ASSESSMENT OF PROFESSIONAL COMPETENCE

NOVEMBER 2019

EXAMPLES
OF VARIOUS LEVEL OF COMPETENCE
IN EACH OF THE TASKS

HOW TO USE THE EXAMPLES

This report has been compiled from selection of scripts that demonstrated the level of competence in each task, which the examiners felt fairly represent the expectation for the level of competence in each task. It is important to refer to the examiner comments on the APC for 2019 to assist in understanding the task before referring to the specimen examples below. The examples are taken directly from candidate scripts, no effort is made to change anything on the examples, including spelling, grammar and errors.

TASK (a)
Respond to Henry Higgins's email requests regarding the assessment of the risk of material misstatement in the 'investment property' account balance.

Highly competent

From: APC Candidate
To: Henry Higgings
Date: 20 November 2019
Subject: Risk of material misstatement

Dear Henry

I hope this email finds you well

I disagree with the conclusion that the risk of material misstatement for investment property should be assessed as high, as risk of material misstatement for an account balance at assertion level and not all assertions will be high risk of material misstatement. The justification to reach the conclusion is also insufficient and could be one of the reasons why the external auditors will not place reliance on the risk assessment. The risk of material misstatement includes both the inherent risk and the control risk which were not assessed on this assessment.

The process should include both factors that will increase the risk and the mitigating factors before a conclusion is reached on the final assessment of the risk of material misstatement. Please find below my risk assessment for Investment property.

Accuracy, Valuation and Allocation
Factors that will increase the risk of material misstatement:

- The property is measured at fair value, which requires a significant judgement.
- The personnel estimating the fair may not have the appropriate qualifications, thus incorrectly understating/ overstating the fair value amount.
- The capitalisation rate used to value real estate, commercial properties in this case, does not take into account the effect of future changes to the property such as improvements or changes in rentals
- Incorrect rate may be used when translating the property held in Zambia
- The balance represents by far the largest account balance in the 2019 statement of financial position and the measurement is complex considering the factors mentioned above.
- The has been a large increase in the account balance from the prior financial year which is attributable to fair value adjustments, which required estimating the fair of the property at year end (Judgements used)
- Additional costs may have been incorrectly capitalised for the new shopping centre acquired during the year

Assess the risk of material misstatement should be assessed as high

Task (a)

Classification

- The properties that are used for both rental and administrative purposes may be incorrectly Classified, but the value of the property used for administrative purposes are only 2%, hence decrease the risk that it will be a material misstatement
- The majority of the properties held by Oikos are for rental purposes. (Aligned to our strategy and IAS 40) further lowering the risk. Assess the risk of material misstatement as low.

Completeness

As the business model of the entity is not volume driven, holds fixed property. It is unlikely to omit properties, as the properties are large and few and necessary to meet loan covenants, hence unlikely to understate the properties.

The investment property is used in the borrowings from the financial institutions, thus may be susceptible to manipulations to ensure that the loan covenants of the entity are met. Consider the control environment, the process in terms of how acquisitions and disposals are approved.

Assess the risk of material misstatement as low.

Existence

The entity holds fixed property, which cannot be easily stolen. The likelihood of not identifying property that was previously recorded is remote.

Assess the risk of material misstatement as low

CUT OFF (Completeness)

The risk of recognising assets in the incorrect financial period is towards the year end. Only one acquisitions were made during the year.

Assess the risk of material misstatement as low

Overall Conclusion

The assertion that will require significant judgements for estimating the fair of the investment property is valuation, the fair value may be susceptible to manipulations to ensure that the property of the entity is valued high, hence could be reassessed as significant.

Please contact me should you have any more queries regarding the above assessment.

Kind Regards
APC Candidate

Task (a)

Examiners' comments
This candidate displayed an excellent understanding of the task and applying preparation during pre-release period (or basic understanding of RoMM), evident by having addressed exactly what was required without having provided any unnecessary/irrelevant information. He/she approached the risk assessment *at assertion level*, dealt with *relevant assertions*, providing good discussions and an *appropriate conclusion* for each one, including the fact that *valuation* is *assessed as being high.* The response is clearly communicated, providing the necessary guidance as was required to enable internal audit to assess RoMM for the rest of the accounts/disclosures. What elevated this candidate's attempt to highly competent included the fact that: • A correct assessment of all assertions provided, including identifying that some factors that will also *decrease* the risk of material misstatement for the investment property balance, was correctly provided. • There was excellent application to Oikos, omission of any generic discussions normally associated with assertions and the RoMM of each.

Task (a)

Competent
Form: Newly qualified CA Sent: Wednesday 20 November 2019, 14:00 PM To: Henry Higgens CC: Gideon Madima Subject: Assessment of risk of material misstatement in the financial statements Good Afternoon I hope you are well. I am in agreement with your assessment of the risk of material misstatement of the investment property as high or significant. I however disagree with the justification. Please see the risk assessment that I performed below that could be used as a template to base the risk assessments for the rest of the items in the financial statements. When performing an assessment of the risk of material misstatement it can be done on financial statement level or on account assertion level. The risk at financial statement level is the risk that the financial statements as a whole could be misstated, where as on account assertion level we can link the risk to the specific account and assertion that could be misstated. In this case I am only going to look at the risk of material misstatement relating to investment property and therefore assessing risk on account assertion level (I would also suggest that a column is added for response to the risk, if I have time I will send this to you as well?):

Account	**Assertion**	**Risk of material misstatement**	**Justification**
Investment property	Accuracy, Valuation and allocation	High	- The valuation of the investment property is subject to a significant level of estimation. The fair value of the property is estimated based on forecasted rentals, estimated property management fees and growth assumptions which are driven by market evidence. (In terms of IFRS 13 these are level 2 and 3 inputs, which requires judgements as there are little observable inputs from the market) - Furthermore management would be willing to overstate the value as it would mean that they have better ratios to obtain loans and also ensure they meet the loan covenants. (Loan to ration value). - Additionally there is a risk that costs are not capitalised correctly.
	Existence	Low	As Oikos does not have a lot of

			Investment property and the number of properties increases minimally each year, the risk that the properties that are included in the investment property balance does not exist is low as physical verification of the properties would have been done.
	Rights and obligations	Low	Oikos would have received title deeds when the properties are registered in their name. Therefore the risk that the properties that are included in the investment property balance is not rightfully owned by Oikos is low.
	Completeness	Low	Oikos would want to overstate the property balance instead of understanding. The risk that they would exclude properties from the investment property balance is therefore low as they would be at risk to breach the loan covenants if investment property is understated.
	Classification	Medium	- In order for property to be classified as investment property, it has to meet the definition in IAS 40. There is a risk that the investment property is incorrectly classified as investment property and should have been classified in terms of IAS 16 as property plant and equipment.
	Presentation and Disclosure	Low	- The disclosure requirements in terms of IAS 40 is not complex therefore the risk that the disclosure of investment property is misstated is low.

Therefore on an overall account level due to the high risk of misstatement of the valuation assertion I would classify investment property as a significant account.

Let me know if you want to add a column for responses to risk of material misstatement as I suggested above.

Kind regards
CA

Task (a)

Examiners' comments
The candidate was considered competent in this task, because of revising the RoMM assessment for Investment Property *at assertion level* and for each assertion an assessment of RoMM was made, as well as giving detailed explanation of the risks/aspects that contribute to the assessment. Valuation, Rights, Completeness, Classification and Presentation was correctly assessed based on the explanations/reasons/risks described for making such assessment. The reason (explanation) for assessing the RoMM for some of the assertions were not 100% accurate or complete, but was accepted as sufficient. The candidate was incorrect in agreeing with the overall RoMM, as we don't assess the RoMM overall for an account balance, in addition to coming to the same conclusion is incorrect as classifying investment properties as a significant RoMM. Revision of RoMM at assertion level to significant is appropriate and ISA315 gives clear guidance and examples of when this will be the case, but not the overall balance. Also the justification of the original assessment by Oikos is not incorrect, but needed to be incorporated in what assertion that would effect. For example the large balance, would affect the materiality of any misstatement in the accuracy/valuation. The new property could influence rights, accuracy, classification, but ultimately the materiality of such property would determine if it is a material risk of misstatement from a quantitative perspective. Overall, the candidate had done the minimum to still be assessed as competent in the task.

Task (a)

Limited competent
From : Newly qualified CA(SA) Sent : Wednesday, 20 November 2019 To : Henry Higgins CC : Gideon Madima Subject : Re: Assessment of risk of material misstatement in the financial Statements Good day Henry, Hope you are doing well. Please find the attached for response with regards to the assessment of risk of material misstatement for Investment properties. Please do not hesitate to contact me should you have further queries. Kind Regards, Newly Qualified CA(SA) <Attachment> I do agree with your assessment of high with regards to the risk of assessment, However the justification of the assessing the risk of assessment as high is incomplete and not clear. This would be my Justification of assessing the Investment Property risk of material misstatement to be high : 1. The Investment property is measured at fair value, thus there is risk that the fair value of the investment property is measured incorrectly, thus the valuation of the investment property being materially misstated. 2. A new shopping center was acquired in the current year, thus there is risk that the shopping center was capitalised even though the recognition criteria was not met (i.e before the risk and rewards were transferred to Oikos), thus the affecting the occurrence assertion. 3. Also, with regards to the new shopping centre, the cost may be have been incorrectly capitalised or not all the cost which qualifies for capitalisation have been capitalised. 4. The investment balance is material, such that any misstatements in the balance may be material. 5. Two of the loan covenants are dependant on the value of the property. Therefore, there is risk that the Fair value of the Investment property is fraudulently reported in order to make sure that the loan covenants are met and the loans are not recalled before the Maturity date. In conclusion, your risk assessment was good, however the justification was no clear and complete, However in future it will be help to justify the risk by identifying and elaborating as to why it a risk by explaining how it will materially misstates the financial statements.

Task (a)

Examiners' comments
The candidate failed to identify that the risk of material misstatement needs to be addressed at assertion level, and thus failed to address the risk for each assertion relevant to the investment property balance. Our view was that without some appropriate discussion around the risk at assertion level, a candidate could not display competency in this task. Even though the candidate did correctly identify some relevant risk indicators, most of the points are not clearly linked to the *risk of material misstatement at assertion level* and the points are merely discussions of factors from an overall perspective. In addition, there was failure to specifically and adequately address and conclude that *valuation has a high risk of material misstatement* for the balance with appropriate explanation, which was a critical aspect for this task. Overall, the answer provided by the candidate was brief and there was insufficient substance and no assessment of RoMM *at assertion level* to address what was required in this task.

TASK (b)
Prepare a memorandum to Henry Higgins regarding the audit of goodwill as requested by Gideon Madima.

Highly competent

From: Newly Qualified CA(SA)
Sent: Wednesday 20 November 2019
To: Henry Higgins
CC: Gideon Madima
Subject: Audit procedures: Goodwill

Hi Henry

I hope you are well

I am always happy to help out where I can.

Please see attached my memo regarding the audit procedures.

Thank you and kind regards,
Newly Qualified CA(SA)

ATTACHMENT:

To: Henry Higgins
From: Newly Qualified CA(SA)
Date: Wednesday 20 November 2019, 10:06am
RE: Goodwill audit procedures

The prior financial years internal audit work surrounding the goodwill balance has been reviewed by myself, and each procedures is individually deemed to be appropriate audit procedures.

However, it is my belief that these procedures alone do not provide sufficient and appropriate audit evidence for the purposes of auditing the goodwill balance. This is due to the fact that there was a disposal of 20% of the shares of Kasuba LLC in the current financial year, and therefore, IFRS requires the entity to perform an impairment assessment for Kasuba LLC to assess whether the goodwill has been impaired. IFRS further requires an annual impairment assessment on goodwill. There is, therefore, a need for additional procedures to be performed.

I have proposed additional audit procedures as listed below, and have included in brackets explanations for technical IFRS terms:

1. Inspect the share register and share certificates of Kasuba LLC to ensure that we (Oikos) are still the controlling shareholder and therefore can recognise goodwill apply group accounting
2. Inspect the details of the new shareholder agreement. Perform a detailed analysis as to

whether the we (Oikos) still have power over Kasuba. Power is defined as the ability to affect the variable returns of Kasuba. If we have power, exposure to variable returns and the power to affect variable returns, we control Kasuba and may consolidate (i.e. combine financial records in the financial statements) Kasuba and recognise goodwill on our Balance Sheet. However, should the new shareholder agreement mean that a unanimous vote is required on issues that would affect variable returns, we do not possess the power to affect variable returns and therefore do not control Kasuba and cannot consolidate Kasuba.

3. If we do still control Kasuba and are required to continue to consolidate, management will need to perform a valuation on Kasuba in order to determine their recoverable amount (an IFRS term for the value of an investment). The following audit procedures can be performed on the valuation:
   - Inspect the calculation of the recoverable amount and ensure that both the fair value less cost to sell (fair value is the price that would be received to sell an asset or paid to transfer a liability) and the value in use has been calculated as per the requirements of IFRS
   - Inspect the calculation and ensure that the fair value calculated is in line with IFRS 13 by performing the following checks:
     - Agree by inspection that the fair value has been determined in the principal market (the main market for which the product is sold) as per the requirements of IFRS 13, considering that IFRS assume the entities market is in the principal market, unless factors indicate otherwise.
     - Agree by inspection that the fair value has calculated using the same assumptions that a market participant would use, and not assumptions that are tailored to the entity
     - Further consideration: The fair value is easily determinable given that shares have just been sold.
     - Agree by inspection that the fair value calculation is calculated at an exit price during an arms length transaction (a transaction at a fair price) with knowledgeable parties.
     - Agree by inspection that the calculation maximises the use of observable inputs.
     - Cast and cross cast the calculation to ensure accuracy
4. Inspect the accuracy of the costs to sell recognised by comparing them to the costs incurred in selling the 20% of shares
5. Inspect the calculation for the value in use (value in use is the future cash flows anticipated from using the cash generating unit) and perform the following procedures:
     - Inspect the inputs made to the calculation and compare them to historical performance by the entity to ascertain if reasonable.
     - Inspect the inputs used, and flex said inputs to inspect how much variation is possible within each input before an impairment (i.e. before the value in use is less than the net asset value (net asset value is the assets less liabilities of the entity) is noted, this sensitivity check acts as a reasonability check for inputs.
     - Cast and cross cast the calculation to ensure the calculation is arithmetically accurate.
     - Inspect the recoverable amount to ensure it is the higher of the value in use and fair value less costs to sell.
6. Inspect the net asset value. Ensure that the net asset value includes goodwill which has been grossed up. (i.e. Goodwill divided by percentage owned times 100%). This is per the requirement of IFRS as the Non-controlling Interests is measured at their proportionate share of net assets and not at fair value
7. Recalculate the difference between the recoverable amount and the net asset value including

goodwill recalculated under point 6.

8. If an impairment is required:
    - Inspect the journal entry to ensure the impairment journal is correct (i.e. DR Expense Cr Goodwill)
9. Agree by inspection that the impairment recognised is the difference between the recoverable amount and the net asset value included in point 6, multiplied by the percentage of shares held as required by IFRS.
10. Inspect that the remaining impairment (if any) after goodwill is impaired to zero is allocated on a proportionate basis to other assets, and that assets are not and that the impairment is allocated fully to goodwill first.
11. Agree by inspection that the allocation of impairment to other assets does not impair said assets to below zero, or below its fair value less costs to sell or value in use.
12. Agree by inspection that the impairment is not apportioned to inventories, financial assets, non-current assets held for sale, investment property, deferred tax assets, IFRS 15 contract assets, and employee benefit assets as is required by IFRS.

Lastly, in Gideon's email to me I noticed that no one on the internal audit team has any IFRS knowledge.

The King Code relates to good corporate governance. Although it is not mandatory for us to apply the King Code, it is still a good guide on the best practices we should be engaged in. The 4th version of the King Code states that the internal audit function should have the necessary skills and resources to address the complexity and volume facing the entity.

Given the complexity of financial reporting, I feel it is necessary for the internal audit function to understand IFRS. I am happy to make this recommendation, on your behalf, to the CEO and the board should you agree with my sentiment.

This could lead to your team either getting further training or being allowed to hire additional staff who understand IFRS.

Task (b)

Examiners' comments
This response illustrates a higher level of professional competence. The candidate did not just respond to the task appropriately, but also had insightful comments and the additional audit procedures provided were clear and insightful enabling a junior to perform the audit procedures. The candidate further demonstrated a good understanding of the accounting implications underpinning the audit of goodwill impairment (both Kasuba and the required annual impairment requirement, which was not done before). Overall the candidate's response included the following: • 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; • 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 vale less cost to sell; and • Noting other valid matters such as that the sale of the shares could have resulted in Oikos losing control over Kasuba LLC and questioning the competence of the internal audit of Oikos. The following elevated the response to a higher level of competence: • The candidate argued what the impact would be on the audit of goodwill should Oikos have lost control over Kasuba LLC; • The candidate first set the scene by giving a detailed, technically accurate and insightful explanation on the fact that we need to consider whether we still have control, before we can actually determine whether the 2018 procedures are still appropriate; • The additional audit procedures provided were insightful and very detailed not only showcasing a clear understanding of the accounting principles underpinning the audit of goodwill, but also, giving clear guidance on how to audit and what audit evidence would need to be obtained in verifying that the goodwill impairment was appropriately accounted for; and • From the response it is also clear that the candidate was able to fully adapt to the change on the nature and discipline of the task which was triggered in the pre-release. The latter showcases a higher level of professional competence as the candidate was able to use the pre-research triggered in the correct context on the day and not just regurgitate irrelevant pre-research.

Task (b)

Competent
<u>Memorandum to Internal Audit Team(For Internal Use Only)</u> Date: 20/11/2019 Preparer: Candidate Subject: Audit procedures for Goodwill **<u>Background</u>** This memorandum serves to demonstrate the audit procedures to be performed on Goodwill and adress certain other matters such as the auditors reliance on the internal audit as well as IFRS 10 regarding whether we still control Kasuba **<u>Goodwill</u>** <u>Appropriateness of current audit procedures</u> 1. The audit procedure of inspecting the accounting policy note and comparing to IFRS for recognition and measurement is a good starting point. However,we also need assess the disclosure requirements required by IFRS. This would include whether we have disclosed our assumptions used as well as our assessment of our CGU's 2. Procedure 3 makes mention to the fact that we will use the auditors assessment 2010 assessment of goodwill as our current basis. This would be inappropriate as per IAS 36, the recoverable amount of goodwill must be calculated every year and compared to the carrying amount. Therefore, we would need to calculate the recoverable amount in the current year. Moreover, they would definitely be changes in the factors used to compute goodwill from 2010 to now as the macroeconomic and business factors changed since then. The Zambian property has been performing poorly which made us sell a certain portion of our holding. This further evidences the need to calculate a recoverable amount using current market conditions and business factors. 3. Agreeing the exchange rate to the bank and re-performing the exchange rate difference is correct. However, we procedure misses out the fact of whether we compared the exchange rate difference to the general ledger as well as the financial statements. Exchange rate differences for a foreign operation must be recognised in other comprehensive income. Therefore, we must inspect the OCI portion of the financials to determine if the exchange rate difference was disclosed there. 4. A management representation letter is also a good point, however, this cannot be used as our only audit evidence. Other procedures need to be performed. The main issue identified here is that management does not make their own assessment of goodwill. They rely on the auditors 2010 calculation which is inappropriate. I would suggest that management calculate their own recoverable amount of goodwill and then the audit team can perform audit procedures on it. This recoverable amount will include the recoverable amount of the Zambian CGU as goodwill cannot generate cash inflows on its own.

Task (b)

Additional Audit Procedures
-Obtain managements calculation of the recoverable amount of goodwill and cast/cross cast schedule.
-Obtain understanding of the relevant controls management has to the preparation of cash flow forecasts and assessment of goodwill.

-The Fair value less costs of disposal of the Zambian CGU can be tested for reasonability by comparing it to the sales proceeds that Oikos received on their share of the 20% disposal. This sales proceeds would need to be grossed up to get a hundred percent to get the full value of the business.
-We must then inspect the calculation to ensure that the higher of fair value less costs of disposal and the value in use of the CGU.
-Compare the recoverable amount of the CGU to the its carrying amount. If the recoverable amount is lower that the carrying amount, re-calculate the impairment and ensure it is recorded appropriately.
-If there is an impairment the goodwill , we must ensure the that the Non-Controlling interest shares is grossed up before determining the amount of impairment. Moreover, we must also ensure that the impairment first is allocated to all of goodwill and then the remainder to other scoped in assets per IAS 36 on a proportionate basis(Investment property at fair value is scoped-in and no impairment can be allocated to it.

-The recoverable amount calculation will most likely be based on a value in use calculation of the CGU of the Zambian subsidiary.
-Ensure that the schedule includes figures from most recent authorised budgets.
-We must test all assumptions used in the value in use calculation for reasonability by comparing it future market conditions and past performance of the business. Some of the procedures on the assumptions in the value in use calculation are as follows:
-Compare growth rates(eg rental growth rates and property expense growth rates) used in the assumptions and assess against past growth rate. These rates can also be compared to the inflation rate in Zambia as well as the macro-economic factor to ensure they are reasonable.
- We must also assess managements ability to predict cash flows by comparing their past budgets to actual results. This will allow us to determine whether managements future budgets are reasonable and can be relied on.
-Compare the long term growth rate used for the terminal value to the expected Zambian GDP growth rate and property market performance.

-Ensure that only relevant cash flow items are included in the forecast and that the forecast period is sufficient
-Compare the discount rate used in the forecast to the WACC used by other listed entities in Zambia and ensure this WACC is a pre-tax rate.

- Inspect the financial statements to ensure that the assumption used to assess goodwill are disclosed appropriately per IAS 36 and IAS 1.

Other Matters
Internal Audit team- It seems like our internal audit team does not possess the sufficient expertise

to perform their work appropriately as none of the remaining team members have IFRS knowledge. I would advise that we employ members that are competent or train our current employees in IFRS as compliance with IFRS is the crux of accounting.

<u>Suitability of External Auditor</u>
I am aware of certain factors that indicate the our current auditors might not be suitable as they are not performing their work in line with their auditing standards. Some of the issues identified are as follows:
1.They place reliance on the work done by our internal audit team which might contravene the ISA auditing standards. This is because our internal audit team are not knowledgeable about IFRS and do not follow a systematic and disciplined approach to their work(Demonstrated by their somewhat poor risk assessment of investment property.
2. The auditors did not challenge us on our goodwill assessment as it seems like we do not estimate a recoverable amount every year.

It might be wise to change our auditors or bring up these audit quality issues to the auditors.
<u>Potential loss of Control of Kasuba</u>

The new shareholders agreement for Kasuba states that unanimous consent of all shareholders is needed for certain decisions. This might indicate a loss of control of the subsidiary depending on which decisions require unanimous consent. If the relevant decisions of the entity require unanimous consent, this might be joint arrangement as this shared control. We would need to obtain the shareholders agreement and assess further which decisions require unanimous consent and assess this against IFRS 10 to determine if we still have control. I f control is lost we would need to de-consolidate Kasuba and recycle the foreign currency translation reserve to Profit and loss.

Examiners' comments

Overall, this response displays the necessary level of competence required for this task.

This evaluation is based on the fact that the candidate:

- Presented a detailed discussion on the continued appropriateness of the audit procedures conducted in 2018 for the 2019 audit with some good commentary and reasoning;
- The candidate also sufficiently discussed and identified that goodwill needs to be tested for impairment which is implied through the additional audit procedures provided.
- The additional audit procedures provided dealt with the issue at hand and it was clear that the candidate does have an understanding of how impairment testing should be performed which included some high level procedures on both the value in use and fair value less cost to sell amounts and in some instances also mentioned the types of audit evidence required.
- The candidate also identified the internal audit lacks the required knowledge.

The candidate did also display some insightful comments such as questioning the competence of the external auditors and the potential loss of control but did not get down to the impact a loss of control would have on the audit procedures to be performed.

Task (b)

Limited competent
Memorandum, To : Henry Higgins From : Newly Qualified CA(SA) Date : 20 November 2019 Subject : Audit Procedure Goodwill Good day Herry i am glad i could be of assistance regarding the goodwill audit procedure review, it is very important that the entire audit team to be technically equiped as not we have problem as Jason jill was the only auditor who is familiar with IFRS 10 The audit team members needs to be organised training on all matters that are not clear to them as per the request from Gideon i have reviewed the audit procedure perfomed on goodwill and i will like to highlight so notable concerns on them . The memorandum will address the address three issues 1. appropriateness of the audit procedure concluded as at 30 September 2018 2. Additional procedure that should be performed on the 2019 audit 3. any Matters below are key things to note before we go to the audit procedure perfomed 1. Per IFRS 3 Goodwill arises on a business combination when Oikos acquired 80% of shareholding of Kasuba LLC based on Zambia which is a foreign subsidary 2. goodwill is measure as the difference between a) Consideration transfered(i.e purchase price) b) plus an Amount of Non controlling interest c) plus the previosly held equity interest d)Less the Net assets recognised 3. if the difference is a Negative the results will be a bargain purchased recognised in profit and loss and this is not the case as we had postive resuls which is goodwill 4. As Kasuba is a foreign subsidiary it should be accounted for interms of IAS 21 as it has different exchange rate(I.E Zambian kwacha) to the Oikos(Which is rand) 5. Just to note Kasuba is a foreign operation per IAS as it it is based in Zambia and its activies (i.e operation the mall in Lusaka is based there. Now let me deal with the first part which is the appropriateness of the audit procedure concluded as at 30 September 2018

Procedure Number	**Appropriateness of procedure and work done on the findings**

Task (b)

1.	although the procedure and the finding done are appropriate , An additional procedure to be done can include obtaining management representation regarding the none change in the goodwill accounting policy and also valuation of the goodwill thereoff
2.	1 .this procedure is not appropriate as it was not agreed to the schedule for Goodwill workings 2. the disclosure was not agreed to be inline with IFRS 3..
3 3a 3b 3c)	General .- the Goodwill scheduled obtained was not casted and cross casted to verfiy the mathematical accuracy 3a) the procedures is not appropriate as it can it can be further supported by documents such as Purchase agreements and also recalculating the auditors workings 3b) procedure appropriate but the findin not appropriate as there is not audit documents auditor can use. obtain a letter from the bank a stating the applicable rate 3c)Not appropriate as good will needs to be assessed on annual basis for imparement . we need goodwill assessment documents
4.	not appropriate as this needs to be done for the 2019 current financial year as well . overall the conclusion is not appropriate as sufficient audit evidence was not obtained based on the above

2. Additional procedure that should be performed on the 2019 audit
- the sale of 20% shares to Wankumbu require the internal auditor to asses if we still have control of the foreign operation by
a) obtaining the shareholders to derminine if the 60% remain can control the relavant activies of Kasuba as per IFRS 3
- equire from management if an imparement test has bee done on the goodwill and that there is also an indicator of imparement(I,E the shoping center not perfoming well
obtain good will annual imparement asssement documents at it needs to be done yearly
- recalcualte the Recoverment amount is if it is greater than the Carrying amount including the good will
-obtain the zambain translated sport rate as at 30 september 2019 from the bank xyz
-Recalculated the the translated amount of good will into rands

3.Additional things to note
- the wont be any defferred tax implication on the goodwill as deffered tax will reduce the net assets value of the subsidiary which will increase the goodwill figure. this will results in an ongoing process of changes to the about of deffered tax and goodwill

Task (b)

- As the new shareholders agreement state that all shareholders have voting rights in proportion to their ordinary shareholdings with the exception of couple of decisions that require unanomous concent . this effecticly means Oikos still has control over Kasuba and it can still consolidated per IFRS 3
-Per IAS 21 the sale will recongnised as a part disposal so the Oikos will have to re- attrubute the proportionne of cummulative amount of exchage rate differences(I,E FCTR) recongnised in OCI to the non controlling interest of the foreing operation
- It should be note that a partial disposal of an entity in a foreigh operation is an riduction in the entities owner's interst
- when applying ISA 21 P48C and IFRS 10 P 23 Oikos has to do the following
a) calculate the gain and loss on disposal
journal
- debit gain on sale of investment
- Debit investment in Kasuba
-ccredit non controling interest(NCI)
- credit change in ownership

-
b) FCTR upon disposal
- the accumulated FCTR gain/loss will be reclassified against equity at the disposal pecentage of 20%
ie Debit FCTR and credit retained earnings
-
Lastly = as the NCI is measured at propotionalte share the goodwill gain/loss will calculated separatly to the analysis of equity(AOE) as it relates only to the controlling interest. on disposal the shares only 20% of the AOE FCTR which excludes the FCTR realting to the good will , will be transferred to the NCI

Should you have any further question do let me know

kind regards
Newly Qualified CA(SA)

Task (b)

Examiners' comments
Eventhough the candidate displayed a significant amount of spelling errors, this did not influence the assessment of the task. Overall, this response did not display enough to be assessed as competent in this task. The response was not well explained and although the response did include a high level discussion on the elements required, the following resulted in this candidate being assessed as limited competent in this task: • The candidate started off with a technical explanation on how goodwill should be calculated, which was not wrong, but it was a theoretical approach to the task and detracted from the quality of the response. (in other words, irrelevant to the task) • Although the candidate did consider the appropriateness of the 2018 procedures, the justifications and reasons given on the appropriateness of these procedures were not always sound and valid. • The candidate did identify that goodwill needs to be tested for impairment, but the additional procedures provided were high level and the candidate failed to display an understanding of how impairment testing should be performed which should have included some procedures on both the value in use and fair value less cost to sell amounts. • The other matters presented were in most instances irrelevant and did not add any value in auditing the goodwill balance per say, which was the task at hand. • The candidate also presented irrelevant discussions from a technical perspective in terms of the FCTR accounting treatment with a sale of shares etc. It is clear that this was pre-researched, which is not incorrect, however not relevant to the task. This further detracts from the quality of the response. • Overall, even though the irrelevant information (unless contradictory or incorrect) did not influence the assessment for the task, the candidate, regardless of having considered all the elements of the task, the elements were not property addressed as part of the response, resulting in a limited competent assessment.

TASK (c)
Respond to Gideon Madima's email by providing comments and questions regarding the deferred tax calculation prepared by Leonard van Dyk.

Highly competent

From: Newly Qualified CA(SA)
To: Gideon Madima
Sent: Wednesday, 20 November 2019, 11:23am
CC:
Subject: Deferred Tax Calc

Morning Gideon,

I hope you are well.

Thank you for providing the deferred taxation calculation.
Attachment C contains the review of the deferred taxation calculation, including comments and questions on the working and inputs.

As per your email, I have not included casting or mathematical accuracy of the workings.

Please do not hesitate to contact me with any further queries - I am always happy to help.
Have a lovely day further.

Kind Regards,
Newly Qualified CA(SA)

Attachment C

I have reviewed the deferred taxation calculation, and included comments and queries thereon below.

<u>Zambian Investment Property</u>
With respect to the sale of a portion of Kasuba, as Oikos still holds control there over, it is correct in including the total investment property amount.

However, it is to be noted that the rate at which the temporary difference is determined should be at the Zambian taxation rate, and not 28%. It should also be considered if there is a Zambian equivalent of CGT, and whether this will be applicable to the investment property deferred tax rate. This may necessitate an assessment of whether the value is gained through use (more likely) or sale.

Furthermore, the tax allowances do not seem to coincide with the Zambian taxation law. The tax base is 85% of the total value. As such, it is determined that the investment property has only been held for two years (10% allowance in Year One, and 5% allowance in Year Two). However, as Kasuba was purchased in 2010, I am expecting a much lower tax base. Is it possible to determine when the investment property was purchased? This may help regarding whether the allowances are determined correctly.

Investment Property - Land
For the local and foreign investment properties, the value of the land should be split from the building. The difference between the base cost (cost price) attributable thereto, and the tax base (Rnil as no allowances are given on land), will have no deferred taxation. However, the difference between the fair value and base cost will have deferred taxation at the CGT rate of 22.5%. This is applicable as the land value is, essentially, derived when the land is sold.

Investment Property - Local
Due to the fact that the building is leased out to tenants, the property is considered investment property under IAS 40. There is a rebuttable presumption that the investment property value is derived through the sale thereof. However, this presumption may be rebutted.

Consideration must be given to the above, as it will change the rate at which the deferred taxation is calculated. At this point in time, I think it may be correct to rebut the presumption due to the fact that the investment property is held to earn rentals, rather than to sell at a profit.

However, if not rebutted, the difference between the fair value of the property and the base cost will be calculated at the CGT rate of 22.4%.

Local Property - Rented Out and Used as Own Offices
The taxation allowances granted are to be considered. As Section 13quin is only available to new and unused property, it must be determined whether all buildings were purchased directly from the constructer's, or if purchased from another entity. From what I can tell, there is a mix between the both.

Should it not be new and unused, there will be no tax allowances and, as such, a tax base of Rnil. Improvements are, however, deemed new and unused and, as such, there may be a tax base therefor within section 13quin at a reduced rate of 30% of the acquisition price.

I would suggest splitting out the properties individually, as well as further disaggregating the original building from the improvements, in order to correctly determine the future number of years available for the allowance, the rate and section applicable.

Office Property - Local
The determination of the office space is to be considered. Should such property space be within the rented out shopping malls, the office space is to be considered with the investment property itself and treated together therewith above. This is as it is an insignificant portion of the total space. However, should it be a separate building completely, it may be split out per the calculation performed.

Office Equipment
It must be considered as to what the equipment is utilised for, as differing percentages are given per allowance. It is suggested to split the equipment per nature in order to correctly determine the tax base. Moving costs are to be, further, considered desperately if necessary - I am not sure if this has ever occurred?

Task (c)

Goodwill
Goodwill is exempt from deferred tax per IAS 12. 15. Therefore, no deferred taxation should be raised therefor. This should, therefore, be removed from the calculation.

Operating Lease Asset
This is deemed to be correctly calculated.

Trade and Other Receivables
As the rental income has been included within the income statement, as well as taxable income, the tax base and calculation is deemed correctly calculated.
However, there may be differences regarding the allowance for doubtful debt percentage granted as a deduction. SARS allows only a 25% (for the 2019 year) allowance. Thus, the remaining 75% will be a temporary difference within the deferred taxation calculation. This may need to be further investigated to determine whether a deferred taxation difference arises.

Gross debtors and the allowance should, thus, be separated to calculate the deferred taxation.

Cash and Cash Equivalents; Interest-Bearing Loans
As there is no deduction therefore, this is deemed to be correctly calculated.

Deposits Received
Further investigation is required into the deposits received and whether these deposits are refundable or not. Furthermore, if refundable, it should be determined whether the amounts are held within a separate bank account. Per my understanding, the deposits are used against any bad debts which occur. As such, the deposits only become revenue when utilised.

If the deposits are refundable, and held separately, they are not deemed to be gross income per Income Tax Act and, as such, not taxed. Therefore, there is no a difference between the income tax and accounting treatment and, as such, a deferred tax difference will arise.

Should the deposits be non-refundable, or refundable but not held separately, the amounts are included within gross income per income taxation. Therefore, there is a difference between the income tax and accounting treatment and, as such, a deferred tax difference will arise.

Trade Payables
Due to the fact that deductions are allowed when incurred, and, per accounting, expensed when incurred, there is no deferred taxation effect and, thus, the calculation is correct.

Taxation Payable
The taxation payable is not to be taken into account within the deferred taxation calculation. Rather, the movement of deferred taxation and income tax per the statement of profit or loss will be taken into account to determine the tax payable.
Conclusion
As per the above, there are more considerations to be taken into account for the calculation of deferred taxation.

Task (c)

Examiners' comments
The candidate achieves comprehensive coverage of the potential issues in the deferred tax calculation and also displays a sound technical knowledge of deferred tax, as well as the various other accounting and tax aspects encompassed in this task. The candidate also demonstrates the necessary pervasive and critical evaluation skills by including comments and/or questions that are professional, clear and technically correct, with just enough technical detail to point Leonard in the right direction. The candidate's response includes valid comments and/or questions regarding the following aspects: • The Zambian tax rate should be used to calculate deferred tax on the Zambian investment property, and not 28%. Also considers potential CGT implications in Zambia, which may be different from South African CGT implications; • The rebuttable presumption in IAS12.51C and potential CGT implications relating to local investment property; • The accuracy of the tax base of local investment properties, considering the requirements of section 13*quin*; • The accuracy of the tax base of office equipment, considering different write-off periods are used for tax allowances based on the nature of the equipment; • The initial recognition exemption relating to goodwill; • The potential deferred tax implications relating to the allowance for credit losses; • The potential deferred tax implications relating to deposits received. The following elevated the response to highly competent: • Comprehensive coverage of potential issues in the deferred tax calculation; • Consideration of the potential impact of the sale of the Zambian subsidiary (i.e. integrating other aspects of the case study into the response); • Questioning the reasonability of the tax base of the Zambian property through application; • Suggesting that land and buildings should be split in the deferred tax calculation since land will have different deferred tax implications than buildings; • Suggesting that buildings should be further disaggregated between the original building and improvements for the purposes of section 13*quin*.

Task (c)

Competent
From: Newly Qualified CA(SA) Sent: Wednesday 20 November 2018, 12:00 AM To: Gideon Madima Subject: RE: Deferred tax calc Good morning Gideon I hope you are well this morning. Thank you for providing me with the opportunity to have a look at the deferred tax calculation. As you probably know, everyone always dreaded deferred tax at university. Hopefully I will be able to assist Leonard in providing some direction. **<u>I have reviewed the deferred tax calculation Leonard has provided and I have noted the following:</u>** **1. Investment Property:** 1. You have added in note 1 that the tax base is the amount of the remaining capital allowances to be granted under applicable tax legislation. This is not technically correct, the more correct IAS 12 definition of a tax base of an asset is the amount that will be deductible for tax purposes in the future. Therefore it can include the cost of the investment property since the original cost will form the base cost in a capital gains tax calculation. 2. IAS 12 provides the rebuttable presumption that the carrying amount of the investment property is recovered entirely through sale. Therefore, for investment property, the CGT rate should be used for calculating the deferred tax on investment property. (28% x 80% - effective tax rate of 22,4%). It would be more tax beneficial to follow the rebuttable presumption than to be taxed at 28%. 3. The investment property in Zambia will also be subject to Zambian's tax rate and capital gains tax rate and should therefore be kept separate from the 28% South African deferred tax calculation. 4. Are we certain that we are allowed the capital allowance for our local investment property. Section 13*quin* of the Income Tax Act have strict requirements where the property should be new and unused, developed/constructed by Oikos before the 5% allowance per annum can be granted. Further, there are also requirements where only an improvement is purchased or a part. Perhaps you should consider constructing a separate schedule that keeps track of these allowances. 5. For the 2% of the own offices used - the tax base should be the original cost of this property since this will be the cost that can be deducted in future. The cost will form the base cost of the capital gains tax calculation. **2. Office Equipment:** 6. The same as mentioned for investment property. You mentioned in note 1 that the tax base is the amount of the remaining capital allowances to be granted under applicable tax legislation. This is not technically correct, the more correct IAS 12 definition of a tax base of an asset is the amount that will be deductible for tax purposes in the future. Therefore it can include the cost of the office equipment less all the capital allowances already deducted. 7. Are you sure that all the correct write-off periods have been used for the different office equipment. You can refer to Interpretation Note 47 of the Income Tax Act that contains all the write-off periods. (Furniture & fittings - 6 years; office equipment (electronic) - 3 years; office

equipment (mechanical) - 5 years).

3. Goodwill:

8. It is correct in saying that the tax authorities do not grant any capital allowances on goodwill, however, according to IAS 12, the recognition of the resulting deferred tax liability is not permitted because goodwill is measured as a residual and the recognition of the deferred tax liability would increase the carrying amount of the goodwill. Therefore goodwill should not be included in the calculation as it is currently and it should be exempt from the calculation.

4. Operating lease asset:

9. It is correct in not including a tax base for the operating lease asset. Since the rental payment constitutes gross income as it accrues to Oikos in terms of the rental agreement, no excess rental payments included in the carrying amount of the operating lease asset will be taxed in future. It is correct in saying that tax authorities do not straight-line leases.

5. Trade and other receivables:

10. It is correct in including the tax base as the carrying amount of trade and other receivables. There will be no taxable future economic benefits relating to the trade receivables when the cash is physically recovered.
11. Have you considered the account receivable allowance? For the current financial year, the old s 11(j) still applies that allows the 25% deduction of the allowance for doubtful debts. (Remember from the next year of assessment, the new s 11(j) will come into effect that will take IFRS 9 expected credit losses into consideration).
12. There will be a temporary difference between the allowance for doubtful debt that will give rise to deferred tax. The carrying amount will be the accounting allowance for doubtful debt you recognised in the financial statements and the tax base will be the 25% of the accounting allowance for doubtful debts.

6. Cash and cash equivalents:

13. There is no deferred tax on cash and cash equivalents. You can always consider removing this entirely from your calculation.

7. Interest-bearing borrowings:

14. The repayment of the capital portion of the loan does not have tax implications because it is capital in nature. Therefore the treatment of the interest-bearing borrowings is correct.

8. Deposits received:

15. Deposits received can be a bit complicated and perhaps case law should be used to determine the tax base of the deposits received. You can read up on the MP Finance Case where a deposit was included in gross income since the intention was to receive it for its own benefit and the Pyott Case where it was not included in gross income since it was not for the benefit of the taxpayer.
16. Firstly, are the deposits received for the benefit of Oikos (not kept separately) or not for the benefit of Oikos (kept separately)?
    - If the deposits are not kept separately, then it should be included in gross income at the earlier of receipt or accrual. Therefore the amount not deductible in future would be the full amount as it was already taxed in full. Therefore the tax base would be zero and would give rise to a deferred tax asset.

Task (c)

- If the deposits are kept separately, then it would not have been included in gross income and the tax base will be the same as the carrying amount, resulting in no deferred tax consequences.

17. Therefore, the intention should be determined to determine if the deferred tax treatment of the deposits are indeed correct and have not been included in gross income previously.

9. Trade and other payables:

18. Since expenses have already been deducted in the year in which they incurred, there will be no amounts deductible in future. Therefore the treatment of trade and other payables is correct.

10. Taxation payable:

19. There is no deferred tax on taxation payable. You can always consider removing this entirely from your calculation.

Please feel free to add anything that I might have missed, I am sure you have a lot of experience with deferred tax for Oikos already.

Kind Regards
Newly Qualified CA(SA)

Task (c)

Examiners' comments
Overall, this response displays the necessary level of competence required for this task. The candidate achieves good coverage of the potential issues in the deferred tax calculation and also displays sufficient technical knowledge of deferred tax, as well as the various other accounting and tax aspects encompassed in this task. The candidate also demonstrates the necessary pervasive and critical evaluation skills by including comments and/or questions that are clear and mostly correct, without any unnecessary theory. The candidate's response includes valid comments and/or questions regarding the following aspects: • The rebuttable presumption in IAS12.51C and potential CGT implications relating to investment property; • The Zambian tax rate should be used to calculate deferred tax on the Zambian investment property, and not 28%; • The accuracy of the tax base of local investment properties, considering the requirements of section 13*quin*; • The accuracy of the tax base of office equipment, considering different write-off periods per Interpretation Note 47; • The initial recognition exemption relating to goodwill; • The potential deferred tax implications relating to the allowance for credit losses; • The potential deferred tax implications relating to deposits received. Although this was overall a good attempt, there are some technical inaccuracies / concerns, for example: • The candidate states that "It would be more tax beneficial to follow the rebuttable presumption than to be taxed at 28%". This is not necessarily relevant / appropriate since the rebuttable presumption is only used for accounting purposes and will not affect the actual tax consequences of investment properties. • The candidate assumes that there is capital gains tax in Zambia, which is not necessarily the case. • The candidate states that the property should be developed/constructed by Oikos for section 13*quin* to be allowed, which is not necessarily the case. • The candidate's argument relating to the operating lease asset is incorrect. Despite the above technical inaccuracies / concerns, these were outweighed by the sufficient valid comments and/or questions, hence competent for this task.

Task (c)

Limited competent

To: Gideon Madima
From: Newly Qualified CA (SA)
Date: 20 November 2019
Subject: Deferred tax calc

Hi Gideon

Please find the attached with my comments of the deferred tax calc that was performed by Leonard.

Kind regards
Newly Qualified CA(SA)

Attachment

1.Investment Property

- It is a good thing that you have split the Investment property as their tax bases will be different according their respective use.
- You are also correct by saying the tax base is the amount of remaining capital allowances that are granted for tax purposes, however your tax bases are not shown as calculations anywhere. Please add calculations as to how you calculated those amounts.
- For the Investments properties that are rented out please also discuss the recoverability and whether the rebuttable presumption will apply or not. This will be your starting point to determine which rate should be used. i.e is it the CGT rate or 28%
- For the properties that are used as own offices we need to apply IAS 16 as this is a owner occupied property

2.Office Equipment

- Please include calculations , however you correct to say its future tax deductions

3.Goodwill

- You are correct the permanent differences arising from the initial recognition of goodwill are exempt in terms of IAS 12

4.Operating lease asset

- You are correct this adjustment for straight lining is a non cash accounting adjustment therefore this will be taxable when received an no deductions will be applied to these receipts hence the Temporary difference.

5.Trade and other receivables

- The amount of R14 030 is a net , right? please split this amount as the gross and the allowance for credit losses have differing deferred tax consequences.

- For the gross carrying amount the Tax base will be the same as the carrying amount therefore no temporary differences. In your calculation your tax base is the same as the carrying amount , this is correct for the gross amount and not the provisions for credit losses.

- For the provision of credit losses the tax base is the Carrying amount less future deductions.

Task (c)

S11(j) applies a deduction of 25% of the provision for doubtful debts therefore the tax base is 25% of the provision. please fix this.

6.Cash and cash equivalents

- You are correct there are no Temporary differences as the tax base will be equal to the carrying amount. The future use of cash will not result in taxable economic benefits therefore no Temporary differences.

7.Interest Bearing borrowings

- This is correct however you should bear in mind that this needs to be split into the capital loan and the interest as the tax implications are different. Even though the final answer is that there will be no temporary differences please take note of the following explanations that led to the same answer as yours.
- The liability portion is capital therefore no future deductions for capital portion therefore the tax base will be equal to the carrying amount.
- The accrued interest portion - interest will be deductible under s24J under the accrual method during the current tax period therefore there will be no future deductions therefore the tax base will be the same as the carrying amount therefore no temporary differences.

8. Deposits received

- Please include some explanations as to why there is no temporary differences otherwise you are correct the tax base is equal to the carrying amount.

9.Trade and other payable

- Please include some explanations as to why there is no temporary difference otherwise you correct the tax base is equal to the carrying amount

10 . Pre-paid expenses

- You forgot to include this on your calculation , please explain if there is a reason.

I hope this will guide Leonard to be able to correct his mistakes, please let him know that he can contact me anytime if he has some queries.

Kind regards
Newly Qualified CA(SA)

Task (c)

Examiners' comments
Overall, this response does not display the level of competence required for this task. Although the candidate considers all the items included in the deferred tax calculation, the comments and/or questions lack the necessary depth and are mostly superficial without the necessary application and critical evaluation / technical justification. The following aspects are particularly concerning: • The candidate raises the issue of possible CGT on investment properties, but the discussion is vague and lacks substance. • The candidate does not raise any concerns regarding the tax base of local investment properties (i.e. whether section 13*quin* is applicable or not); • The candidate does not raise any concerns regarding the Zambian property; • The candidate concludes that own-use offices should be classified as owner occupied and accounted for in terms of IAS 16, without any reasoning or justification; • The candidate agrees with Leonard's explanation of the tax base of office equipment and does not challenge the correctness thereof; • The candidate states that goodwill is exempt from deferred tax but agrees with Leonard's treatment thereof in the deferred tax calculation (which was incorrect). • The candidate states that tax base of deposits is correct without any reasoning or justification. Overall, the candidate failed to achieve sufficient coverage of valid issues and did not display the necessary level of technical knowledge or pervasive and critical evaluation skills that were required to be assessed as competent in this task.

Task (d)

TASK (d)
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.

Highly competent

To: Gideon Madima
From: Newly Qualified CA(SA)
Date: Wednesday 20 November 2019
Subject: Comments on Excel spreadsheets regarding property acquisition

Hi Gideon,

I hope you are well.

Please see below my comments on your excel modelling spreadsheet.

1. Firstly i would like to comment on the projected rental income by Newco 667's accountant. Given that the average rental escalation for 2017 - 2019 has been around 4% it appears that the escalation in the forecasting period of 6% and 7% seems a bit too high. I think we would need to be more prudent here and therefore do more research as to what the current industry trends are for escalations for similar properties. The inflation rate is currently around 5% in SA and therefore i think an escalation of 7% will not be accepted by tenants especially given our economic environment.

2. Given that vacancy rates have been rising from 2017 - 2019 i would like the question why there is a forecasted decline in vacancy rates over the 5 year forecasting period. Given the latest vacancy rate of round 7% and i would think that the forecasted vacancy rates of 6%-4% appears too low especially given the large increases in monthly rentals. I think a more appropriate vacancy rate would be around 5% - 6% and slightly rising over the period.

3. Average property expenses have been increasing by around 6% for 2017 - 2019. I think the increases of 5% into the forecasting period also seem a bit too low given that inflation is around 5% and expected to increase slightly over the next few years. I think more research into inflation forecasting and average industry increases on similar property would need to be done to come up with a more accurate figure.

4. GLA has remained the same throughout the forecasting period and therefore this presumes that no additions will be made to the property over the course of the next 5 years. If any additions will be expected to made to the property these outflows will be needed taken into account for the IRR calculation as well as any value added to the exit sales price.

5. A cap rate of 9% has been used. There appears to be no adjustments made to this cap rate to reflect the property specific factors. Factors like the location, conditions, tenant mix and size should be factored into a property specific cap rate in order to calculate the fair value of the acquisition property.

Task (d)

6. Has any work been done on the 100m offer price of the acquisition? Is this a fair price to pay for the property? I think a range of valuation techniques should be used to evaluate the 100m purchase price. I would consider adjusting the 9% cap rate for property specific factors and then discounting future net rental income to calculate a valuation. I would also look as similar properties in the market that have recently been sold and make the necessary adjustments to compare the fair value. In conjunction with this i would also perform a discounted cash flow valuation.

7. No tax has been taken into account for the calculation of the IRR. Tax on rental incomes and tax deductions for interest payments, property expenses as well as any other property specific allowances need to be taken into account for the IRR calculation. No CGT has been taken into account upon the disposal of the property in 2024.

8. Has any work been done on the 135 713 exit value in 2024? I think a capital appreciation of 35% over the course of the 5 years seems a bit too optimistic given our current economic environment. I think some work needs to be done to better forecast the exit value in 2024 by looking an capital appreciation of similar properties over the last few years and adjust this for our current economic environment.

9. Will the interest rate be linked to prime? If so interest rate forecasts will need to be performed into the 5 year forecasting period.

Please let me know what you think of my above comments and i am more than happy to talk through them.

Thanks a lot.

Kind regards,
Newly Qualified CA(SA)

Examiners' comments

This candidate did not waffle but was succinct. He/she dealt with all the key factors to consider (forecasts, cap rate (regardless of the cap rate implicit in the proposed acquisition (7.8%) could have been compared to Oikos' 9.0% general cap rate used), R100 million valuation and taxation). What elevated this attempt to highly competent included:

- Identifying that CGT may need to be deducted from the exit proceeds
- Discussing the reasonability of the exit value
- Communication skills displayed

Task (d)

Competent
To: Gideon Madima From: Newly Qualified CA(SA) Subject: Potential acquisition of property Hi Gideon Kindly find below my comments on your excel spreadsheet valuation of the potential property target attached. Let me know if you have any questions or comments. Kind regards, Newly Qualified CA(SA) **ATTACHMENT**

Input/assumption	**Comments**
Rental income growth and average monthly rental per square meter	The model assumes the following rental growth rates of 7% (2020), 8% (2021), 8% (2022), 7% (2023), 7% (2024) over the forecast period. Are these rental growth rates considered reasonable in light of historic rental growth of 2.4% (2019) and 3% (2018). Are these growth rates consistent with the escalation clauses in the leases with existing tenants and will the tenants accept these escalations? The historical trend suggests declining rental growth, which is consistent with the challenging macro economic backdrop in South Africa and the negative rental reversions being experienced by the major REITS. On what basis does the model calculate rental income? Using total GLA or only occupied GLA? See discussion point below on provision for vacancies. Furthermore, the SAPOA industry report as at May 2019 shows average retail market rental growth of between 4.6% and 5.7%. Based on the GLA of this property, it would be classified as a neighbourhood center which has experienced an average growth rate of 5.56% in 2019. The rental growth assumptions appear optimistic and may need to be revised. Remember we should always be more conservative in our forecasts to add a buffer for forecasting risk and other unforeseen errors.
Provision for vacancies	If rental income has been forecast based on total GLA, the model needs to factor in a provision for vacancies to accurately forecast rental income. If this had already been incorporated into the rental income calculation then ignore the previous point.

Task (d)

	The model forecasts a declining trend in the provision for vacancies as a % of GLA to stabilise at 4% over the forecast period, despite being 6% in the current year. The 4% is in line with our key competitors FY2019 vacancies of between 2.6% - 4%. As per the SAPOA report, vacancy rates were reported as 5% for neighbourhood centers. I am happy that 4% is a reasonable and conservative assumption for vacancies over the forecast period in the context of the struggling SA consumer, high unemployment the lack of economic growth in the country and changing consumer patterns.
Annual increases in property expenditure	It should be assumed that annual increases in property expenditure will be at a minimum in line with inflation expectation. The model assumes increases of 5.5% in 2020 and then stabilises at 5% over the remaining forecast period. Given the increase of 6.5% in 2019, which increased from 2018, how do we justify the slowing expenditure growth, especially within the context of the economy? Property expenses are growing at above inflationary levels for the major retail REITS owing to above inflation hikes in rates and taxes and electricity tariffs. The SAPOA industry report reflects annual property expenditure growth of 7.67% on average in 2019 for neighbourhood centers. I would be comfortable to use inflation expectations plus a buffer for above inflationary pressures incurred on administered municipal costs.
GLA	Given the move away from brick and mortar retail and the significant growth opportunities in online retail, is it realistic that the total GLA will not be reduced over time and stay constant? Many of the major retail centers are downsizing to increase trading density growth. The future of retail is evolving at a rapid pace and this should be considered.
Financing cash flows	The financing cash flows should not be included in the valuation/return model as the discount rate should already account for the cost of debt. Therefore the loan advance, interest paid should be removed. The financing decision is a separate decision that should be evaluated based on the net present cost basis of the financing cash flows discounted at the cost of debt.
Cap rate	I do not think it is appropriate to apply the standard cap rate of 9% to value this property. Oikos applies the 9% cap rate for its lower LSM neighbourhood retail centers. The cap rate should reflect the asset-specific characteristics and risk factors. This property is located in Pretoria CBD and therefore warrants a lower cap rate adjustment to account for the prime location of the property, the commuter networks nearby and the footfall in this area. The lower cap rate will result in a

	higher valuation and hence a lower IRR. Further adjustments should be made for the age of the property, the creditworthiness of the tenants, the proportion of national anchor tenants in place, the length of the leases etc. Furthermore, if the cap rate has remained unchanged from the prior year, then it has not incorporated the deterioration in the SA government bond yield to reflect the pending Moody's downgrade to junk status. The cap rate should be a function of the risk free rate on SA government bonds plus asset-specific risk premiums. The SAPOA industry report reflects a cap rate of 9.31% on average in 2019 for neighbourhood retail centers and an exit cap rate of 9.07%. Our competitors cap rates range from 8.3% (Safari) to 9.7% (Vukile). Therefore I think we need to revise this cap rate.
Exit value	It is correct to include a exit value to value the property using a reversionary cap rate, however I have my concerns over the use of the cap rate of 9% as discussed above. The SAPOA report shows that on average an exit cap rate of 9.07% was applied in 2019.
Valuation	The model only computes an IRR. I would suggest we discount the cash flows at the weighted cost of capital applicable to this asset (pre-tax) to determine the valuation of the property and compare it to the R100m being proposed.
Forecast period	Is the 5 year forecast period in line with our intention to dispose of the property within 5 years? Why would we not want to hold onto the asset for longer seeing as it is in a prime location? Are any leases in place expiring within this five year period that could result in vacant space or negative rental reversions on renewal?
IRR	On the face of it, an IRR of 26.6% seems very attractive. However we need to adjust the model for the issues identified above. We should compare this IRR to an internal hurdle rate such as our cost of capital (for example, 15%) to evaluate the value creation potential of this acquisition

Overall:

The assumptions were provided by Newco 667's accountant and need to be verified, either independently or through our own due diligence. We cannot rely on the integrity of this numbers alone without third party evidence or detailed analysis.

In addition, Yvonne and her brother in law own the property and may be willing to sell it at off market values. The valuation is therefore very important to ensure we would pay a fair price.

We can perform the following due diligence:
Obtain copies of the invoices received for property expenses to inform the growth rates
Review the tenant statements and leases of the major tenants to verify the contractual escalations and the length of the leases.

Task (d)

Inspect copies of the Service Level Agreements with cleaning and security companies etc to determine the completeness of costs included
Perform a site visit to physically inspect the property
Obtain a copy of the seller's bank statements and agree the rental paid by the major tenants to the bank statements.
Is this property environmentally compliant? Get an environmental expert to sign off on the property.
Have a engineering expert sign off on the structural competence of the property.
Assess whether there are any existing land claims on the property?

Task (d)

Examiners' comments
This candidate displayed enough to be assessed as competent in the task. He/she discussed the reasonability of the forecast rental income, vacancies and property expenses and made reference to SAPOA reports (evidence of good pre-research). Concluding that the forecast vacancies of 4% is reasonable was questionable and concerning. There was good discussion around the 9% cap rate however, the candidate then suggests a lower cap rate to be used in valuing the property because of its location, which will push the value higher, which is the issue. Recommending a higher valuation to your boss in practice may not be in Oikos' best interests. Discussion of the 5-year period did not make much sense. The case study made it clear that there was a hypothetical exit in 2024 – Oikos may choose to hold onto the property for a longer period but the potential return on investment was the task at hand. What the candidate did well is suggesting that the IRR should be compared to Oikos' hurdle rate/cost of capital. The candidate then goes beyond the scope of the task by suggesting various due diligence procedures. The task was to review and comment on Gideon's Excel's workings and forecasts, not to perform a due diligence investigation (irrelevant information, which did not influence the assessment of this task). It was clear that this candidate was able to perform the task competently and be of value in practice. The attempt, however, was far from perfect and there are areas for improvement.

Task (d)

Limited competent
To: Gideon Madima From: Newly Qualified CA (SA) Date: 20 November 2019 Subject: Potential acquisition of property <u>Valuation using the Cap rate</u> • The capitalisation rate used is the blanket 9% , this needs to be adjusted for the risks of the area you buying the property in. • The net operating income used when calculating the value of the property using the cap rate excludes interest expense therefore please remove the interest expense. • Please excludes the advance payments as well as they do not relate to the future value of the property • The value of the property should be calculated using the net rental figure divided by the cap rate. • Did you perform a due diligence on the cash flows to ensure accuracy and integrity pf the figures. <u>Period of the CAP rate valuation</u> • The cap rate should be calculated every year for every property as the economic conditions changes and the areas where the property are situated changes. IRR • The cashflows should exclude the interest expense therefore please remove them • The IRR is the internal rate of return there it measures the return of the property <u>CAP RATE vs IRR</u> • The IRR is more than a cap rate and both rates can be used to evaluate the return of the property, for the cap rate the lower the cap rate the higher the value of the property and the higher the cap rate the lower the value of the property Factors affecting the cap rate • Interest expense • maco level economics and demographics • The type of property • Micro level market influences Kind regards Newly Qualified CA(SA

Task (d)

Examiners' comments
This candidate failed to critically discuss the forecast rental income, vacancies and the property expenses. Without some relevant discussion around the forecasts, a candidate could not display competency in this task. The candidate did identify that the financing elements (interest expense and loan advances/repayments) should be excluded from the forecasts. This could be argued to be the correct capital budgeting technique used in an investment analysis scenario. It could also be argued that the financing elements should be included since this is a very important aspect of property acquisitions and return on investment. There was some generic discussion around cap rates however, this could have been more applicable to the property in question. For example, the cap rate implicit in the proposed acquisition (7.8%) could have been compared to Oikos' 9.0% general cap rate used. Furthermore, the cap rate could have been discussed in relation to the location of the property (Pretoria CBD). The candidate's theory dump adds limited value in practice. Overall, this candidate's response was too brief. There were numerous relevant factors that could have been discussed, to elevate to borderline competent such as: • Taxation was excluded from the forecasts • How was the hypothetical exit value arrived at in 2024? • Should working capital be included in the forecasts? • Has repairs and maintenance been included in the property expenses? • Is the proposed acquisition in line with Oikos' strategy of investing in properties in smaller towns and cities? • Yvonne Njeke is conflicted and needs to remove herself from the decision making re the acquisition

TASK (e)
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.

Highly competent

From: Newly Qualified CA(SA)
To: Gideon Madima
Date: 20 November 2019
Re: The Ziki Saga

Hi Gideon,

I am happy to hear that the final meeting has taken place and that an agreement has been made. It is also good news that Ziki will remain listed, especially since we have obtained some of their shares as a result of this whole process.

Please see my response below regarding the accounting and tax implications of this agreement.

Tranche B Shares

Accounting
We will receive shares in Ziki and therefore we will have an investment in Ziki. The investment needs to be measured and this can be done in one of two ways:
1. Fair Value through profit or loss.
2. Equity accounting if we have a significant influence shareholding, which is not the case (12% is not significant influence).

The fair value of these shares need to be determined in terms of IFRS13. Fair value is a market based measure and is not entity specific and maximises observable inputs and minimises unobservable inputs. Fair value is the price that would be received to sell an asset or transfer a liability.
As Ziki are listed, we would be able to determine the market value of the share. However the shares are restricted and therefore the fair value would most likely be slightly less than the market value. An alternative measure would be to value the shares at the value of what they are "paying for", i.e the 30% rental for 3 years.

These shares will be received in exchange for a reduction in rental of 30%. As these shares have all been revived upfront, we (Oikos) have received compensation (when we received the shares) for rental income that will only be earned over the next 3 years.

When the shares are received, an amount equal to the fair value (as determined above) will be raised as an investment and the corresponding entry would be to raise a deferred income liability. Each month, when the 30% rental would have been paid, the amount will need to be removed from deferred income liability and recognised as revenue.

This will not result in a new lease contract as there has been no lease modification. There is no lease modification as the amount of rental will still be 100% of the rental, however 70% will be received in cash and 30% in shares.

Taxation

The 30% rent for the next 3 years will need to be included in taxable income in full in the year in which the shares were given to Oikos. This is because income is recognised at the earlier of receipt or accrual and the income has been received in the form of shares.

When the shares are sold (if this is the case), there will be taxation effects. The starting point will be to determine whether the shares are income or capital in nature. We may need to make use of a tax expert in order to determine this. However, I am of the opinion that they are capital in nature as the shares were not acquired for speculation purposes and were simply received as a form of payment. Oikos did not obtain the shares for the purpose of selling them and may not even sell them, they only received them due to the financial position of Ziki.
On the assumption that they are capital in nature, if the shares are sold they will attract capital gains tax. The capital gain will be included in taxable income at 80% and thereafter taxed at 28%. The tax base of the shares will be the original value raised for accounting purposes.

VAT

We will raise output VAT on the rental income received (normal rental income and rent received in advance).

<u>Cash Consideration</u>

Accounting

We will received 75 cents for every Rand of debt outstanding and therefore the remainder will need to be written off.

The value of debt outstanding is R3,38 million, therefore we will only receive approximately R2.5 million.
Therefore, the difference R0.88 million will need to be written off as a bad debt. This will be done by expensing the amount to bad debts and decreasing the accounts receivable balance.

When money is received from Ziki, the entry would be to increase the cash account and decrease the accounts receivable amount.

The current provision for bad debts for Ziki will need to be re-instated and re-assessed. Therefore, the amount will be taken out of the allowance for doubtful debt account and included in accounts receivable. We then need to assess whether there is a need to raise a provision for doubtful debts in the financial statements over this remaining amount that is being paid at 75 cents to the Rand.

Taxation

The amount that is written off as a bad debt expense is deductible for tax purposes under s11(i), provided that it was included in our taxable income in the current or prior year.

If we raise an allowance for doubtful debts, a s11(j) deduction will apply. This deduction has been amended from years of assessment starting on or after 1 January 2019, therefore the older

version of the deduction is appropoiate for the current year. I noted in your email on Friday that the tax allowance has actually been calculated using the new allowance.
The applicable allowance for the current year is 25% of the amount raised as an allowance for doubtful debt and will be deductible in the current year. This amount must then be added back in the next year.

VAT
We originally raised output VAT on the rental charged. However, now that a portion has been written off, we can raise input VAT for the amount written off as a bad debt.

I trust this will help you to draft your memo. Let me know if you have any questions.

Kind regards,
Newly Qualified CA(SA)

Examiners' comments

The candidate's solution addresses all of the core financial reporting components of the task and some higher-level aspects. These include:

- the recording of the cash settlement received;
- the write-off of the bad debt;
- the reversal of the allowance for credit losses;
- the recognition of the rental received in advance which is to be recognized as income over time;
- the recognition of an investment in Ziki for the shares, either at fair value through profit or loss, or through the use of equity accounting if there is significant influence; and
- the possibility of a lease modification in terms of IFRS 16.

The candidate also identifies that 12% is not significant influence and recognizes that the fair value will need to be determined in terms of IFRS 13. It is also identified that the shares are restricted and therefore the fair value would be different to the listed price. An alternative measure is offered, being the value of the 30% reduction in rental.

The candidate's solution addresses all of the core normal tax components of the task and some higher-level aspects. These include:

- the bad debt write-off in terms of s11(i);
- the reversal of the s11(j) allowance including identifying that the allowance has been calculated using the new s11(j) provisions; and
- the gross income inclusion on the shares received in return for a reduction of the 30% rentals and subsequent CGT implications.

The candidate's solution addresses all of the core VAT components of the task and some higher-level aspects. These include:

- the Vat input on the bad debt written off;
- the Vat output on the barter transaction (30% portion); and
- the Vat output on the 70% rental income.

This candidate has achieved all of the core aspects of the task and some higher-level aspects. Accordingly, this candidate was assessed as highly competent in this task.

Task (e)

Competent
To: Gideon Madima From: Newly Qualified CA(SA) Subject: Ziki Saga continues Hi Gideon Thanks for updating me on the outcome of the business rescue proceedings. Please find attached the accounting and tax implications of the business rescue settlement agreement to include in your memo for circulation to the board. I would just like to clarify that section 19 of the Income Tax Act would not be applicable to Oikos in this scenario, as my understanding is that section 19 only applies to debt reductions from the perspective of the debtor (Ziki) and not the creditor (Oikos). Therefore I do not believe we need to consult an expert on section 19. Please let me know if you have any questions. Kind regards, Newly Qualified CA(SA) **ATTACHMENT** **Accounting implications:** **<u>Tranche A:</u>** IFRS 9 provided guidance on how financial assets, such as the trade receivable from Ziki, are to be treated in the event of a debt restructure/compromise. The business rescue agreement states that we will be receiving 75 cents in the rand for the outstanding debt. As the contractual cash flows between Ziki and Oikos have not been substantially modified, this transaction will not be deemed as a substantial modification in terms of IFRS 9. The difference between the amount owing by Ziki and the 75 cents in the rand to be received shall be written off as a bad debts expense in profit loss as the amount is irrecoverable. The debtor and the allowance for doubtful debts will be derecognised as Oikos is no longer unconditionally entitled to the full amount owing to the approval of the business rescue plan. The journal entries will be as follows: Dr Cash receivable (A) 2.535m [3.38m x 75%] Dr Bad debts expense (P/L) 0.845m [(3.38m x 25%)] Cr Trade Receivables: Ziki (A) 3.38m *Recognising entitlement to 75 cents in the rand and writing off 25% as irrecoverable*

Dr Allowance for doubtful debts (-A) 1.07m
Cr Bad debts expense (P/L) 1.07m
Derecognising the allowance for credit losses and bad debts raised previously

Tranche B:

The existing lease agreement between Oikos and Ziki is an operating lease in terms of IFRS 16. The settlement terms for Tranche B represent a lease modification per IFRS16. Oikos shall account for the modification as a new lease from the effective date of the business rescue plan approval by creditors and shall consider the existing operating lease asset/liability relating to the original lease as part of the lease payments for the new lease.

Therefore, the existing operating lease asset/liability relating to the lease with Ziki that exists at the date of modification shall be treated as prepaid rental or accrued rental of the new modified lease and the remaining lease payments shall be recognised on a straight line basis over the remaining lease term. Note that when performing the straight line calculation for the new modified lease terms, the existing operating lease asset/(liability) should be deducted/(added) to the gross rentals over the 3 years before straight-lining in terms of IFRS16.

The number of shares received in Ziki gives Oikos a 12% shareholding and the ability to appoint one member to the Board of Ziki. Consideration needs to be given to whether this arrangement amounts to Oikos having signficant influence over Ziki. The existing of significant influence can be evidenced by representation on the board of directors in terms of IAS28:6(a). If this is the case, then Oikos would need to apply equity-accounting to account for Ziki in its consolidated accounts.

I am of the opinion that Oikos does not have significant influence over Ziki due to the fact that it only holds 12% of its shares and that Oikos has not appointed one member to Ziki's board. In addition, Oiko can waive this right to appoint a board member. However, we should consult a legal and IFRS specialist to confirm this.

The shares received in Ziki should be recognised as a financial asset equivalent to the value of the total 30% rent reductions over the 3 year period. The contra entry to this should be to recognise rental received in advance (a liabilty) to reflect that Oikos still needs to perform its service of providing space to Ziki. I do not have sight of the rental amounts payable by Ziki to perform the calculation.

Furthermore, when the cash is received from Ziki for rentals, Oikos should recognise the cash, unwind the rental received in advance, recognise the straight line rental income and the balancing figure will be the operating lease asset or liability.

When Ziki's shares reopen for trading on the JSE, any movements in its share price should be accounted for by Oikos as a fair value gain/loss in profit loss.

Task (e)

Additional considerations

Consideration needs to be given to what the fair value of the shares are in terms of IFRS13, as a market participant would take into account the holding period restrictions on the tranche B shares. One can assume that the market participants trading listed shares in Ziki would impute this illiquidity discount into the value of the share (decrease the share price) and no further adjustments would be required.

Another consideration is the timing of the Tranche B shares received. As the shares are received upfront and rental payments will take place over the three years, there may be a derivative that exists in this arrangement as the value of the reduction (and therefore the shares) depends on the value of the payments to be received. This is consistent with Resilient's treatment of the Edcon reduction in rent.

A final consideration is the time value of money. My understanding is that we receive the rental on a monthly basis and therefore no significant financing component exists in this arrangement. Therefore we do not need to discount the future rentals to determine the value of the investment.

Taxation implications

The doubtful debts allowance of R430k appears to be incorrect. This allowance seems to have been calculated based on the new section 11(jA) provision of the Income Tax Act that is only applicable to years of assessment that commences on or after 1 January 2019. Furthermore, the amended section specifically excluded lease receivables. Therefore as at year end September 2019, the tax allowance should be raised based on 25% of the allowance for doubtful debts.

I know you have asked me to ignore the deferred tax consequences but I think this is an important issue to raise. We need to perform the following adjusting journal entries to correct this.

Dr Deferred tax asset (SFP)	45 500 [430k - (1.07m * 25%)]	
Cr Deferred tax income (P/L)		45 500

Correction of deferred tax on allowance for doubtful debts

<u>Tranche A</u>

<u>Income Tax</u>

The rental in arrears from Ziki has already been included in gross income as rental income. Now that 25% of the debt has gone bad, Oikos is entitled to a bad debts deduction under s11(i) of the Income Tax Act. This is because the debt is deemed to be irrecoverable post the approval of the business rescue plan by creditors and the taxpayer has therefore exhausted all reasonable steps to recover it. Therefore Oikos can claim a deduction of R845k from taxable income in its 2019 year of assessment. The net effect is that 75% of the rental will be included in Oikos' taxable income, which is consistent with the cash to be received.

These shares will be a capital asset for Oikos and the base cost in terms of the Eighth Schedule will be equal to the market value of the shares received in terms of paragraph 34.

Task (e)

VAT:
Oikos is a mandatory VAT vendor based on its turnover. In terms of s22(1) of the VAT Act, Oikos has made a taxable supply (supply of space for rental) for consideration (rental), had furnished a return for which output tax on the supply was payable (output tax would've been levied at 15% on the rental) and has written off so much of the consideration that has become irrecoverable (25%).

Therefore under s16(3) of the VAT Act, Oikos can claim an input tax deduction for the 25% that is irrecoverable. The amount is as follows:

(R845k/3.38m) x (3.38m x 15%) = R126 750 input vat claimable.

Tranche B

Income Tax Act

The shares received are essential a payment made for the portion of the rental due. The gross income definition includes any amount in ' cash or otherwise'. In the case law of Brummeria and Lategan, it was determined that 'cash or otherwise' includes anything receivable with a determinable monetary amount. The value of the shares should therefore be included in Oikos gross income on receipt or accrual. The onus is on SARS to determine the value to be included in gross income as was the case in the Bummeria case, although the fair value of the shares can be determined with reference to the listed price of the shares, however consideration should be given to the restrictions on liquidity.

Another issue is whether these shares are capital or revenue in nature. As the Income Tax Act does not define these terms, we need to consider applicable case law. I am of the opinion that the shares are capital in nature (considering the three year holding period and the intention of Oikos not to sell the shares for a profit immediately) and therefore the base cost of the shares will be the expenditure actually incurred to receive the asset which is equal to the 30% rent reduction over the three years.

VAT

As the consideration is not paid in money, output VAT will be levied on the open market value of the shares using the VAT fraction of 15/115 and payable to SARS at the earliest of receipt or accrual.

Task (e)

Examiners' comments
The candidate's solution addresses most of the financial reporting components of the task. These include: • the cash settlement received; the write off of the remaining trade receivable balance; • the reversal of the allowances for credit losses; • the recognition of an investment in Ziki and the contra rental income received in advance; and • considers whether the Tranche B shares settlement could be considered a lease modification in terms of IFRS16. In addition the solution further considers whether the investment in Ziki could be considered an investment in an associate in terms of IAS 28 and also recognizes the restrictions on the Tranche B shares and considers whether the fair value of the shares should not be discounted for illiquidity. In terms of the normal tax components of this task, the candidate has addressed a sufficient number of the components to be assessed as competent in normal tax. The candidate addressed: • the application of section 11(i) of the Income Tax Act, dealing with the write off of the bad debts; • the gross income inclusion on the shares received in return for a reduction of the 30% rentals while then going on to also consider the subsequent CGT consequences and that the base cost would be equal to the market value. While the candidate doesn't address the reversal of s11(j) the candidate has debated whether the tax allowance of R430 000, provided in the pre-released information, was raised correctly as it should have been based on 25% of the allowance for credit losses and not 40%. In addressing VAT, the candidate has considered the input tax adjustment of the bad debt written off and also recognizes that there would be output tax on the receipt of the shares in return for a reduction of the 30% rentals. To be assessed as competent in this task candidates were expected to display competence in each of the discipline areas examined. This candidate has displayed the appropriate level of competence in financial reporting, normal tax and VAT.

Task (e)

Limited competent

To: Gideon Madima

Sent: Wednesday 20 November 2019

From: Newly qualified CA (SA)

Subject: Accounting and tax implications resulting from the business rescue

Dear Sir

You have asked me to prepare a memo that will be used by the board of directors with the accounting and tax implications of the business rescue.

Please find the attached memo with the accounting and tax implications

Kind regards

Newly qualified CA(SA)

MEMO

To: Gideon Madima

From: Newly qualified CA (SA)

Date: 20 November 2019

Subject: Accounting and tax implications resulting from the business rescue

In this memo I will discuss the tax and accounting implications of the following decisions finalised and agreed between Ziki and Oikos in terms of Ziki paying the amount outstanding:

6. The amount paid for the outstanding debt by Ziki is only 75 cents of the rand
7. A reduction of 30% in rentals for the next three years in return for the shares in Ziki

<u>Accounting Treatment - Cash settlement</u>

The total amount owed by Ziki is R3,38 million and a related accounting provision has been recognised at R1,07 million

In terms of IFRS 9 a lease receivable is recognised as a financial asset as it meets the definition of a financial assets.

In terms of IFRS 9 the cash settlement will result in contractual cash flows to Oikos and those cash flows are solely payments of principal and not interest, therefore this financial assets does not meet the amortised cost measurement.

As the financial assets did not meet the conditions to be measured at amortised cost it will be measured at Fair value through P/L (in which case any transaction costs will be expensed through P/L).

As Ziki has negotiated to pay 75 cents of the rand Oikas will have to raise a credit loss of the 25 cents in profit and loss. Oikos will have to de-recognise the receivable and the provision raised and include the credit loss of the 25 cents

The following Journal will be applicable:

Dr Bank (0.75*3,38 million)	2,54	
Dr Allowance for credit losses	1.07	
CrTrade Receivable		3,38
Cr Bad debt written off		0,23

<u>Accounting Treatment - Tranche B shares</u>

-As the is a reduction of 30% in the rentals this might trigger a lease modification, however when assessed below it does not seem as a lease modification

- The following are the factors that need to be considered for a lease modification:

13. A change in Scope - the scope of the lease in with Ziki has not changed as Ziki is still leasing the same asset and the lease term has not changed
14. A change in Consideration - Although the amount of rent payable in cash is reduced by 30%, this reduction amount is still transferred as consideration to Oikos in the form of Tranche B shares. Therefore the consideration has not changed and this renegotiation with Ziki is not a lease modification as defined.

As this is not a lease modification Oikos will have to recognise rental income from Ziki in the same manner going forward as before (straight lining of lease payments over the lease term). However going forward a normal lease receivable will be only be recognised at 70% of the rental consideration, with the other 30% being recognised as an Investment in Ziki (Financial asset)

Task (e)

As the share are received upfront Oikos will recognise an asset for the investment in shares in Ziki and rental income received in advance for the next two years.

The investment in Ziki will be measured at their Fair Value with the difference between the Rental income and the Fair value recognised in profit or loss.

The rental received in advance will be de recognised each year with the amount that is accrued to Oikos with regards to the lease.

A trade debtor will be raised each year for the amount that is owed with the difference to the rental straight lining recorded as lease operating an asset / liability.

Taxation treatment - Cash settlement(Allowance for credit loss)

In terms of the income tax s11 (j) allowance for doubtful debts was amended effective from years beginning on / after 1 January 2019. Oikos's year end is the 30 September thus the new s11(i) cannot be used, therefore Oikos must apply the previous s11(j) which is 25%.

The new s11(j) speaks towards those companies that have (Oikos has) and those who have not yet applied IFRS 9 . In the case of Oikos , they have adopted IFRS 9 and thus will apply the second provision of s11(j)

S11(j) states that taxpayers applying IFRS 9 for financial reporting purposes , may be granted a loss to the impairment of debt excluding lease receivables.

However the new s11(j) does not apply to lease receivables therefore we should apply the old s11(j) of 25% on the loss allowance

VAT consideration

As 25 cents will be written off , Oikos should apply the VAT Input adjustment to reverse the original output Vat recognised.

Task (e)

Examiners' comments
This candidate addressed the financial reporting, normal tax and VAT components which had to be considered. The candidate's solution addresses in a succinct manner all of the financial reporting components of the task. These include: • the cash settlement received; • the write off of the remaining trade receivable balance; • the reversal of the allowances for credit losses; • the recognition of an investment in Ziki and the contra rental income received in advance; and • considers whether the Tranche B shares settlement could be considered a lease modification. However the candidate is still assessed as LC as the taxation components in this tasks is extremely weak and lacks the depth of understanding expected from an entry level CA. The candidate has only addressed the application of section 11(j) of the Income Tax Act, but has not considered the reversal of the previous deduction claimed when the debt is written off, therefore no recognition was given for 11(j) discussion. Similarly the VAT component has almost no discussions apart from the input tax adjustment of the bad debt written off. To display competence in this task candidates were expected to display competence in each of the discipline areas examined. This candidate has only displayed the appropriate level of competence in financial reporting and therefore cannot be assessed as competent in this task.

Task (f)

TASK (f)
Respond to Yvonne Njeke's email regarding the Ziki matter.

Highly competent

To: Yvonne Njeke
From: Newly Qualified CA(SA)
Date: Wednesday 20 November 2019
Subject: Considerations on Ziki Proposal

Good Morning Yvonne,

I trust you are well.

Thank you for giving me the opportunity to give you some of my considerations regarding the Ziki proposal. Please see below what i think should have been considered before going ahead with the proposal.

1. I think the first thing we should have considered is what the fair value of the shares we will be receiving when compared to the present value of the 30% reduction in the lease payments over the next few years. It seems as if this comparison has not been done and thus i suggest we calculate what the total value of the shares we are receiving are worth and compare this to the reduction in the income we will forgo. It could be possible that the 12% stake is worth significantly less than the rental reduction and thus we would loose out.

2. I think we should have considered the fact that the shares received under Tranche B are restricted and can only be sold in 1 third lots at the end of 12, 24 and 36 months. Depending on what happens to the share price of Ziki over the course of the next 3 years this might negatively affect our cash flow as the share price of Ziki could likely decline even more should Ziki's position worsen.

3. We should have considered the risks involved with an equity position especially a company that is in business rescue. Should Ziki's position deteriorate dramatically and they file for bankruptcy ordinary equity will rank below other debt and thus it is possible we could face significant losses on the equity position. Considering the fact that the shares are restricted and the share prices starts to tank further we will not be able to exit the position and face significant losses.

We should have also considered if there was an option to take preference shares over ordinary shares.

4. We should have also considered whether there are other tenants available to let to instead of Ziki who have a similar line of business and would create the same tenant mix such as KFC or Chicken Licken.

5. We needed to consider whether it is viable that Ziki will be able to turn around and get into a better position. There seems to be no research done on the state of the company and the track record of those charged with governance to see if it is actually possible to survive the business

rescue. Business success rates in SA are extremely low at around 10-12% and thus the chances of them surviving are really low.

6. We also needed to consider whether our 12% stake and ability to appoint 1 member of the board will be enough to make a difference at Ziki and help turn them around.

7. We needed to consider whether an investment in a fast food chain fits the general startegic overview of Oikos. The investment in Ziki seems to not match the property groups investment portfolio.

8. It seems as if we also did not consider if there were any other options available for Ziki's restructuring and seemed to blindly accept the proposal without any further research. We could have possibly for example, purchased the full equity up front and received full rental over the next 3 years.

9. We should have considered if it is possible to hedge the risk of Ziki's share price declining and determine whether there are put options available to sell the 12% at the end of 3 years for a fixed strike price.

10. We should also consider what other tenants would think of this proposal. I am sure that other tenants are also in tough financial positions and thus they might take this a preferential treatment of Ziki and also demand lower future rentals.

11. It should have also been considered if other creditors of Ziki are also receiving equity with the same restrictions which upon completion of the restriction period there could be a flood of shares in the market driving the price down

I hope the above helped even though it is too late to change our minds. Please let me know if you have any further questions about the proposal.

Thanks so much.

Kind regards,
Newly Qualified CA(SA)

Task (f)

Examiners' comments
The candidate's response is impressive. This task assessed the ability of candidates to think on their feet, and to identify ***multiple issues***, which should have been considered prior to accepting the terms of the Ziki's offer. The candidate providing "to-the-point" response, addressing a number valid issues, which should have been considered. The following considerations were key in achieving a highly competent on this task: • Weighing up the fair value of the 12%-stake against the present value of the lost lease revenue over the next three years and not by implication against the total value lost. • The candidate identifies the potential downside to accepting the shares – the share price tanking with no stop loss being available given the trading restrictions, which apply. • The candidate correctly identifies that by accepting the equity swop, Oikos would be worse off in the case of a liquidation of Ziki's than they would have been had they been a creditor of Ziki's on liquidation. • The candidate correctly questions the ability to replace Ziki's with a tenant such as KFC or Chicken Licken. Both of these tenants are national brands focusing on the same LSM-group as Ziki's. This is important as it would attract similar footfall to that attracted by Ziki's, It would have been value adding had the candidate made reference to footfall in their response. • The candidate questions whether the business rescue will indeed succeed and whether those charged with governance will be able to turn the fortunes of Ziki's around. It would have been more appropriate had the candidate specifically referred to the track record of the business practitioners appointed. • The candidate correctly identifies that by having the ability to appoint one member of the board of directors of Ziki's, Oikos could positively influence the outcome of the business rescue proceedings. Given the difference in business models it is unlikely that Oikos would be able to contribute significantly to changes in the strategy or business model of Ziki's. • The comment regarding the difference in strategic focus needs to be considered with circumspection. This outcome was forced on the directors of Oikos given Ziki's poor performance. No decision was taken to change the strategic focus of Oikos. • The candidate correctly questions whether there were any other alternatives on the table, other than the plan of the business practitioners. • The candidate also correctly identifies the setting of a precedent in accepting the terms – other tenants might well in future demand similar treatment. • The comment that should all the creditors receiving Ziki shares sell them simultaneously, the market price will drop. Not only did the candidate achieve good coverage of the primary commentary sought, but a number of high-level aspects were also addressed by the candidate.

Task (f)

Competent
To: Yvonne Njeke Date: 20/11/2019 From: Newly Qualified CA(SA) Subject: Ziki Saga Good afternoon Yvonne, I agree, the decision regarding the exchange was not a straight-forward or clear cut decision to make. Our relationship with Ziki and their impact on our centers is quite complex due to the footfall they bring in, however I have summarised a few points we could have considered before going into the meeting: 1. Was there a possible 3rd party replacement for Ziki's floor space? The issue which arose was it was unlikely we could find another tenant to replace Ziki, However could other suitable fast food chains which compete in the same segment of Ziki been approached with favourable terms lease terms - ex Chicken Licken, KFC, Steers etc 2. What would have been the projected impact of Ziki's closure on footfall? How severely would this have affected our remaining tenants / would this increase the vacancy rate? 3. What was the nature behind Ziki's business rescue proceedings? Was it due to short-term liquidity crisis, unprofitability, poor management, failure to meet debt obligations 4. Who were the appointed business rescue practitioners and what was their previous track record? Have they been successful in the past? Can they be relied upon. 5. Key indicators of success is the formulation of a business rescue plan which is accepted and approved by all stakeholders affected. What was the sentiment when the plan was proposed? 6. What does the business rescue plan entail - ex discontinuing stores, retrenchment of employees, cost cutting. Does it make sense to continue the arrangement if stores are reduced. 7. Is there a possibility that future debt incurred won't be recovered? What is the goal of the business plan? Is it to recover funds for creditors or turn the company into a going concern. 8. Have there been any other listed retail businesses / food chains which have entered business rescue? What was the outcome / statistics of success amongst them 9. What is the fair value of shares received in consideration for the decrease in rentals. Is it a fair transaction 10. What is the current state of the lower LSM segment? Currently unemployment and CPI is at an all time high, what is the chance of the market recovering within the short-term? 11. How would the original Tranche A and Tranche B offering affected our loan covenants if we had to perform the debt / equity swop and issue of shares for a decrease in lease payments?

Task (f)

12. What is the reputational risk if we refuse the transaction? Would we be blamed for the potential job loss that would be incurred due to liquidation of Ziki?

13. Who are the other shareholders of Ziki? What is our % in relation to theirs? Could we obtain some sort of control due to our % shareholding?

What is the potential upside of this transaction? How much could the shares be worth if the Ziki recovers and would that profit match the 30% of lease payments forsaken to acquire the shares

The above includes both pros and cons of the transaction. Now that the transaction has occurred, I think that we should support our investment in Ziki the best we can and await the results of the business rescue proceedings.

Warm regards
Newly Qualified (CA) SA

Task (f)

Examiners' comments
The candidate identified a number of issues, mainly of a strategic nature which should have been considered prior to accepting the Ziki's offer. These include: • Questioning the ability to replace Ziki's – the candidate correctly identifies that Ziki's wos uld need to be replaced with a fast-food chain focusing on the same LSM segment which Ziki's focuses on. The three fast-food chains suggested all operate on an national level and have strong brand identifies. • Indicating that should Ziki's close down, this would impact on the footfall attracted to the Oikos shopping centres. • Although not ideally phrased, the candidate appears to question the reason(s) for Ziki's being in financial distress. The response would have been even better had the candidate questioned whether it is possible to in fact place Ziki's on a trajectory to sustainability. • They candidate recognises the dependency on the business practitioner(s), in terms of who they are and their track record, in respect of the business rescue proceedings succeeding. • The candidate correctly questions what the business rescue plan entails – the candidate could have expanded on this issue further! The candidate also appropriately questions whether previous businesses in financial distress have successfully exited business rescue. • The candidate questions whether the value of the shares being received is in fact fair when compared to the lease revenue foregone. Ideally the candidate should have questioned whether the fair value of the three years' lease revenue foregone = fair value of the shares allotted. Ideally, the fair value of the shares needs to be adjusted for the liquidity discount given the trading restrictions on the shares. • The candidate correctly identifies the impact on the legitimacy of Oikos should it have not agreed to the offer, resulting in job losses. • The candidate correctly questions the upside in the share price. What about the downside? Further improvements: • Why question the state of the LSM segment? Surely, the candidate's research should have focused on this? The candidate should be providing an overview of the outlook for the industry. • Oikos is being allotted a 12%-stake – hence the candidate should be questioning to what extent Oikos can influence the business rescue process. Notwithstanding the critique levelled against the candidate's response, the response remains a good response to the task.

Task (f)

Limited competent
Email To :Yvonne Njeke From : Me Date : 20-11-2019 Subject: Re: Ziki Saga Dear Yvonne, Yes Gideon has told me about the settlement reached. Below I will address your requests. <u>Key factors to consider before voting in the creditors meeting</u> The business rescue proceedings should have been carried out in accordance with Companies Act requirements. As per the Act we are affected persons as creditors. Section 128 defines business rescue as proceedings to facilitate the rehabilitation of a company (Ziki) that is financially distressed. We should have ensured that the rescue plan is drafted in a manner that will maximise the likelihood of Ziki continuing in existence on a solvent basis or if not possible, it results in a better return for the company's creditors (that will be us). We should have also checked that the liquidation proceedings have not been initiated against Ziki, otherwise the business rescue would have been illegal. We should have also considered the duration of the proceedings, protection of property interests and the effect on employees and contracts. With regards to the business rescue plan contents, we should have ensured the following: 1. A complete list of all the material assets of Ziki and which ones are held as security. 2. A complete list if creditors 3. The probable dividend 4. A complete list of holder of share 5. A copy of the written agreement of the practitioner's remuneration 6. Proposals Assumptions and conditions <u>Decision to reduce our rentals and take equity stake</u> 7. Rent reduction: • Advantages - we continue to get cash inflow (we retain client) • Disadvantages - Our operating lease asset is reduced/impaired (negative impact on financial position) 8. Investment in Ziki • Advantages - we have influence to change things around through our participation on the board. • Disadvantages - This might bring losses onto our books. <u>Conclusion</u> Given that it is difficult to replace Ziki as tenant and the footfall they bring, I think it's a good thing we retained them as tenant and as an investment. For more information please do not hesitate to contact me. Regards, Me

Task (f)

Examiners' comments
The candidate provided a limited response – too little key considerations was identified by the candidate. The candidate only identified two valid issues which should have been considered prior to the acceptance of the offer: • Oikos' ability to influence the business rescue process by virtue of its ability to nominate a director to the board of directors of Ziki's. The degree of influence, which Oikos will depend on how many directors serve on the board. This information is not provided in the scenario. • Ziki's brings footfall to the Oikos malls and as such, should they fail and should Oikos not be able to replace them, then the Oikos malls will experience less footfall. This would obviously impact on the performance of the other tenants. Ideally, the candidate should have identified that this could ultimately result in an increase in vacancy rates, which would negatively impact on the fair value of the Oikos properties and loan-to-value indicator. The candidate could have improved on their response as follows: • The candidate states that the business rescue plan maximise the likelihood of Ziki's being able to continue as a going concern. The candidate needed to unpack this issue – what are the root causes for Ziki's having landed up in business rescue and can Ziki's fate be successfully turned around? What is the track record of the business rescue practitioner(s) in successfully turning companies in business rescue around? • The candidate seems to be looking for confirmation that Ziki's should be placed in business rescue rather than be liquidated. Chapter 6 of the Companies Act regulates the process of placing a company in business rescue. These requirements would have already been addressed? Hence, why mention this? • Providing a checklist, which is what the candidate in essence provides, covering what the contents of the business plan should be, does not address the task. The task required identifying considerations – the list provided does not address this in any way. • Listed in the competent response for task F, as provided above, reference is made to some of the other issues, which the candidate could have mentioned in their response, which would results in the candidate displaying competence.

TASK (g)
Respond to Gideon Madima's email regarding the key risks facing Oikos.

Highly competent

From: Newly Qualified CA(SA)
To: Gideon Madima
CC:
Subject: Key Risks

Hi Gideon

I never get tired of getting my input, thanks. All of this is a nice challenge.

Please see attached my proposed 7 key risks.

Just something extra: I suggest we start compiling a complete risk register of our enterprise wide risks and focus on enterprise risk management. This would enhance our risk management and ensure accountability and that risk is effectively monitored and improve the chances of a complete risk universe.
Risks also needs to be assessed and measured in terms of impact (severity) and likelihood (changes of happening) and not only be static on a list. A developing trend is measuring risk in terms of veracity as well (Sped form event to impact being felt) - this will really set our risk management apart form our peers and will help us really use enterprise wide risk management as a tool to both protect and create value.

I would gladly assist with this as well as creating controls or mitigating actions for these risk identified (and any other).

Cyber security risk was a close number 8 but with the looming wifi roll out, I'm sure this will increase and become a tope risk contender.

Let me know if anything is unclear.

Kind regards
Newly Qualified CA(SA)

Top 7 risk register (Attachment task g)

Risk	Description	Impact
Increased competition and tenant retention	The REIT industry is extremely saturated in South Africa with 23 Listed REIT's in on the JSE. This does not take into account other unlisted property companies such as Oikos. This puts pressure on margins and rental escalations, as tenants can always try and find a cheaper	The impact on Oikos would be increased vacancies of not managed or mitigates. Lower rental escalations in order to remain competitive. This also decreases the willingness of tenants to enter into longer term rentals as they would want to see what

	location elsewhere.	else they can get for the same or better price and not be locked in wit the rental increases on a downward trend. Overall this leads to tighter profitability margins.
Macro economic environment	The general South African Macro economic outlook is negative. This is due to slow economic growth (GDP), political inaction and uncertainty, policy uncertainty such as land expropriation without compensation and extremely high unemployment.	Slow and low consumer spending affecting lease negotiations and tenant retentions as well as increase pressure on lower rental escalations, resulting in increased payments in arrears and vacancies.
Volatility in interest rates and increased cost of financing	With Moody's outlook change of South Africa's sovereign debt to negative (but still at investment grade) and global geopolitical uncertainty - the risk of interest rates rising remains. The risk is further increased as all of our debt is variable wand Oikos does not have a hedging policy.	Seeing as all of our debt is at variable rates (prime less x%) and no clear hedging strategy in place - increased rates will result in increased financing costs and less distributable earnings. This will also affect the loan covenants related to interest cover and take us closer to breach (even tough there is a safety margin currently). This will also impact our future growth as funding will be more expensive - leading to restrictions on our strategy of acquisition growth.
Rising cost of occupancy for tenants from increased rates, taxed and utilities	Increased utility costs such as electricity (Eskom almost yearly above inflationary increases) and water price increases (due to looming drought across South Africa) as well as other rates and taxes increases our biggest single cost .	If these increases can't be absorbed by tenants it will put pressure on lower margins through increased net rentals, tougher lease negotiations and increased payments in arrears.
Social instability risk	Risk of social and political disturbances and labour unrest in areas where Oikos has properties.	This could lead to damages, shops being looted and damaged, as well as decrease economic activity in the area which could also lead to reduced margins and pressure on payments in arrears.
Refinacing and maturity risk	Risk that a large portion of upstanding debt matures at a single point in time (or close together).	This puts pressure on short term liquidity and cash flows as can be seen from the net current liability and large portion of debt repayable every year over the past three years. This can also hamper our acquisition growth strategy as we cannot accumulate funds in our war-chest for

		juicy acquisitions or obtain new financing form banks given our current maturity profile.
Suboptimal investments	Risk that investments are over-valued initially and we overpay. Or that projected returns do not materialise.	Increase the potential for lower returns and lowers the overall profitability. Additionally such a property will be difficult to sell in the market give the current circumstances and saturated retail market.

Examiners' comments

The candidate firstly provides interesting insights relating to enterprise risk management (ERM), and in particular the comment regarding measuring the veracity of risks, is insightful and value adding. It is also very impressive that the candidate mentioned the role of risk management in the value creation process and that robust risk management could create a strategic advantage for the enterprise.

The task required candidates to provide seven *key risks for Oikos* (describing the risk and the impact). Key risks can be defined as being risks, which could ultimately impact the *sustainability of Oikos*.

It would have further elevated the candidate's response, had the candidate explained briefly why certain risks which had been identified by Oikos' management as being key, were omitted from the list provided by the candidate. The candidate's response incorporated six risks considered key – the last risk could be mitigated and would not be a key risk for Oikos. The candidate did however stick to only providing seven risks as requested.

The candidate eloquently identified and described the risks as well as identifying the potential impact of the risks identified. The candidate correctly identified:

- Challenges around tenant retention and lease renewal negotiations given the oversupply of rental space and number of role-players in the industry,
- The macro-economic environment as having a negative impact on vacancy levels at the Oikos shopping centres.
- The risk of interest rate hikes given the rating agency issue as well as geo-political factors (impressive!).
- Increasing utility costs, which have been inflating at rates in excess of inflation, create margin pressure for the tenants and result in these administered costs not being recovered by Oikos.
- Social unrest in the areas where Oikos' centres are located posing a threat to the physical security of the shopping centres. The candidate also correctly implied that a reduction in footfall at these shopping centres could result from the political instability.
- Given the bullet repayments required, Oikos would likely have to refinance the debt facilities to extend the term of the facilities.

Task (g)

Competent
From: Newly Qualified CA (SA) To: Gideon Madima Date: 20 November 2019 Subject: Risk Register Good day Gideon As requested please find attached as summary of the seven key risks facing Oikos, as well as its potential impact on Oikos. Upon a review of some competitor integrated reports available online I do believe that the key risks outlined in the Power Point presentation are appropriate. However, I have included some additional risks as well. In relation to the potential impact, I have concluded on the severity and likelihood on each risk. Please expect a separate email soon regarding the roll-out of the free wi-fi in our properties. Please let me know if you have any queries on the attached. Kind regards, Newly Qualified CA(SA) **ATTACHMENT 1: KEY RISKS - OIKOS**

Key risk	Potential Impact on Oikos
1. The risk of increasing vacancies due to limited economic growth, increasing unemployment and changing consumer spending. This is also due to increased competition leading to difficulty in tenant retention.	This will have a both an operational and financial impact. In relation to the operational impact, more time will need to spent negotiating with current tenants to retain them. In relation to the financial impact, discounted rentals to retain tenants or a lost rentals due to increased vacancies leads to loss of revenue and subsequent distributable earnings. Severity = Critical Likelihood = Possible
2. Rising interest rates and the adverse impact on the group's gearing and cost of funding, both in relation to current debt as well as future debt for expansion.	This will have a both an operational and financial impact. In relation to the operational impact, more time will need to spent managing relations with current dent providers. A breach of any loan covenants due to this risk will result in disruption in operations and subsequent reputational damage. The financial impact is the higher cost of funding and a decrease in distributable earnings as well as the large adverse impact on cash flows should any debt

	covenants be breached and loans recalled. Severity = Serious Likelihood = Possible
3.Under-performing of third-party managers in collection of rentals as well as inaccurate invoicing of utility costs and upsetting tenants.	This will have a both an operational and financial impact. In relation to the operational impact, there is a reputational risk associated with tenant dissatisfaction. In relation to the financial impact, inaccurate invoicing may lead to risk of misstatements in financial reporting. Severity = Major Likelihood = Unlikely
4. Non-compliance with statutory laws and regulations applicable to the operations of Oikos e.g. Consumer Protections Act, Companies Act, Property Practitioners bill etc	This will have a both an operational and financial impact. In relation to the operational impact, there is a reputational risk associated with the breaching of any law. In relation to the financial impact, any possible penalties from doing so may have a large impact on earnings. Severity = Major Likelihood = Rare
5. The risk of IT systems failure and cyber security breaches	This will have a both an operational and financial impact. In relation to the operational impact, down time of mall servers leading to disgruntled tenants can lead to reputational damage. The loss of tenant / customer data due to cyber security breaches can also lead to reputational damage. The financial impact would be any damages claimed by tenants from Oikos due to events above. This may have a large impact on earnings. Severity = Serious Likelihood = Unlikely
6. Rising costs of occupancy for tenants from increased rates, taxes and utilities	This primarily has a financial impact due to the potential inability of tenants to absorb the costs. This will increase our net cost to income, resulting a decrease in distributable earnings. In relation to Oikos' operations, tenant relations will need to be carefully managed when on-charging these costs to avoid a break down in relations and loss of tenants. Severity = Serious

Task (g)

	Likelihood = Possible
7.Social instability risk, which relates to risk of political and social unrest in the socio-economic areas where the entity operates in.	This will have a both an operational and financial impact. In relation to the operational impact, management would need to dedicate time and resources to closely monitor the political and social condition of areas in which it holds properties, in order to adequately prepare for any unrest. The financial impact would be in the form of repairs and maintenance costs incurred to fix any potential property damages which may arises from such unrest. Severity = Serious Likelihood = Possible

Task (g)

Examiners' comments
Although the task required identifying ***seven key risks***, tolerance was incorporated in terms of, needing to identify an adequate number of key risks, including an explanation for each of the risks identified which entailed identifying the root cause of each risk, and thereafter indicating what the impact of each risk would be *on Oikos*. The candidate went further than the task required by assessing each risk in terms of the severity of the potential impact of the risk and the likelihood of the risk arising. The valid key risks identified by the candidate include: • The challenging macro-economic environment resulting in increased vacancy levels in the Oikos shopping centres and making lease renewal negotiations more challenging. • Increasing interest rates and their impact on Oikos – the candidate did not link this risk to the potential downgrading by Moodys in the near future, resulting in higher interest rates, while access to debt funding will likely become more challenging. • Rising occupancy costs is a risk as they cause margin pressure from the tenant-perspective. This could further result in recoverability issues from Oikos' perspective in recovering these administered costs from the tenants. • The risk of physical damage is valid given the location of the Oikos shopping centres. A further impact thereof, which the candidate should have identified is the negative impact on footfall resulting from protect action in the area where the particular shopping centre is located. The following risks, given that they are operational/legal/technological in their nature, will not have as severe an impact on the sustainability of Oikos, and hence were not considered key in determining the candidate's competence: • Underperforming third-party managers • Non-compliance with laws and regulations • IT-systems failures and cyber security threats Other valid risks which the candidate could have mentioned include: • Refinancing risk related to the bullet repayments at the end of the term of the borrowings in place. • The strategic opportunity missed by not making use of big data to identify key trends, which should be considered in Oikos' strategy formulation going forward. • Poor municipal infrastructure and service delivery. • The expropriation of land issue at present and the lack of certainty around the land issue in South Africa. The candidate's measurement scale could have seen the candidate using more appropriate terminology. For instance the occurrence of a risk is not rare but rather remote. In terms of severity of impact, the candidate could rather have used the term significant than serious, however the latter does not affect the assessment of this task.

Task (g)

Limited competent

To : Gideon Madima
From : Me
Date : 20-11-2019
Subject: Re: Risk register

Hi Gideon,

Not at all, I am more than happy to assist. Below, I have addressed all your concerns and questions.

Main risks or not

1. Increased vacancies - this is a problem for all property companies as reported by SAPOA.
2. Rising interest rates - with the moody's negative ratings the entire economy is feeling pressure so this is a big risk.
3. Under-performing third parties - we do not have much control over their operations so it is worth looking into.
4. Non-compliance with laws and regulations - this is a big issue in the country given the ethical dillemas faced by Rebosis directors with regards to the Jiraserve saga.
5. IT systems failure & cyber security - theft and misuse of data is big issue which the POPI Act and other data protection regulations are trying to deal with.

Top 7 risks

No	Risk description	Explanation	Potential impact on Oikos
1	Increased vacancies	This is a risk where clients either opt to use virtual shops like online stores to sell some of their products. Some tenants' business are closing down due to loss of sale	Property value decrease Revenue decrease
2	Rising interest rates	Increase in financial risk as we might find it difficult to settle high interest-bearing debts	Cash flow pressure High loan-to-value ratio
3	Under-performing third party managers	These managers could perform bad plumbing and maintenance work which could affect tenant business and assets Poor rent collection Poor credit assessment of tenants Incorrect invoicing Incorrect management reporting	Poor collection may result in increased credit losses Contracting defaulting tenants Unhappy tenants due to over or under-billing Incorrect decisions taken by management
4	Non-compliance with laws and regulations	New property laws may be difficult to comply with. Amendments to Property practitioner	Penalties and interests Damage to reputation Loss of tenants

Task (g)

		Act, like property defects etc We could also share personal data obtained from the wifi usage illegally.	Sanctions in Zambia
5	IT systems failure & cyber security	Hackers could steal tenant information either from our system or from the use of the new proposed wi-fi. Some tenants rely of connection at all times so we can't affect their business negatively.	Litigations against us Reputation damage Unhappy tenants
6	Rising costs	Increase in electricity costs, rates and utilities	We will be forced to recover these costs from tenants by increasing rentals which will result in unhappy tenants
7	Damage to property	Damages due to strikes and looting.	Increase to insurance premiums Non-renewal of leases Loss of potential tenants

For more information please do not hesitate to contact me.

Regards,
Me

Task (g)

Examiners' comments
This candidate's response is a good example of an inappropriate response, which was presented by many candidates for this task. In identifying seven ***key risks***, candidates needed to identify risks, which in essence could jeopardise the sustainability of Oikos going forward. As such, the following risks are not valid key risks: • Under-performing third party managers: this is an operational risk, with Oikos not having a dependency risk on the third party property managers. They could easily be replaced should the need arise – if need be, Oikos could even perform these tasks on an in-house basis. • Non-compliance with laws and regulations: although this legal risk is a valid risk that the company could be exposed to, it is unlikely that their non-compliance would result in a sustainability issue. • IT systems failure and cyber security risk: this too is an operational risk which would be contained before taking on strategic proportions. The candidate could in fact have been competent, had their risk identified been better explained and the impact(s) of these risks been correctly identified: • Rising costs: the fact that utility costs are increasing annually at rates in excess of inflation will make it increasingly more difficult for Oikos to recover these administered costs. Should Oikos not be able to recover these costs, then Oikos' own profitability and value will be at risk. The recovery of the administered costs will be part of the terms and conditions agreed to in the lease agreement – it is inappropriate to state that the recovery of these costs would result in unhappy tenants – they are required to pay for their agreed share of these costs. • Damage to property: the candidate failed to link this risk to the fact that the Oikos shopping centres are typically located in areas susceptible to protest action, hence an increased risk of potential property damage. The impact would also be a reduction in footfall, with customers avoiding these areas at times. With regard to the first two risks identified by the candidate: • Increased vacancies: although a valid risk, the candidate's explanation of the risk is problematic. Given that Oikos focuses on the lower LSM customer segment, would on-line shopping be a threat? No! The Oikos tenants are exposed to margin pressures due to the challenging macro-economic environment – this is the root cause of the threat of increasing vacancy rates. • Rising interest rates: the candidate failed to explain the interest rate risk and the root cause of the risk (possible downgrading by Moodys). The candidate therefore did not present enough, properly explained risks, in order for them to be considered competent on the task.

TASK (h)
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.

Highly competent

Email
From :Newly Qualified CA(SA)
Sent: Wednesday 20 November 2019, 17:00
To: Gideon Madima (CFO)
CC:
Subject: RE: Risk Register (B)

Good morning Gideon

Please find my response to your second query with regards to the risk register below.

I have added my comments on the risks already included in the draft risk register below, as well as additional risks to consider to add to the risk register.

1. Commentary on current risks included in risk register:

Risk 1: Wifi-Functionality

I agree that the wifi not functioning property is a risk in this case. I would, however, expand this risk by including the impact on our operations. As the wifi may be used by our tenants in their business operations for store management (such as real time accounting records and store surveillance), and in our own operations for our cloud based property management software which we intent to install, the risk should also include the effect on our operations.

I would also add into the response that we intent on having support staff available at all times on call-centres to follow up on any wifi problems, as well as spot checks after the roll out to ensure the wifi is working accordingly.

Risk 2: Cost of Wifi

I would rephrase the risk, as we would not be directly earning revenue from the wifi installation. The installation will impact on our tenants, who would have higher revenue figures and more footfall. This will indirectly affect our ability to retain tenants and improve our vacancy. We could rephrase it as 'the benefit' obtained from the wifi.

The response can then be rephrased to what additional revenue can be earned from advertising to customers and from the sale of customer data collected to tenants. I would, however, refrain from including the last initiative with regards to selling customer collected data to tenants, as this is against the Protection of Personal Information (POPI Act), and we will not be allowed to sell customer data, unless agreed to by the customer. We can, however, use the analytics obtained from the data and sell these to tenants to improve their own operations.

2. Additional risks to consider:

Please see the additional risks that will have to be considered with regards to the free wifi:

Risk	Response
The wifi may result in security breaches with regards to shoppers accessing illegal websites from the wifi, which can result in legal prosecution against Oikos.	Approach a reputable site developer to assist in creating the website to host the shoppers, at which point the shopper will have to agree to the terms and conditions of using the free wifi and the restrictions with regards to using the wifi. Approach a reputable IT and software engineer to assist with blocking pages and websites with illegal contents from being accessed by the shopper.
The wifi may be hacked by means of backwards hacking, through which hackers may obtain access to the systems of Oikos, resulting in a loss of data and data corruption.	Approach a reputable IT and software engineer to assist with building and installing the necessary fire walls, in order to ensure data privacy and no unauthorised access being obtained to the wifi.
The costs with maintaining the wifi with regards to updates and hardware upgrades may be costly, which can result in long term losses from this project.	Approach the financial division of Oikos and create an appropriate budget with regards to the costs to maintain and update the wifi project, and plan these expenses into the overall budget for Oikos for the upcoming years.
The wifi may not be accessible or as cost effective in rural areas where wifi availability such as fibre is minimal. This may result in higher costs in rural areas, with fewer competitive quotes being available, which may result in larger losses.	Do research with regards to the availability of fibre and other wifi networks such as ADSL in each are where there is an Oikos shopping centre, and approach developers and Internet Service Providers as to opportunities to partner with these providers to install reliable internet access in these areas.
The unreliable electricity supply can have an effect on the availability of Wifi in the areas affected by electricity shortages, such as load-shedding.	Ensure that the wifi network also runs on the shopping centre's emergency power supply (generators, etc). Do research and have an ongoing team responsible for being up to date with planned outages to ensure that the emergency power supply is available on these dates.

If you have any questions or additional comments on the risks I have provided above, please feel free to let me know.

Kind regards
Newly Qualified CA(SA)

Task (h)

Examiners' comments
This candidate critically responded to the identified risks (ongoing maintenance, impact of risk on the operation, Increase in footfall and impact of selling customer information) and identified other risks (security breaches, unreliable electricity supplier, and accessibility of wi-fi due to fibre). What elevated this attempt to highly competent included: • Identified that availability of the wi-fi, due the limited availability of fibre and responding to the risk appropriately by assessing availability and partnering with a service provider to provide reliable wi-fi service • Other risks and responses were well articulated. (Security breaches, unreliable electricity supplier, and accessibility of wi-fi due to fibre) • Communication skills displayed

Task (h)

Competent
To: Gideon Madima From: Newly qualified CA(SA) Subject: Risk register Date: 20 November 2019 Good day Gideon In addition to the email sent previously, I chose to send this email separate in order for you to better keep track of the two separate issues required. Please see my response below relating to the free wifi roll out. I agree with the first risk that you raised. If wi-fi is not available or adequate this could definitely lead to unhappy customers. To expand on this risk I would suggest including the following as well to expand: High volumes of traffic could slow down download speeds which would lead to wi-fi not being usable by customers further leading to their frustrations. I agree with your response as well. I have however noted the following responses to add: 1. We need a reliable service provider in order to adhere to the continous needs required in the malls. This includes contacting various service providers before finding the one that will best suit our needs. We also need to compare prices and services delivered before deciding on one to use 2. We also need to consider the bandwidth that would be needed in order to ensure appropriate speeds are generated in order to prevent lagging of wi-fi or inability to operate on the wi-fi. 3. It would also be good to have an in-house IT expert that can assist with the relevant IT needs if not required to be performed by the service provider With regards to the second risk, I agree that there is various additional cost that needs to be considered such as initial implementation cost, monthly wi-fi etc. It is a big risk that we would incur to much cost without being able to recover any of it. I however think the wi-fi implementation should not merely be a source of additional revenue but the focus should rather be the overall benefit of the free wi-fi that should be embedded in future tenant retention through them acquiring additional revenue from customers and therefore wanting to lease from us. It is however crucial that we try and recover some of the cost of the wifi. In addition to your responses I have the following comments: 1. It is a great idea to try and advertise on the free wi-fi. This could help us recover some of the cost by way of monthly advertising fees being charged 2. We should have discussions with the tenants. Some of the cost of the wi-fi might be incorporated in their monthly rental. We however have to market the additional benefit they will receive very carefully as we do not want to exploit them. 3. We should research the possibility of getting government funding for the project- seeing as this is in a LSM area, there might be a possibility to obtain funding from government and getting a government BEEE accredited service provider to handle the project. 4. We should be careful about selling data of customers to tenants and other retailers. The Protection of Personal Information Act. prevents us from sharing personal information without the appropriate consent. This should be carefully considered and the right avenues have to be taken. legal opinions as well as appropriate consent from customers needs to be

obtained before this can be done.

I have also raised the following risks and responses to mitigate these:

Risk:	**How to mitigate the risk:**
1) There is a risk that customers only visit the mall for the free wi-fi but no shopping takes place leading to the tenants not really benefiting from implementation	The wi-fi given should be capped to say 50mb per customer per day. If additional mb's are needed they will need to purchase goods from one of the tenants in order to obtain a wi-fi promo code. This would ensure customer spending and benefits to the tenants
2) Risk of illegal activity being performed on the wi-fi putting company and tenant reputation at risk	Service provider should be informed that the appropriate firewalls are needed. They should also provide regular feedback on review activity on the various sites. In addition certain sites should be blocked from entering them
3) Risk of hackers stealing personal information from the customers and tenants and therefore potential claims being made against the tenants and or Oikos.	The necessary firewals and security should be in place from the service providers' side. Furthermore a risk plan should be implemented should this occur. Furthermore, the company should ensure appropriate terms and conditions are set up which is accepted by the customers and tenants before logging into the wifi.
4) Risk of theft of cables and routers leading to additional cost for Oikos to replace them	Sufficient insurance cover needs to be in place to address possible theft and damage to ensure we can claim money back should this occur
5) Inaccurate budgeting and planning leading to high levels of cost being incurred and unecessary additional expenses being incurred	A detailed budget and cost allocation needs to be prepared prior to the start of the project. Regular budget to actual analysis needs to be performed and overruns needs to be assessed.
6) Risk that the wi-fi implementation does not comply with the necessary laws and regulations leading to penalties being incurred or the project needing to be halted	A legal expert needs to be approached to ensure Oikos is compliant with all laws and regulations before the project is started. Also continous discussions with legal experts need to be ensured.
7) Risk of overcrowding in malls from people that do not want to shop but merely wants to use wi-fi for personal gain. This can discourage users that actually want to shop and put strain on customer / tenant relationships.	This links in with the response above. Users will only have access to a certain amount of data before being prompted to buy additional megabytes from the tenants in order to receive a promo code.

I trust the above will assist you in setting up a risk register for the free wi-fi effectively

Kind regards
Newly qualified CA(SA)

Task (h)

Examiners' comments
The task required the candidate to address the existing risks in the risk register on the day and to give additional risks that should be considered for the implementation of free wifi. This candidate demonstrated the ability to discuss and respond to the risks identified and other risks, with appropriate responses to mitigate these risks. The candidate was able to address the ongoing maintenance by a service provider and vetting of suppliers for the first risk identified. Discussion around consideration of additional costs and selling of the customer data that could be in breach of POPI ACT were also considered for the second risk. The candidate addressed the risk of customers visiting the malls just for wi-fi, security breach, theft of cables and routers with appropriate responses needed to mitigate these risks (restricting user time or data limits to prevent network overload), firewalls and sufficient insurance cover for any incident). The candidate was able to answer the tasks leading to competency with some improvement needed. Some of the risks and responses were repeated or not relevant.

Limited competent
Email From : Newly qualified CA(SA) Date : 20 November 2019 To : gideon madina Subject: RE :key risk register risk of identified risk review -1 not adequate as customers next to mall go for buy groceries and some don't have wifi - not adequted as Oikos can rent the infrustructure with is cheaper additional risk - risk of not compliance with POPI Act - not adquate staffing to roll out the project - risk of cyber security and hacking please let contact me for more details kind regards Newly qualified CA(SA)

Task (h)

Examiners' comments
This candidate failed to critically comment on the identified risks and responses and to identify sufficient other risks relating to the roll-out of free wi-fi with appropriate responses. The attempt of this task was limited, it showed lack of planning, preparation and understanding of the task. Had some discussion around the identified risks which were not considered to be relevant, as the discussions were around customers going to the mall to buy groceries not for wi-fi and Oikos being able to rent infrastructure that is cheaper. The risk of non-compliance with POPI Act and risk of cyber security and hacking were considered with no responses to mitigate these risks. The candidate response was too brief and limited, hence limited competence was displayed for this task. There were numerous relevant risks and responses that could have been considered: • Risk of cyber security (Firewalls) • Non Compliance with POPI Act (Getting consent, terms and conditions) • Unreliable electricity supplier (Generators) • Risk of customers visiting the malls just for wi-fi (Restricting user time or data limits to prevent network overload) • Theft of cables and routers (Sufficient insurance cover for any incident)

TASK (i)
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.

Highly competent

From: Newly Qualified CA(SA)
To: Freeman Njeke
CC:
Subject: Hope for children trust

Hi Freeman

Thanks for giving me the opportunity to give my input on this matter

Please see my responses in the attached document.

I would prefer to discuss this with you rather than having it included in an agenda. I will be available at you request

Let me know if anything is unclear.

Kind regards
Newly Qualified CA(SA)

Attachment to document I
Hope for Children Trust

Thoughts on Governance

I believe that Governance in a NPO such as the hope for children's trust is just as important, if not more important than for normal privately held companies The reason for this is the increased societal impact and general interest to act in the public interest (as a charitable trust). With this is mind I think I have the following areas that require attention:

- Conflicts of interest at trustee level

I believe that there might be a conflict of interest for the interest of Freeman Njeke and Hendrik Jooste.

Freeman Njeke is acting for the benefit of the trust in relation to the "urgent matter" in the previous minutes, but to the detriment of Oikos of which he is indirectly a shareholder as well as a Chairman to the board. He is also likely a beneficiary of the Njeke trustee that provided the funding to acquire the shares in Oikos and is currently receiving 10% per annum in interest, not being market-related supports my opinion regarding the independence of the board. Hendrik Jooste wants to use this position as a trustee to influence bursary allocations (in terms of schools). This is so that the academic results of his school looks better as the students getting bursaries are performing well academically.

Trustees have an fiduciary duty to act in the best interests of the trust. Whilst employees/directors have an legal obligation to act in the best interest of their respective companies.

Task (i)

- Representation of an independent trustee

The presence of an independent trustee on the board will greatly enhance the credibility of the trust and could attract more donations. All trustees are either directly involved with the operations, have an interest indirectly or in the case of James Kolisi, might feel indebted to the other trustees for the bursary and will not be willing to say no.
I will not be independent as I will be employed by Oikos and will not be able to fulfill this role.

- Ethics

The trustees should lead ethically and effectively and create an ethical culture for other employees or volunteers to follow. I believe their are indications that trustees have inclinations to act un-ethically in a sense. This is evidenced by the fact that the audit trail of allocations are not very strong and that a familiar auditor will be appointed as to avoid "in depth" investigations and verifications.

- Enable stakeholders to make informed decisions

Based on the fact that the bookkeeping and audit trail of allocations are poor, I believe that we are not enabling stakeholders, especially donors and funders (such as banks) to make informed decisions about capital allocations to the trust. The reporting we do should be meaningful and a faithful representation of the allocations and other transactions we have entered.

- Appointment process

The appointment process as a trustee should be formalised and transparent. This will ensure that the right candidates are appointed. I believe that due to the fact that I can be appointed with this speed might place doubt over the authentication and transparency of my appointment and the process a as whole. A formal process is crucial to ensure that credibility is kept - which will ensure better funding.

Thoughts on Finance

- Bursary allocations: Private schools

Private schools are a lot more expensive than public schools. I think an assessment needs to be undertaken to determine whether the benefit of private schooling for one individual will outway the benefits of public education for up to 5 pupils every year. I think that private school bursaries can be awarded to individuals who perform well academically, but we need to be congnisent of the fact that there are millions of children that can't attend school at all. Perhaps there is away we can better the public schooling received in the areas by having an after school - help centre where learners can get help with homework they are struggling with. I think By doing this we can increase our impact/footprint.

- Investment in shares: Oikos

I believe the investment in Oikos is not appropriate given the goals and objectives of the trust. The Trust needs annuity type income to pat yearly bursaries, and Oikos does not offer this type of return or cash flow. An investment in a listed REIT will over this type of income, and will reduce the pressure on servicing debt as well as ensure cheaper financing from banks. Currently we have no cash inflows, which is not sustainable and given our operations and the public benefit derived thereof, we need to ensure our sustainability.

The financial situation of the trust leads me to believe that it is currently not being run as a financially viable institution, and as such is coming up short in it's objective to be a public benefit organisation.

General thoughts about appointment

As a CA(SA) I have to comply with certain ethical principles. In saying this, I think there might a few instances where might feel a bit uncomfortable as part of the board considering my duty, and moral conviction to cat in an ethical manner. Perhaps I am just reading the situation and you can clarify for me.

I am uncomfortable with the statement that "If I conduct myself appropriately". As a CA(SA) I value my integrity and I have a duty to act with honesty. I am not sure what you meant by this statement, but could you perhaps clarify?

I am not sure what exactly my role as a CA(SA) will be, but if it involves the preparation of the financial statements I have a duty to fairly represent the underlying economic reality f the company's state of affairs. As such, I will compile the statements in accordance with the appropriate accounting framework, and ensure the statements and presentations made within them are complete, accurate and free from error or bias to the best of my ability, i.e. a faithful representation of the facts and circumstances.

I would just like to point out as well that I do not intend to be a front or serve as a "window dressing" for the governance of the trust just to attract the funds of donors. If I serve as a trustee I intend to do all that I can to act to the benefit of the public, as this is part of my ethical requirements and moral conviction, as well as the role of a charitable trust.

Proposed auditors

Lastly, I would just like to discuss the independence of the auditors for the audit of the financial statements of Oikos. The trust has a close relationship with the Njeke family and the fact that the audit firm do extensive work for the Njeke family and its business interests.

The auditors need to be independent both in appearance and in mind to be able to conduct the audit in accordance with the highest quality standards as well as the auditing standards. I believe that both in appearance and in mind, they are no longer independent. This is more evident based on the fact that Izza and Associates have in the past relied quite heavily on the work of internal audit.

Task (i)

Examiners' comments
This candidate understood the crux of the task which was to address both the governance and funding concerns of the trust. What elevated this candidate to highly competent was the following: • The candidate not only addressed governance and funding concerns that was evident from the "pre-leased" information, but was also able apply the "information on the day" in considerable depth to both the governance and funding concerns. **Governance** • From a governance perspective he/she understood that there was a number of conflict interest issues, and noted Freeman who is the chairman of the board of Oikos as well as the chair of the Hope for Children Trust. In addition, he/she also identified that Hendrik Jooste was not independent which information which was only evident on the day was. • Still from a governance perspective, the candidate noted the poor record keeping of the trust, and how this could possibly be keeping the trust from getting donors as there is no reliable information to provide to prospective donors. • The candidate also understood that appointing auditors who are familiar to obtain a favourable report, is both an ethical concern as well as something which is a threat to the auditors' independence. **Funding** • The candidate clearly understood that the current funding model is unsustainable • In addition, the candidate questioned how the trust could even go ahead with the suggestion of purchasing properties for resale if they have cash flow constraints, not to mention that this of course places the needs of the trust over Oikos. • The candidate also questioned why bursaries should only be for private schools when there are good public schools and especially given the cash flow constraints of the trust which was quite insightful **Tone** • The nature of this task was that the candidates were expected to highlight concerns, and in practice pointing out the weaknesses can be quite difficult when trying to maintain a respectable tone. This candidate was able to be stern in pointing out a significant number of concerns but at the same time it did not come across as rude or disrespectful, which was quite well done.

Task (i)

Competent
To: Freeman Njeke Date: 20/11/2019 From: Newly Qualified CA(SA) Subject: Hope for the children trust Good afternoon Freeman, I would firstly like to thank you in giving me this opportunity in giving back to my community. Giving bursaries to disadvantaged children is a noble cause and hope I can make an impact if I decide to join the trust. I believe i can add value and ensure an effective governance structure. I would like to add the following agenda points for the next meeting: <u>Financial difficulties experienced by the trust</u> The trust in its current form is not sustainable. The trust is currently growing large amounts of debt which is unlikely to be settled in the future as Oikos is currently in a growth phase. The trust needs to restructure its financing. <u>Donor funds - Change in procedures and policies</u> If the trust is to accept donations from donors in the future, it needs to implement additional controls in order to safe guard donor funds. This includes controls over bank accounts, changes in structure so that bursary candidates are selected transparently and fairly, greater transparency in relation the financial performance and position etc <u>Strategy, objective and purpose of the trust</u> The objective, strategy and ultimate goal of the trust needs to be evaluated. The trust was established for non-profit purposes however it is considering profit generating operations to sustain itself. This may cause compliance and regulatory issues. <u>Legal and Tax compliance of the trust</u> If the trust is to accept donations, it needs to be registered as a non-profit organisation per S30 of the income tax act in order to avoid tax on donations at the trust rate. It is also required to register as a PBO to issue certificates to donors (This will make donations tax deductible and entice more donors) <u>Appointment of auditor</u> I think the board should consider various auditors before deciding on Izza. The costs, reputation and benefits should be compared. I feel that appointing the right auditor to the trust will ensure value added services ie identification of deficiency in control, identification of areas of non-compliance which can be addressed in the future, suggestions for improvement etc It is also inspiring to see that you have a positive attitude towards the governance and ethical conduct of the trust, as requested I have formulated a professional opinion on the trust's current governance structure and provide steps on how it can evolve and grow to be and to be seen as a responsible corporate citizen. The opinion I have created is based on the principles and

framework prescribed by the King Code - 6.3 supplement for non-profit organisations. The framework provides the best practices for non-profit organisations.

My suggestions for improving governance are as follows:

- Interest bearing debt must be restructured, the trust should balance being financially viable as well as meeting its objective sustainably
- The structure of the trust needs to be amended. Additional independent non-executives need to be placed onto the trust - if not possible, the current member may have to be changed . King IV recommends that a conflict of interest should be avoided on the board. Conflicts of interest include personal and financial - for example Hendrik Jooste can be seen by outside parties to benefit financially from students being enrolled at his school.
- The trust should reconsider how it maintains its financial records, maybe by an external party. In do not think appointing Oikos' financial department is advisable. King IV advices that the governing body be seen as a responsible corporate citizen - which is unbiased and uninfluenced. Donors could think that Oikos' has too much influence over the trust
- If additional shareholders are accepted, the board of trustees should be amended, King IV recommends that a stakeholder inclusive approach be adopted. Until this point, Oikos has been the only donor and has benefited from the trust and its reputation. If more donors are added to the trust, the trusts actions should reflect consideration for all stakeholders.
- A remuneration / nomination policy should be set. King IV recommends this, so that a separation of interest takes place - this also ensures that current members are fairly remunerated in relation to the market and that those with the best interest of the trust are appointed.
- We need to evaluate and determine what laws and regulations the trust needs to comply with and make all trust members aware - statutory compliance is key for good governance

I would like to commend the committee on the following points so far:

- The trust has enabled previously disadvantaged children the right to an education
- The committee has a diverse range of skills and experience which is key
- The CEO demonstrates an eagerness to lead ethically and effectively and wants to govern ethics in a way that supports the establishment of an ethical culture, the two key principles of the King Code

I think the above points are the starting point to success and with time, the trust can flourish.

Once the above is discussed and navigated through at the next meeting, I will convey my decision accepting my appointment as trustee

Warm regards,
Newly Qualified CA (SA)

Task (i)

Examiners' comments
This candidate understood and addressed the crux of the task which was the funding and the governance concerns. From a governance perspective, that candidate identified conflict of interest arising from the "on the day" information relating to Mr Jooste. In addition, he/she provided valuable insight as to why an independent auditor should be appointed as they can provide valuable suggestions for improved sustainability of the trust. From a funding perspective, the candidate understood that the funding model was unsustainable due to the growing debt. There were however a number of matters which the candidate either did not address or which was irrelevant. These included: • At times they were a bit long-winded on King IV, where a straightforward application of the facts to the task required would have been more appropriate • The candidate did not address any concerns around the record keeping and bursary allocation process of the trust • The candidate did not address the suggestion made to purchase properties identified by Oikos and selling it Oikos at profit. This would of course be placing the needs of the trust above Oikos and it would have been good if the candidate raised this. Regardless of the irrelevant information provided, the candidate gave sufficient coverage of the governance and funding issues to be deemed competent in this task.

Task (i)

Limited competent
Email To : Freeman Njeke From : Me Date : 20-11-2019 Subject: Re: Hope for the Children Trust Dear Mr Njeke, I am honoured to have been selected as an individual who can lend financial credibility to the Board of Trustees. <u>Items to place in the agenda</u> • Bursary allocations - Reason: why don't we take learners to good performing government schools • Governance - refer to reason below <u>Improvement to governance of the Trust</u> The trustees have a fiduciary duty and should act in the best interest of the trust. The best way to improve governance is to comply with the King IV code which sets the standard for best practice. Some of the principle therein indicated the following: • The organisation should be and be seen to be a responsible corporate citizen • Composition of the board - should be comprised of the appropriate balance of knowledge, skill, experience, diversity and independence for it to discharge its governance role objectively. • The board should act in the best interest of the organisation • The board should avoid conflict • The board should act with due care and diligence • The board has the responsibility to anticipate and prevent negative outcomes • The board should adopt a stakeholder-inclusive approach in executing responsibilities • The board should approve code of conducts and ethics policies Below are my observations which are not in compliance with the above principles and requirements. We should correct them and I suggest we discuss them in our next meeting. • Chairman of Trust is chairman of Oikos - the chairman is currently not independent • CEO of Trust is the brother of Chairman of Oiko - CEO is not independent • Jooste is principal of TipTop high school who benefit indirectly from the bursaries - not independent • As an employee of Oiko - I am not independent • Mr Freeman informing the Board about properties that could yield good return for the Trust with minimal risk   • This would be taking away opportunity from Oikos and not acting in the best interest of Oikos. • The use Oiko's boardroom shows the conflict We need to replace the board members with independent members if we want to secure funding. <u>Improvement to funding of the Trust</u>

Task (i)

- Loan to the Njeke Family Trust - As Oikos, let's reduce the interest rate.
- Bank financing - let's negotiate better since Oikos has a good relationship
- Oiko dividends - We don't have control here
- Bank overdraft facilities - let's replace with cheaper debt
- Raising funds from corporate donors:
    - Audited AFS of medial publicity
        - Ability of audit to evaluate the bursary allocation - yes it is possible if designed correctly through analytical procedure and third party confirmations.
        - Izza & Associates to perform audit
            - Since the auditors have performed extensive work for the family and its business interest it is advisable to appoint a different auditing firm. Their involvement will create a conflict of interest which create a threat to their objectivity, there is a familiarity threat and they should not to take the work.
        - Reportable irregularity - the sale of property to Oiko at a significant profit may be picked up by other auditors and reported to IRBA so we should be careful here.
        - Favourable audit report - unfortunately the auditors need to act objectively and issue an opinion based on facts we should accept any valid opinion.
    - CA (SA) as part of the board for media publicity:
        - My involvement in the Board of Trustees creates a conflict of interest because the Trust is our shareholder and this creates a threat to objectivity as per my professional code of ethics. It is for this reason that it is advisable for me not to accept the appointment because it will be in contravention with the professional body code which may result in me losing my CA (SA) designation. I am also expected to act with professional competence and due care, accepting the appointment will not be professional behaviour from my side.

<u>Trust purchasing properties that would be of interest to Oikos</u>
Concerns:
The Jiraserve sagais making news and we if our transactions is picked up by the media, the directors might be reported as delinquent-.

- Sold to Oikos after Six months at a significant profit:
    - Oikos recognises Investment property at high cost (over-valued)
    - Not in the best interest of Oikos

I appreciate the opportunity for opening of doors in Oikos but I am determined to work hard and earn my way up.

I would not have a problem with no remuneration because I would be my way of giving back to the community.

For more information please do not hesitate to contact me.

Regards, Me

Task (i)

Examiners' comments
The candidate did well to identify the independence/conflict of interest concerns of the Mr Njeke as well as Mr Jooste, but did not show that they understood that the current funding model is unstainable. This was evident as the candidate suggested cheaper interest rates etc. but debt in itself is unsustainable especially given fact that there are no inflows. In addition, the candidate listed a number of points which were either not relevant or they did not show enough application of the facts to the crux of the task for e.g.: • Stating that the bursary allocation process can be audited through analytical procedures? How the process should be audited was not asked for, what would have been more appropriate is to link the poor paper trail back to why there are governance concerns. • While touching on the favourable audit report, the candidate stated that "we should accept any valid opinion", again while this may true, a key concern here in the context of the task was that the candidate should have questioned the integrity of the trustees if they are only wanting to appoint familiar auditors in the hope of getting a favourable audit report. • The reference to the reportable irregularity due to the sale of properties, is incorrect as this would not be illegal, but the key issue would have been that the trustees would be placing the needs of the trust over that of Oikos. • The candidate was also too long winded with dumping the King IV code, where a straightforward application of the facts to funding and governance concerns would have been more appropriate in the context of the task.

