately the profitability of Oikos.
- Accepting the proposal to reduce the future rental in exchange for an equity stake could set a dangerous precedent amongst the other Oikos tenants.
- Questions whether Oikos or an independent third-party has valued the 12%-equity stake? Depending on the performance of Ziki going forward, these shares could either increase or decrease in value.
- Questions whether the valuation of the shares has been discounted given the trading restrictions which exist in respect of the shares being received?
- Has the tax liability resulting from the inclusion in the gross income of Oikos of the fair value of the shares being received been considered? This would result in a significant cash outflow for Oikos.
- Preventing job losses in the prevailing economic environment would impact positively on Oikos' social responsibility.

Task (g)

Competence area	APC 2019 candidate results		
	Not competent	Borderline	Competent
Strategy, Risk Management & Governance	24,5%	49,2%	26,3%

Pre-released information: Document A, slide 10 of the PowerPoint presentation

Information on the day: Document 7

Task: Respond to Gideon Madima's email regarding the key risks facing Oikos.

Amongst the slide presentation provided in the *pre-release information*, is slide 10, containing five key business risks. In the *information on the day* in an email, Gideon Madima questions whether the five risks in the said slide are in fact the main risks which Oikos are exposed to. Candidates were required to respond to this email by formulating (implying identifying) the top seven risks which Oikos are exposed to, and to briefly explain each of these risks and the potential impact(s) thereof on Oikos. Gideon's email also states that should the candidate feel the need to replace any of the five risks contained in the PowerPoint presentation, they should feel free to do so.

The desired response should have included an explanation as to why the candidate had elected to leave certain of the risks listed in the PowerPoint presentation. What would a top/main risk entail? In the main, such a risk would be a risk which if it were to materialize, could jeopardise the continued existence (sustainability) of Oikos. The following risks would typically be considered to be top risks, *amongst others*:

- Increasing vacancies – the root cause being the challenging macro-economic environment which has resulted in declining consumer spending.
- Rising interest rates – the possible rating downgrade may trigger an increase in both the repo and prime base-rates. As Oikos has floating rate debt, this would result in an increase in the cost of Oikos' funding. The availability of debt funding going forward could also be negatively impacted by a rating downgrade.
- Refinancing of the existing debt facilities – Oikos has bullet repayments at the end of the five-year term of the loans used to acquire properties. If Oikos is unable to refinance the bullet amounts, then the company would be exposed to significant liquidity issues.
- Location of the Oikos shopping centres – these areas are often hotspots during social unrest. There is a risk of physical damage to Oikos property and disruption to the business operations of the Oikos tenants due to service delivery protests.
- Service delivery constraints – the Oikos shopping centres may be dependent on local municipalities for the supply of both water and electricity. A stable supply of these utilities is currently a challenge in some parts of South Africa. Loadshedding is a further related issue, posing a challenge for the Oikos shopping centres.
- Utility costs increasing at rates in excess of inflation – Oikos would typically recover most of these costs from its tenants. The significant escalation in these costs would make it increasingly difficult for Oikos to recover these costs from its tenants resulting in declining profitability.
- Oversupply of retail property space – in some areas, an oversupply of retail space exists. This, coupled with the macro-economic environment, would create huge challenges from an Oikos perspective regarding the retention of the existing tenant base as well as the attraction of new tenants. The filling of vacancies and the lease payment negotiations taking place prior to the renewal of a lease agreement, could significantly impact on Oikos' profitability and sustainability.
- Should the South African government go ahead with its intention to expropriate land and in cases do so without compensation, this would result in a significant destruction of value for Oikos and the wider property industry.

What might at face value have appeared to be an easy task, turned out to be quite the opposite during the marking process. As noted above, a little more than one quarter of all responses were considered to not be competent. The main reason for this being that candidates identified *operating risks* rather than *major risks that could threaten the sustainability of Oikos*. Three of the risks provided in the PowerPoint slide were operational in nature and hence within the control of Oikos's management. Many responses included the increasing vacancy rates and rising interest rates with in many cases only

one additional valid risk being provided. These responses were typically at best, assessed as being borderline competent. Candidates providing only two valid risks were deemed limited competent in this task.

Finally, the task required that the impact(s) of the risks identified, be provided. A number of candidates for some reason, decided instead to supply risk mitigants/risk responses. These candidates did not respond to the task appropriately, and as such, not matter how valid the risks they identified, were, these candidates could not be competent in the task as their responses were inadequate.

Task (h)

Competence area	APC 2019 candidate results		
	Not competent	Borderline	Competent
Strategy, Risk Management & Governance	12,7%	43,6%	43,7%

Pre-released information: Document A and slide 12 of the PowerPoint presentation
Information on the day: Document 8
Task: Respond to Gideon Madima’s email request by evaluating the proposed addition to the risk register relating to the roll-out of the free wi-fi:

- Critically comment on the identified risks and responses; and
- Identify any other risks relating to the roll-out of free wi-fi and appropriate responses needed to mitigate these risks.

Candidates were asked to respond to Gideon’s email request by evaluating the proposed addition to the risk register relating to the roll-out of the free wi-fi. The introduction of free wi-fi project in all Oikos-owned shopping centers by June 2020 was strongly triggered and candidates had the opportunity to pre-research and prepare the key matters that will need to be addressed to ensure that the free wi-fi project is a success.

The information on the day presented candidates with the email from Gideon Madima (document 7 in the information on the day). In this email the need to update the risk register, including the two below identified risks and responses relating to the roll-out of the free wi-fi was noted.

- The wi-fi functionality may not be adequate or may be unavailable at times, resulting in unhappy customers and a loss of footfall in our shopping centres - Appoint a reputable company to install the wifi equipment, and test the system at pilot sites before rolling it out to all shopping centres.
- The cost of acquiring and installing the wi-fi facility may exceed the revenue that can be earned from it, causing a direct financial loss to Oikos - Undertake research to determine what revenue can be earned from advertising to customers using the wi-fi network, and from the sale of customer data collected to tenants and other retailers.

In answering this part successfully, candidates needed to critically comment on the identified risks given and also provide response. In addition, candidates need to also provide other risks relating to the roll-out of free wi-fi and appropriate responses. The following comments and responses on the identified risks given would typically be considered but not limited to:

Agreeing to the relevance of the first identified risk and response to the risk:

- Vendor vetting by requesting quotes from different reputable vendors.
- Ongoing maintenance ensuring connectivity and functionality of the wi-fi.
- Consideration of the quality of the hardware to be used.

Agreeing/ disagreeing to the relevance of the second identified risk and response to the risk:

- Considering additional costs that might be incurred with introduction of the free wi-fi.
- Revenue from the introduction of free wi-fi might not be easy to quantify.

- Increase in footfall in Oikos- owned shopping malls as results of the introduction of the free wi-fi.
- Consider the risk of non-compliance in selling customer data.

Other risks relating to the roll-out of free wi-fi and appropriate responses included the following:

- The threat of cyber criminals accessing user data - Oikos would need to protect user data by ensuring there are firewalls to protect unauthorised access.
- Non-Compliance with POPI Act – ensuring compliance by getting consent from customers and also ensuring customers agree to terms and conditions applicable to data sharing.
- Unreliable electricity supplier - investing in generators to ensure that wi-fi access is available during shopping centres times.
- Risk of customers visiting the malls just for wi-f i- restricting user time or data limits to prevent network overload.
- Theft of cables and routers - making sure Oikos has sufficient insurance cover for any incident.

Most candidates were able to competently deal with all aspects of the task by addressing the identified risks, providing other risks and responses relating to the roll-out free wi-fi. For those candidates that displayed borderline competence in task H, this was largely due to the candidate only addressing other risks or only the two identified risks and responses. Candidates who did not do well in this tasks did not respond to the task appropriately, and as such, these candidates could not be competent on the task as their responses were inadequate.

Task (i)

Competence area	APC 2019 candidate results		
	Not competent	Borderline	Competent
Strategy, Risk Management & Governance	25,2%	46,9%	27,9%

Pre-released information: Document E

Information on the day: Document 9

Task: Draft an email to Freeman Njeke in which you explain any concerns you may have about the way the Hope for the Children Trust is funded and/or governed, with reference to the information at your disposal regarding the Trust.

Candidates were required to explain any **funding and governance** concerns regarding the Hope for the Children Trust (HfC) based on information at their disposal i.e. the pre-release information and the information on the day.

In Document E of the pre-release information it was made clear the the HfC Trust has the potential to do great things through the allocation of bursaries to disadvantaged school-going children but that the trust is constrained due its current cashflow situation. It was also made clear that the trust’s cash flow problems stems from the fact that the trust acquired shares in Oikos from the Njeke family Trust which was funded via an interest-bearing loan. The investment in Oikos was acquired with the hope that Oikos would declare dividends annually, but this has not been the case and hence in addition to the loan already taken out for the shares in Oikos, the trustee’s have had to take out additional bank loans to continue fund bursaries.

Hence from **a funding** perspective, the pre-release information therefore strongly indicated how the trust is currently being funded and candidates were expected to recognise that this funding model is not sustainable.

Furthermore, Document E of the pre-release information goes on to raise a number of **governance concerns** which should have been triggers or matters which could have been raised by candidates simply by applying the the pre-lease information, these matters include:

- The fact that the recordkeeping at the HfC Trust is rather poor, which shows poor corporate governance

- The fact that the recordkeeping was done by Freeman Njeke's brother (Rolihlahla), and with Freeman being the Chairperson of Oikos in whom the HfC Trust has shares, there could be a potential conflict of interest
- The fact that Freeman Njeke is both the chairperson of Oikos and the chair of the Board of Trustees of the HfC trust is a further conflict of interest.

The information on the day presented candidates with an email from Freeman Njeke (candidates should have already from the pre-release information pick up that Freeman was the chairperson of Oikos and chair of the board of trustees). In this email it was noted that Freeman is delighted that you as the newly qualified CA (SA) will be joining the board of trustees but that you will not get paid however that he (Freeman) will ensure doors open for you at Oikos. Candidates were expected to realise that this may be a possible intimidation threat to their independence.

In addition, the information on the day also had an attachment which was the minutes of a board of trustee meeting which provided further clarity on the **funding and governance issues** already identified in the pre-release information. The information contained in this attachment, should have caused candidates to raise further additional issues related to funding and governance. These further issues could have included but is not limited to:

- The fact that Mr Jooste is also a trustee, and the principal of the Tip Top High School, and is now pushing for more bursaries to be allocated to his school students. This is therefore a conflict of interest.
- Rolihlahla (Freeman's brother) is being paid R100 000 for allocating bursaries, which may be excessive and is especially questionable given the cash flow constraints of the trust.
- The integrity of the board of trustees is also in question given that they want to appoint Izza & Associates to audit the trust simply because they believe their familiarity with them could lead to a favourable audit report.
- Finally, the HfC trust is considering alternative fund raising opportunities by seeking properties which may be of interest to Oikos and selling at a significant profit to Oikos. While this may have commercial substance, the concern is that this places the concerns of the trust over that of Oikos, and the bigger concern is how is the HfC trust going to fund these properties given their cash flow constraints.

The pre-release information and information provided on the day allowed candidates to analyse and comment on numerous funding and governance concerns. The level of difficulty of this task was assessed as fair as there was not any significant changes on the day. The only changes provided more clarity on the funding and governance concerns which were already triggered in the pre-release information.

A competent candidate in this task presented the following in his/her response to the task:

- A discussion of both funding AND governance concerns. Although the task mentioned "and/or", both the funding and governance concerns were so core to the issues at the trust, and these concerns were evident in both the pre-release and the information on the day.
- Recognising that the main purpose of the trust is to allocate bursaries, and continuing to do this via loans is an unsustainable finance model.
- Identified and explained the possible conflict of interest relating to Freeman, Rolihlahla and Mr Jooste
- Noting any other funding and governance concern arising on the day such as the poor record keeping, the reasonability of paying R100 000 to Rolihlahla, the ethical concern over the expectation of auditors due to their familiarity and the purchasing of properties for resale to Oikos at a profit.

Other issues that candidates could have mentioned which were deemed as being insightful include, but are not limited to, included:

- Questioning how the HfC trust would fund properties given their cash flow constraints.
- Identifying that if the trust did manage to acquire properties, the tax applicable to trusts is very high, so any sale of properties will be taxed at either 40% or a CGT rate of 36%
- Recommending that the trust be registered as a public benefit organisation as this will allow donors to claim S18A tax deductions.
- Suggesting obtaining a copy of the trust deed of HfC and reviewing such.

Most candidates were able to address both the governance concerns of the task as well as the funding concerns, however many responses were too brief or did not explain the issues. From a funding perspective most candidates picked up the cash flow constraints but did not show an understanding that continuing the HfC trust's main operations (which is providing bursaries) via loans is unsustainable. From a governance perspective, most candidates only mentioned the pre-release information which was relevant but not adequate as this was limited to identifying that Freeman and Rolihlala may not be independent but there was a lot more application required of the on the day information. In some cases candidates also dumped King IV which is not completely wrong but needed application to the facts of the scenario. In other cases candidates listed the Companies Act requirements which is not applicable to a trust.