Part (a)	**With reference to the development of the CargoPlat™ app –** **(i) explain, with reasons, from which date an intangible asset should have been recognised given that the CargoPlat™ app meets the definition of an intangible asset in terms of IAS 38;**	**Marks**
1	*An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:* *(a) The technical feasibility of completing the intangible asset so that it will be available for use or sale.* *(b) Its intention to complete the intangible asset and use or sell it.* *(c) Its ability to use or sell the intangible asset.* *(d) How the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.* *(e) The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.* *(f) Its ability to measure reliably the expenditure attributable to the intangible asset during its development (IAS 38.57).*	
1.1	UC demonstrated the **technical feasibility** of completing the CargoPlat app on **2 May 2022**, when the board approved the technical details of the app. The IT team demonstrates that the **technical feasibility** was met on **2 May 2022** as the board instructed the IT team to design an outline framework for a concept version of the design of the app.	1
1.2	UC demonstrated its **intention to complete the app and use** it on **10 January 2022,** as all the directors pledged their commitment to make the stated dream a reality.	1
1.3	UC demonstrated its **ability to use the app** on **5 March 2022**, where the market research report indicated that there was a market *(significant number of users are likely to use such an app and services)* for the app after Trokkie's detailed report was approved, which emphasised that UC has all the technology and resources to develop such an app and use it effectively in its operations.	1
1.4	UC demonstrated how the app would **generate probable future economic benefits on 11 June 2022** by approving the formal budget of future expected profits from using the app and forecast of the development costs of the CargoPlat app and the expected (probable) profits. By that date, **market research** had also indicated that a **significant number** of companies would probably use such an app and UC's services.	1
1.5	UC demonstrated the availability of adequate **technical and other resources** to complete the development and to use the app on **10 January 2022**, based on Trokkie's detailed report that UC has all the technology and resources to develop such an app and use it effectively in its operations. However, UC demonstrated the availability of adequate **financial resources** to complete the development and to use the app on **17 June 2022**, when it received confirmation from its local bank for a loan. *(Before then, UC did not have the financial resources and the company was facing funding pressures.)*	1 1
1.6	UC demonstrated its ability to **measure reliably the expenditure** attributable to the development of the app on **11 June 2022**, with the board's approval of the formal budget of future expected profits from using	1

	the app and forecast of the development costs and seeing that they have an accounting system.	
2	Conclusion It seems that all the criteria for the capitalisation of development cost as an intangible (under IAS 38.57) were met on **17 June 2022** (the latest dates indicated in applying the individual criterion above).	1C
	Available	**8**
	Maximum	**7**
	X1: Communication skill – logical argument	*1*
	Total for part (a)(i)	**8**

Part (a) With reference to the development of the CargoPlat™ app – (ii) prepare an extract of the prior period error note in the financial statements of UC for FY2024. • **Only present any correction for each individual financial statement line affected and do not present any subtotal or total of any statement.** • **Do not present the totals of the closing balance of equity items at the end of the year.** • **Narrative information is not required.** • **Ignore all forms of taxation.**			**Marks**
Extract from prior error note			
	31/12/2023	**31/12/2022**	
	R	**R**	
Effect on the statement of profit or loss and other comprehensive income			
(Increase) in cost of sales/amortisation/operating expenses (½) (amortisation: R5 010 000 / six years' useful life)	(835 000)		½
(Decrease) in revaluation surplus (OCI) (½)	(120 000)		1
Effect on the statement of financial position			
(Decrease) in intangible assets (1)	(2 325 000)	(1 370 000)	1C
(Decrease) in the revaluation surplus (½)	(120 000)		½
(Decrease) in opening retained earnings (½) *(could also be presented as an effect on the statement of changes in equity)*		(1 370 000)	½C
Calculations			
C1: Calculation impact on the financial statements			
(Research costs should have been expensed in 2022 (1))	(1 200 000)	(1 200 000)	1
(Launch event costs should have been expensed in 2022 (1))	(170 000)	(170 000)	1
(Revaluation model could not be applied as there is no active market and the accounting policy of UC is to measure intangible assets under the cost model in 2023 (1))	(120 000)		1C
(Accumulated amortisation: R5 010 000 / 6) (1)	(835 000)		1C

Decrease in intangible assets	2 325 000	1 370 000	
(Research costs should have been expensed in 2022 (½))		(1 200 000)	½C
(Launch event costs should have been expensed in 2022 (½))		(170 000)	½C
Decrease in opening retained earnings		1 370 000	
	Incorrect treatment	**Correct treatment**	
C2: Calculation of the app recognised as an intangible asset	**R'000**	**R'000**	
Research phase	1 200	–	
Development phase	5 010	5 010	
Launch event during IT convention	170	–	
Initial cost – December 2022	6 380	5 010	
Revaluation during FY2023	120		
Amortisation for FY2023 (5 010 000 / 6)		(835)	
Closing balance	**6 500**	**4 175**	
Correction needed (4 175 – 6 500)		**(2 325)**	
		Available	**8.5**
		Maximum	**8**
		Total for part (a)(ii)	**8**
		Total for part (a)	**16**

Part (b)	**With reference to the lease agreement with ITT –** **(i) discuss whether you agree that UC may have elected the recognition exemption at the commencement of the lease;**	**Marks**
1	*An underlying asset can be of low value only if –* *(a) the lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee;* *and* *(b) the underlying asset is not highly dependent on, or highly interrelated with, other assets (IFRS 16.B5).*	
1.1	UC needed to consider the guidance of what is regarded as of low value, as noted below: UC **cannot** use each individual component of the server **on its own** because the server acts as one uniform device **OR** UC can only use the individual components together with the other components, which are all part of the lease agreement and are **readily available** to UC as the lessee.	1
1.2	Therefore, the second criterion is not met as the individual components are **highly dependent** on, and **highly interrelated** with, the other components of the servers as the components need to be c**onnected and working in sync in order for the server** to act as one uniform device.	1 1
2	<u>Conclusion</u> As the criteria for a low-value asset has not been met, UC should not have elected the recognition exemption based on the low value of the individual components but should have treated the **whole server as a single lease,** because the aggregate value of components (each valued at between R30 000 and R75 000) exceeded the low value accounting policy threshold of R80 000.	1C
	Available	**4**
	Maximum	**4**
	Total for part (b)(i)	**4**

Part (b)	**With reference to the lease agreement with ITT –** **(ii) prepare the journal entries to correct all aspects of the lease on 1 January 2024.** • **Irrespective of your answer in part (b)(i), assume that UC has not elected the recognition exemption.** • **Assume that journal entries that relate to any previous financial year cannot be posted to the previous year, and that any correction should be made to the opening balance of the items as at the beginning of the current year.** • **Assume that all corrections are material.** • **Ignore all form of taxation.**			**Marks**
Journal entries				
		Dr.	**Cr.**	
Right-of-use asset (server) (SFP) **C1**		720 508		
Lease liability (SFP) (amort 12)			543 052	1
Retained earnings: opening balance (SCE) **C2**		29 380		
Accumulated depreciation: Right-of-use asset (SFP)			240 169	1
Correcting the recognition of the lease of the server				

Calculations		
	Amount	
C1: Measurement of lease	**R'000**	
Initial measurement of lease liability: PV = ? 12 pmt/year (½); n = 36 (½); PMT = 25 500 (½); I = 11.75(½)	770 508	2
Initial measurement of right-of-use asset (same as lease liability (IFRS 16.24(a))	770 508	
Less: Lease incentive received (IFRS 16.24(b))	(50 000)	1
Total	**720 508**	
C2: Retained earnings – opening balance	**(xx) = cr**	
Lease expense incorrectly recognised in FY2023, to be corrected (alt C3): [(36 x 25 500 (1) – 50 000) (½)] x 12/36 (½)	(289 333)	2
Depreciation on right-of-use asset for FY2023 (720 508 / 3) (1)	240 169	1C
Finance costs on lease liability for FY2023 (amort 1-12) (1)	78 544	1C
Total	**29 380**	
C3: Net straight-lined lease expense (correct to the opening balance of retained earnings), and balance of lease accrual		
Total lease payments (36 x 25 500) (½)	918 000	½
Less: lease incentive received (½)	(50 000)	½
Net lease payments	**868 000**	
Recognised for first year (868 000 / 3) (½)	289 333	½
Cash flow during the first year [(25 500 x 12)(1/2) – 50 000] (½)	256 000	1
Balance of accrued lease	**33 333**	

Part (b) ALTERNATIVE			**Marks**
Journal entries			
	Dr.	**Cr.**	
Right-of-use asset (server) (SFP) **C1**	720 508		
Lease liability (SFP) (amort 12)		543 052	1C
Retained earnings (SCE)	240 169		1
Accumulated depreciation (SFP)		240 169	
Retained earnings (SCE)	78 544		1
Lease liability (SFP)		78 544	

Calculations		
	Amount	
C1: Measurement of lease	**R'000**	
Initial measurement of lease liability: PV = ? 12 pmt/year (½); n = 36 (½); PMT = 25 500 (½); I = 11.75(½)	770 508	2
Initial measurement of right-of-use asset (same as lease liability (IFRS 16.24(a))	770 508	
Less: Lease incentive received (IFRS 16.24(b))	(50 000)	1
Total	**720 508**	
C2: Retained earnings – opening balance		

Depreciation on right-of-use asset for FY2023 (720 508 / 3) (1)	240 169	1C
Finance costs on lease liability for FY2023 (amort 1-12) (1)	78 544	1C
Available		**12.5**
Maximum		**12**
Total for part (b)(ii)		**12**
Total for part (b)		**16**
TOTAL FOR PART 1		**32**

Part (c)	Discuss whether or not UC's financial statements for FY2024 are required to be audited or if an independent review would be sufficient.		Marks
1	In terms of s30 (2a & b) and s30(7) of the Companies Act read with Companies Regulation 28 and 26, the annual financial statements must be audited in the following circumstances:		
1.1	*If it is a public company* – as UC **is a private company ((Pty) Ltd),** this requirement is not met.		1
1.2	*If it has elected to be audited in terms of the company's Memorandum of Incorporation (MOI) or if a shareholders resolution requires it or if the company's board has so determined – as the board is reconsidering the audit of the financial statements.* • UC's **MOI does not contain a voluntarily audit clause** and • an audit is also **not required by the shareholders**.		 1 1
1.3	*A company that holds assets in a fiduciary capacity for persons who are not related to the company and such assets exceeds R5 million or if it is a non-profit company meeting certain requirements (for example a state-owned entity).* • UC is a technology company in the trucking industry and, evident from the financial statements, it appears that **no such assets** are being **held** for **3rd parties in a fiduciary capacity**.		 1
1.4	UC is **not a subsidiary** of a **company listed** on the JSE, and **hence not required to be audited** in terms of the JSE Listing Requirements.		1
2	*If it is any other profit or non-profit company, the public interest score of the entity may indicate that it is required to be audited or reviewed by the regulations.* *Thus, taking into account whether it is desirable in the public interest with respect to its annual turnover, the size of the workforce or the nature and extent of its activities by determining the public interest score of the entity.*		
	UC's public interest score for FY2024 will be calculated as follows (regulation 26(2)):		
2.1	One point for the average number of employees during the year employees (including executive directors):	40	1
2.2	One point for every R1 million in third-party liability (or part thereof): (R73 725 000 (**0.5**) (total equity and liabilities) – R6 991 000 (**0.5**) (equity) – R65 000 (**0.5**) (deferred tax liabilities))/1 000 000 (**0.5**) Alternatively, candidates can add all third-party liabilities Do not penalise the candidate if they include correcting journal entries.	67	2
2.3	One point for every R1 million turnover (or part thereof) - turnover = R124,8 million	125	1
2.4	One point for every individual who directly or indirectly has a beneficial interest in the company's securities (i.e. a shareholder) – five shareholders	5	1
2.5	Based on the FY2024 financial statements UC has a public interest score of:	237	1C

Part (c)	**Discuss whether or not UC's financial statements for FY2024 are required to be audited or if an independent review would be sufficient.**	**Marks**
3.	*If an entity's public interest score is between 100 and 350 and its financial statements are internally compiled, its financial statements will be subject to an audit.* • Up to FY2023 and a portion of the FY2024 financial statements were **prepared by 'Mr TAcc'** and since his resignation the **CFO appears to have taken over** this function and therefore **it is internally compiled.**	1
4	**Conclusion** As UC's public interest score is **between 100 and 350 and its financial statements are internally compiled**, it will be subject to an audit.	1C
Note – there is no evidence in the scenario suggesting that the financial statements had been externally compiled		
	Available	**13**
	Maximum	**10**
	Communication skill – logical argument	*1*
	Total for part (c)	**11**

Part (d)	**Discuss the ethical requirements that Ingxelo will have to consider as part of the pre-engagement activities of the audit of UC's financial statements for FY2024.** • **Do not discuss the significance considerations of the SAICA or IRBA Codes of Professional Conduct or provide safeguards.**	**Marks**
	In terms of the SAICA (and IRBA) Code of Professional Conduct, it is in the best interest of the public and required by the Code that a professional accountant be independent when performing an audit engagement. Inxgwelo is an assurance firm and all professional accountants in public practice, as defined by the Codes of Professional Conduct, need to comply with the Code.	
1.	Maxwell Jones is a registered auditor, performing professional services to the public and therefore is a professional accountant in public practice and must comply with parts 1, 2, 3, and 4A of the SAICA/IRBA Code of Professional Conduct.	1
2.	<u>**Issue:**</u> The directors are of the view that paying an audit fee for FY2024 would be a waste of money (might not be willing to pay audit fee). OR UC is facing financial difficulty (low cash flow, current liabilities exceeding current assets, and funding difficulties), hence the company might not be able to pay the audit fee upon completion of the audit.	½
2.1	This could create and **intimidation threat/self-interest threat** to **independence (in particular objectivity).**	½ ½
2.2	Maxwell might feel pressured to perform additional non-assurance services as a value add, which may not be allowed in terms of the codes, to influence the director's opinion about whether an audit would be worth spending the money, leading to a breach of the codes.	1
2.3	Maxwell might overlook misstatements in the financial statements/non-compliance of laws and regulations in an attempt to remain in good standing with management to receive the audit fees.	1
4.	<u>Issue:</u> Maxwell was requested to assist Bongani with the correction of the errors made by Mr TAcc.	½
4.1	**UbudCargo (Pty) Ltd is not a public interest entity** in terms of the codes' definition because it is **not a listed company** and is **not** defined by the **Companies Act** (Companies Regulation) as being a **public interest entity** that meets the PIS Score.	1
4.2	This could result in Maxwell advising on certain accounting standards, which entails the provision of non-assurance services to an audit client.	1
4.3	The provision of accounting and bookkeeping services is prohibited by the codes, but he is not recording or calculating the entries and therefore rather providing advice and recommendations. (SAICA CoPC 600.11, 601 and Companies Act s90(2)).	1
4.4	By assisting with the correction of the errors, Maxwell is **not** assuming management's responsibility.	1
4.5	Advising on the treatment of accounting errors could result in management adopting the recommendations; hence the auditor would have played a role in the accounting treatment and is thus providing accounting services.	1
4.6	Providing accounting services to an entity that is not a PIE, is prohibited unless the service is routine or mechanical in nature, and providing advice on correction of accounting errors is not routine or and requires significant judgement.	1

4.7.1	This may create a **self-review threat/self-interest threat** because Maxwell will not appropriately evaluate the results of a previous judgement made on which the audit team may relied (600.13 A1).	½
4.7.2	**Independence (objectivity/integrity)** is threatened because his professional judgement might be compromised as a result of his involvement in the correction of the errors and might be biased (accepting) towards the calculations when auditing the corrections with which he assisted.	½ 1
4.7.3	**Professional behaviour** is also threatened since Maxwell would need to consider whether UC would be is complying with the requirements of s90(2) of the Companies Act and whether he would be associated with any non-compliance. *Ingxelo Auditors Inc. cannot provide services related to the maintenance of any of the audit client's financial records or the preparation of any of its financial statements or habitually or regularly perform the duties of accountant or bookkeeper of the audit client.* This service is also not regularly or habitually provided by Maxwell. Assisting the audit client by advising on the correction of errors without processing the corrections or preparing the financial statements would not necessarily result in non-compliance with the Companies Act. However, if Maxwell does engage in such activities in preparing the financial statements, he would be contravening the Act.	½ 1 1
5.	**Issue:** The directors might refuse to grant permission to Maxwell to communicate with the predecessor auditor due to the professional relationship that ended abruptly and badly.	½
5.1	This may create a **self-interest threat** to the following:	½
5.2	**Professional competence and due care** might be compromised if the auditor accepts the engagement before knowing all the relevant facts surrounding the relationship between management and the previous auditor. (CoPC 320.4)	½ 1
5.3	**Confidentiality** might be compromised if the auditor communicates with the previous auditor without obtaining the necessary permission from the client.	½ 1
5.4	**Professional behaviour** might be breached if management refuses to grant Maxwell permission to communicate with predecessor auditors, without a valid reason/exceptional circumstances, and Maxwell accepts the audit, in which case it would be prohibited by the Code. (CoPC 320.6)	½ 1
6.	**Issue:** Several potential non-compliance with laws by UC is evident in the scenario: • Ss28 and 29 of the Companies Act of South Africa have not been adhered to when the financial statements included significant errors made/questionable reporting practices by the previous accountant and not identified timeously by the CFO and the previous auditors. • There may have been data breaches and regulatory compliance issues signaling a potential breach in key laws relevant to the industry within which UC trades. These trigger NOCLAR considerations under CoPC 360.	1 1
5.1	A **self-interest threat/intimidation threat** arises since Maxwell could fear association with the **NOCLAR** and potentially not follow the due processes prescribed by the Code.	½

5.2	The fundamental principle of **professional behaviour /integrity** is threatened due to potential association with non-compliance with laws and regulations.	½ 1
6.	**Issue:** Maxwell is the only registered auditor in Ingxelo, and the firm might not have resources (in particular staff) to perform the audit.	½
6.1	This creates a **self-interest** threat to the following:	½
6.2	• **Professional competence and due care** since as the only registered auditor, of a small auditing firm, Maxwell and the team might not have sufficient time to obtain any relevant training where they require additional technical competencies to apply and audit complex IFRS principles within the complex industry. (CoPC 320.3A3); and • The firm might not have sufficient staff to perform the first-time audit that involves an increased scope due to prior period errors and opening balance testing, placing Maxwell under pressure to perform a significant amount of work himself, which could result in misstatements not being detected or compromise the engagement performance.	½ 1 1
	Available	**28.5**
	Maximum	**11**
	Y6: Ethical reasoning	*1*
	Total for part (d)	**12**

Part (e)	**Describe the substantive tests of detail procedures you would perform to obtain sufficient appropriate audit evidence regarding the initial recognition and measurement as well as the subsequent measurement of the individual lease liability relating to the office building and the warehouse for FY2023 and FY2024** • **Assume that the present auditors are not relying on the work of the previous auditor.**	**Marks**
Initial recognition		
1	Inspect the minutes of directors' meetings and capital expenditure committee's meetings authorising the lease agreement with EmbiP (occurrence).	1
2	Inspect the Memorandum of Incorporation (MOI) of UC to confirm it has been complied with, in particular that the borrowing powers/conditions have not been breached (occurrence).	1
3	Inspect the lease agreement to determine if – • it conveys the right to control the use of the building in order to be capitalised in terms of IFRS16 (rights and obligations); • the parties to the contract are UC and EmbiP (rights and obligations); and • it was signed by the relevant authorised officials of UC and EmbiP (occurrence).	 1 1 1
Initial measurement		
4	Obtain the lease liability amortisation schedule from management showing the initial recognition and measurement of the liability for both years, cast and cross cast the listing to ensure it is mathematically *accurate*.	1
5	Through inspection, agree the closing balance (current and non-current portion) of the lease liability as at 31 December 2023 and 2024 on the schedule to the general ledger, trial balance and financial statements to ensure that the listing is *complete*.	1
6	Obtain a management representation letter regarding the *accuracy, valuation and allocation* of the lease liability.	1
7	Agree through inspection of the financial statements, the opening balance for FY2024 with the corresponding closing balance for FY2023 to ensure *accurate* transfer of closing balances.	1
8	Inspect the accounting policy for lease liabilities to ensure it is consistent year on year and in line with IFRS.	1
9	Obtain and inspect the **rental agreement** between UC and EmbiP for the following: • The floor area (300m2 and 900m2) and rental per m2 (R450) (accuracy). • The commencement date (1 January 2023) and the lease period (five years) (accuracy). • Payment terms (in advance) and any increases in the annual rental (6% per annum) (accuracy). • Refundable deposit of R100 000 (accuracy).	 1 1 1 1
10	Assess the reasonableness of the interest rate used in the lease calculation (incremental borrowing rate) through inspection of the interest rate on other UC long-term liability contracts/correspondence with financial institutions, over a similar term and with similar security to borrow the funds to obtain an asset of a similar value in a similar economic environment (IFRS16) (accuracy).	1

11	Recalculate the *accuracy (AVA)* of the initial measurement of the lease liability on 1 January 2023 through – • recalculating the initial rental payment per the lease agreement (square meters x rate); • recalculating the escalated rental payments per annum (payment x 1,06) for the duration of the lease; and • recalculating the PV of the cashflows above using the incremental borrowing rate.	1 1 1
12	Inspect UC's bank statement and cash payment journal on 1 January 2023 for the payment of the deposit and the first year's annual rent and on 1 January 2024 for the second annual rental payment (occurrence).	1
Subsequent measurement		
13	Recalculate the *accuracy (AVA)* of the subsequent measurement of the lease liability on 31 December 2023 and 2024 through a – • recalculation of the closing balance of the lease liability using the rental cashflows, including the rental payment made and the accrued finance cost; and • a recalculation of the split between the current and non-current portion of the lease. (AVA, classification)	1 1
14	Inspect the lease agreement (or minutes of directors' meetings/ communication with legal counsel) for any addendum modifying any of the lease stipulations, for example an increase/decrease in the term or annual lease payments, that might require an adjustment to the value of the lease liability. (AVA)	1
15	Through discussion with management, assess the necessity of any adjustments required based on any modification per the procedure above and recalculate of any adjustments that were made.	1
	Available	**23**
	Maximum	**14**
	X1: Communication skill – clarity of expression	*1*
	Total for part (e)	**15**
	Total for part II	**38**

Part (f) **Perform an analysis of the financial information, based on the extracts from the management accounts prepared by Bongani by –** **(i) calculating profitability and liquidity ratios;** ● **Your calculations should include unit economic ratios.** ● **Do not perform an analysis on the free cash flow valuation performed by Bongani.**					**Marks**
Ratio calculation					
	FY2023	**FY2024**	**FY2025**	**FY2026**	
Profitability and unit economics					
(Decrease) / increase in revenue (provided)		*-21,2%*	*20,0%*	*15,0%*	
Cost of purchased transport as % of revenue	77,2%	82,1%	71,8%	65,6%	1.5
Gross profit	*36 180*	*22 390*	*42 229*	*59 316*	1
Gross profit margin (%)	22,8%	17,9%	28,2%	34,4%	1.5C
Operating cost	*19 069*	*18 370*	*19 280*	*20 337*	1
Operating cost as % of revenue	12,0%	14,7%	12,9%	11,8%	1.5C
Operating profit margin (%)	10,8%	3,2%	15,3%	22,6%	1.5
Net profit margin (%)	5,6%	-0,6%	8,5%	13,0%	1.5
Return on assets	11,4%	-1.0%			1.5
Return on equity	83,5%	-11,0%			1.5
Revenue per customer	1 779,78	1 313,68	1 426,29	1 565,67	1
Cost per customer	1 373,26	1 078,00	1 024,10	1 026,44	1
Gross profit per customer	406,52	235,68	402,18	539,24	1C
Personnel cost per employee	234 889	218 750	168 636	163 867	1
Liquidity ratios					
Current ratio	0,78	0,61			1
Debtors' days	60,00	65,00			1.5
Creditors' days	70,00	81,82			1.5
Cash cycle	(10,00)	(16,82)			1
Cash ratio (cash and cash/current liabilities)	4,3%	2,6%			1
				Available	**22.5**
				Maximum	**19**
				Total for part (f)(i)	**19**

Part (f)	**Perform an analysis of the financial information, based on the extracts from the management accounts prepared by Bongani by –** **(ii) commenting on the outcome of the calculations you performed in part (f)(i).** ● **Your calculations should include unit economic ratios.** ● **Do not perform an analysis on the free cash flow valuation performed by Bongani.**	**Marks**
1	**Revenue**	
1.1	A 21% decline in 2024 indicates significant challenges, possibly reflecting a loss of market share because of the competition from traditional logistics companies, other technology-based service companies and trucking companies.	1
1.2	Lower revenue could also be attributed to customers and suppliers facing demand pressure due to higher interest rates and inflation.	1

1.3	The tough economic conditions that have placed pressure on customers as well as the competition could also have forced UC to lower its prices to stay competitive as evidenced by the fact that customers increased by 6 000 and yet the revenue still declined.	1
1.4	A 20% revenue growth projection for 2025 and 15% for 2026 seems optimistic given the sharp decline in 2024.	1
1.5	Improved advertising alone might not be sufficient to increase the revenues by that much and revenue growth might be too aggressive.	1
1.6	The increase in advertising costs is not reflected in the operating costs.	1
1.7	It could be argued though that since customers increased by 6 000 in 2024, and are projected to increase by 10 000 in 2025, and another 5 000 in 2026, if revenue per customer could increase as well, the revenue projection may not be too highly overestimated.	1
2	**Gross profit**	
2.1	The gross profit margin decreased from 22,8% in 2024 to 17,9% in 2025. This could be because selling prices were lowered to cope with increased competition in the market or it could be because of rising costs due to tough economic conditions.	1
2.2	The gross profit margin is projected to increase by 10,26% in 2025 and 6% in 2026, which is quite significant and not supported by current information.	1
2.3	The increase in gross profit is because the cost of purchased transport is forecast to increase only with inflation of 5% for both years.	1
2.4	This may be unreasonable considering revenues are projected to increase by 20% and 15%. As most of the purchased transport costs are incurred on a shipment-by-shipment basis and not contracted for on a medium-term basis, this annual 5% increase does not make sense.	1
2.5	The cost of fuel in South Africa is likely to increase by more than 5%, which is a further indication that the 5% increase in the cost of purchased transport might be unreasonable.	1
3	**Operating cost and operating profit**	
3.1	Operating cost as a percentage of revenue increased from 12% in 2023 to 14,7% in 2024. The slight increase in operating cost seems unreasonably low given the decrease in the revenue.	1
3.2	The cost as a percentage of revenue is forecast to be 12,9% in 2025 and 11,8%, in 2026 due to the cost increase being kept between 4% and 6%.	1
3.3	This may be unreasonable considering that the number of employees is expected to increase in the forecast years. The small increase in cost suggests that the cost per employee will drop, which is either unrealistic or could cause operational inefficiency or low morale.	1
4	**Return on assets and return on equity**	
4.1	The return on assets dropped significantly by 12,4% in 2024, mainly due to the decrease in profitability as a result of the decrease in revenue.	1
4.2	The return on equity has decreased materially (2023: 83,5%, 2024: -11%) indicating a deterioration in shareholder value.	1
5	**Net profit percentage**	
5.1	The net profit margin is also projected to increase by 9,1 percentage points in the 2025 forecast and by 4,5 percentage points in 2026. This is not supported by past performance and is relying on the projected increase in revenue.	1
5.2	The decrease in the net profit percentage of 6,2 percentage points in 2024 was mainly due to a significant decrease in revenue as well as a smaller decrease in the cost of transport and related services.	1
6	**Liquidity ratios**	

6.1	The current ratio worsened to 61 cents in current assets for every R1 current liability in 2024 from an already poor 78 cents in 2023. This could be due to the lower revenue and resultant lower receivables.	1
6.2	Debtors' days worsened by five days in 2024 with customers taking longer to pay. This could be due to the demand pressures faced by their customers due to higher interest rates and inflation.	1
6.3	The creditors' days increased by 11,82 days to 81,82 days, which may indicate that UC may be struggling to make payments to creditors on time.	1
6.4	The negative cash cycle could be an indication that the company is facing liquidity problems and may not be able to meet its short-term liabilities when due based on the current working capital figures. Alternatively, UC might be getting cheaper credit from their suppliers which could be a positive from a funding perspective .	1 1
6.5	The negative working capital/cash cycle could also be the result of UC having to make prompt payments to suppliers, whereas customers only have to pay when delivery is made.	1
6.6	A negative working capital/cash cycle could be indicative of a structural financing problem which puts the business at risk of cashflow constraints	1
7	**Available cash**	
7.1	UC's cash ratio is very poor at 2,62% in 2024 compared to 4,29% in 2023. This means that it does not have sufficient cash to cover its current liabilities	1
7.2	It seems that the owners may have historically extracted dividends when the company is unlikely to have met liquidity tests. This is not conducive to liquidity and planned growth plans.	1
8	**Customers**	
8.1	Revenue per customer decreased significantly by (466 / 26%) in 2024. The increase of 6 000 customers in 2024 could indicate that, in 2024, UC may have gone for an increase in volume at the expense of a drop in price.	1
8.2	Stiff competition also played a role towards the significant decrease of revenue per customer.	1
8.3	The profit per customer decreased to R235 in FY2024 from R406 in 2023, which represents a 42% drop. This is mainly due to the decrease in revenue.	1
9	**Employees**	
9.1	The cost per employee has decreased by 6,9% in 2024. This should be investigated as it could lead to lower staff morale or possible inefficiency.	1
9.2	Cost per employee is forecast to reduce even more in 2025 which, again, could possibly lead to inefficiency or low staff morale.	1
	Available	**33**
	Maximum	**10**
	Y1: Critical thinking	***1***
	Total for part (f)(ii)	**11**
	Total for part (f)	**30**

Part (g)	**Criticise the free cash flow valuation performed by Bongani.** • **Do not re-perform the valuation** • **Assume that calculations are arithmetically correct**	**Marks**
1	The number of years in the forecast may be too short. If relevant information was available, it would have been appropriate to increase the planning period.	1
2	It seems most items are estimated to grow by 5%, even working capital, which raises the question of whether the CFO really applied his mind in estimating future cash flows. The figures appear to be inflated to artificially increase the value of the company.	1
3	The growth of 7% into perpetuity is questionable in view of the decline in revenue in 2024 and that the industry is only expected to grow by 5% over the next three years and at 5,9% thereafter.	1
4	Synergy benefits should not be included in a fair value calculation but only be included in a maximum price calculation.	1
5	The revenue included should be that of UC only and not the gross revenue.	1
6	No adjustment was made for the depreciation of right-of-use of assets. This should have been added back as these are non-cash items.	1
7	It is in incorrect to deduct both the lease instalments in the free cash and the lease liability at the end of the valuation. In a free cash flow to firm valuation, financing activities are excluded from the free cash flow analysis, and debts are deducted from the firm value instead. Thus the lease payments should not be deducted in the free cash flow analysis, and the total market value of the leases on the valuation date should be deducted from the enterprise value.	1 1
8	It is incorrect to include revenues and costs associated with the intangible assets in the free cash as well as add the value of intangible assets at the end of the valuation, since this will be double counting.	1
9	The app (included in intangible assets) is the main driver of revenue for UC, and therefore it does not warrant a separate valuation as its risk profile is that of the business. For all other intangible assets it could be argued that these could have a different risk profile and could therefore warrant a separate valuation.	1 1
10	The amount included for intangible assets to be acquired in future is also not correctly calculated. The CFO should estimate what UC will spend on intangible assets and not merely add inflation to the movement in intangible assets.	1
11	The 5% on capital expenditure to be acquired seems arbitrary and does not seem to support the massive increases projected for revenue and customer numbers. There should be a proper estimate of PPE to be acquired.	1
12	The working capital included should be the movement between the estimates of future years and not just the net working capital on 2024, increased by 5%.	1
13	Bad debts should not be included, as its impact would be accounted for in the movement in accounts receivables.	1
14	Amounts are included in the net working capital that should be excluded, such as the short-term portion of the lease liability and interest-bearing borrowings.	1
15	A share of the profit of the associate should be removed from the free cash flow as it carries a different risk profile from the business of UC.	1
16	The investment in the associate should be valued separately and added to the valuation.	1
17	The acquisition of shares in an investment in an associate should not be deducted from the valuation.	1

18	The market value of the interest-bearing debt was not deducted from the valuation.	1
19	The taxation calculated does not take into account the movement in tax on the statement in financial position, as it was not properly accounted for in the movement in working capital (5% increase used instead of movement).	1
20	The movement in deferred tax should be removed from the income tax expense.	1
21	No adjustment was made for tax on finance costs. For the lease, the s11(a) deduction for the lease payments should be adjusted for.	1 1
22	Dividends received are exempt in terms of s10(1)(k). Thus no adjustment is needed for tax.	1
WACC		
23	The equity beta of Roberts should be un-levered, using the Hamada formula to remove the effects of its financial leverage.	1
24	The beta should be re-levered using the Hamada formula with UC's debt to equity ratio.	1
25	An adjustment should probably be made for the country risk premium	1
26	The following adjustments could also be made:	
26.1	Small stock premium (increase the discount rate, thus reducing the value of the firm (and thus the equity).	1
26.2	Specific risks (e.g. adjustment for marketability and lack of liquidity being unlisted)	1
27	UC’s business risk is increased by reliance on a customer. One customer accounts for 10% of revenue vs less than 2% for Roberts.	1
28	Roberts is diversified, as it offers air and sea transport, which UC does not.	1
29	The two companies are operating in two very different markets that have varying competitive dynamics, regulatory requirements, etc.	1
30	The risk-free rate should be the long-term yield on ten-year bonds or for a longer period and not for a shorter period of two years.	1
31	The capital structure weight should be based on the debt ratio (debt over enterprise) and not the debt to equity ratio.	1
32	The cost of debt was incorrectly not calculated after tax.	1
33	The minority discount was inappropriate to apply. The DCF method is a majority valuation and a majority stake is being valued.	1
34	The use of the target debt to equity ratio may be questionable as the current interest-bearing debt to equity ratio of UC is 3,55 ((21 595 + 3 205) / 6 991).	2
	Available	**39**
	Maximum	**19**
	Y2: Integrative thinking	*1*
	Total for part (g)	**20**
	Total for part III	**50**