



Initial Assessment of Competence

Professional Paper 1

June 2026

Copyright, proprietary rights and permitted use

© The South African Institute of Chartered Accountants (SAICA). All rights reserved.

The SAICA Initial Assessment of Competence (IAC) questions, solutions and examiners comments ('these documents') constitutes proprietary intellectual property and professional know-how of SAICA. It has been developed and is maintained as part of SAICA's mandate to uphold the quality, integrity, and high professional standards of the Chartered Accountant profession, which underpin public confidence and the value and attractiveness of SAICA membership and designation.

Access to, or use of, these documents does not confer any right, licence, or interest in the intellectual property contained herein. Except where expressly permitted by SAICA in writing, no part of these documents may be copied, reproduced, adapted, published, distributed, or used for commercial, quasi-commercial, or third-party standard-setting purposes.

These documents may be used solely for legitimate educational, regulatory, or professional purposes, in a manner that preserves their integrity, acknowledges SAICA as the owner and source, and does not undermine SAICA's role as custodian of professional standards or dilute the value associated with SAICA's membership and designation.

Any authorised access to or use of these documents is subject to, and must be exercised in accordance with, SAICA's Intellectual Property Management Policy, as amended from time to time.

Disclaimer clause: All names of persons, places and business entities mentioned in these documents are fictitious and any resemblance to real persons, living or dead, places and business entities are purely coincidental.

1 Background

Inpahla SOC Ltd ('Inpahla') is a wholly state-owned entity operating in the freight and logistics industry that delivers goods throughout South Africa. Inpahla was first formed in 1860 and is incorporated as a company in terms of the Companies Act with a financial year end of 31 March. Inpahla is subject to taxation in terms of the Income Tax Act, and none of the exemptions applicable to section 10 is available to it. It has adopted IFRS® Accounting Standards. Inpahla is not subject to any specific exemptions available to state-owned enterprises.

Inpahla has historically been the primary provider of bulk transport services for the mining industry, and owns railways, ports and fuel pipeline infrastructure in South Africa. The vision of the company is to unify and develop the South African economy by providing a globally competitive, stable, reliable and cost-effective transport system. This should promote sustainable growth and diversification of the country's economy.

The company has the following divisions: national ports authority, port terminals, fuel pipelines, engineering, freight rail, and property.

Inpahla has historically performed well, meeting its dual objectives of serving the country and running at a profit to provide revenues for the government. In the past, the company relied on operational cash generation and retained profits, coupled with a conservative debt policy, to fund its activities. Inpahla's average debt-to-equity ratio, including short-term debt, has historically averaged between 40% and 45%, while its cash interest cover ratio was maintained at a comfortable level of approximately four times. The cash interest cover ratio is calculated as cash generated from operations (after changes in working capital) plus interest paid, divided by interest paid.

In recent times the company has come under financial pressure, with deteriorating profitability and rising debt levels due to increasing oil prices and losses stemming from adverse foreign exchange movements. These factors have reinforced concerns about the deteriorating domestic inflation outlook that persisted during previous reporting periods and subsequent changes to interest rates by the South African Reserve Bank to reduce inflation, which negatively impacted Inpahla's operations. In addition, South Africa's persistent electricity constraints and heightened volatility in global prices for commodity exports also affected mining customers, driving customer volumes and profitability down.

The interim results for the 2026 financial year (FY2026) reflected a significant deterioration in Inpahla's liquidity position and an increase in its obligations. The cash interest cover ratio declined to 1,93 times.

Furthermore, Inpahla's profitability decreased because of various operational challenges that resulted in a decline in the volume of goods transported. These included the following:

- Ageing infrastructure;
- Damages due to train collisions;
- Community unrest and riots that affected the company's ability to deliver;
- Shortage of spares for maintenance and repairs of equipment because of inflexible procurement and localisation requirements (e.g., the requirement to buy spares from local producers rather than import them);
- Lack of support from equipment manufacturers due to contractual disputes;
- Instances of train derailments;

- Theft of railway tracks;
- Adverse weather conditions;
- Power outages affecting lines due to electricity constraints or breakdowns; and
- Many instances of crime and theft that included irregular tender processes and corruption.

2 Debt covenants

Inpahla's persisting operational challenges, deteriorating performance, pressure on cash flows, and ongoing liquidity and funding constraints, have placed debt covenants at risk. This has resulted in debt rating agencies downgrading the credit rating of Inpahla.

Inpahla has bonds that are listed on the Johannesburg Stock Exchange and other international markets. It recently published its reviewed interim results for the six months ended 30 September 2025 that showed a larger net loss than in the same period in FY2025. It also reported a further increase in its net liability position from FY2025. Its auditors issued an unmodified review report with an emphasis of matter paragraph on going concern for the interim results.

The company is said to be experiencing political pressure to improve and report favourable results due to increasing pressure on the government's finances. A significant proportion of Inpahla's debt is guaranteed by the South African government. Inpahla management have stated that, in view of the significant debt exposure, a modified audit opinion would result in a default on the loan covenants. This would cause the company's long-term debt to become immediately payable, which could trigger the government's guarantee. In management's opinion, this could lead to a further downgrade of the country's sovereign risk by credit rating agencies, potentially driving the country into a recession.

3 Turnaround strategies

In response to these challenges, the company has developed two potential turnaround strategies relating specifically to the funding required to drive improvement in operational performance, volume recovery and a return to profitability.

Proposal 1: Government funding and an increase in debt

Inpahla could request a guarantee of R47 billion from the government to support the funding of the turnaround strategy. This would be used to raise further debt. Currently, lenders will not provide funding to Inpahla without additional guarantees from the government.

The government would also be requested to inject additional equity into Inpahla in return for the issue of more shares to reduce debt and meet the required financial ratios for Inpahla to continue participating in the debt capital markets.

Furthermore, the company would also request a reduction in the onerous requirements of public finance management legislation and regulations related to procurement requirements. These relate particularly to spares for locomotives¹ and port equipment, as such legislation and regulations limit the speed with which procurement can be executed.

¹ The powered component of a train, used for pulling railway carriages.

Proposal 2: Privatisation

Inpahla could enter into a public-private partnership with private sector participants on a basis of 60% and 40% public sector and private sector ownership respectively. This would take the form of setting up new subsidiary corporate entities. Corporate assets would be moved into these subsidiary companies. This would enable Inpahla to contribute assets that are currently not fully utilised and in need of capital investment for repairs and maintenance, while the private investors would inject capital and bring the experience required to get the assets operational. Both would share the benefits brought about by the partnership.

4 Damaged locomotives

Ten years ago, Inpahla purchased locomotives from a supplier, the Wuoche Locomotives Corporation ('Wuoche') in China. A number of these locomotives were damaged by derailments, accidents and incidents of vandalism. As a result, they have been out of service and standing idle for six years or more. Wuoche has refused to supply the parts or design information to repair the locomotives due to contractual disputes and ongoing corruption cases in the original purchase process. This has resulted in payments for the locomotives being frozen.

Due to the damaged locomotives, there has been a gradual deterioration in the services that Inpahla is able to provide to its freight customers, affecting the mining industry in particular. This has resulted in lost revenue for Inpahla and the mining customers which cannot trade as they cannot deliver their goods. Furthermore, there has been lost tax revenues to the government and increased unemployment.

According to legal experts, the dispute relating to Wuoche, the original supplier, will not be resolved within the next five years and it is unlikely that it will agree to sell replacement parts to Inpahla.

A proposal has been made to place the locomotives in a public-private partnership where Inpahla partners with a private company, which will provide the funding to repair the locomotives. The partnership will use a new supplier who would have to redesign, manufacture and fit the components to get the damaged locomotives running. It is estimated that the entire process will take approximately 12 months. A German supplier, Zug AG, approached Inpahla with the redesign proposal. Zug has the necessary expertise to adapt existing parts from its locomotive products to repair the damaged locomotives, which will attract redesign costs.

An assessment was performed to bring one locomotive back into service. The following information was obtained from this reasonability assessment:

- The expectation is that once the locomotives are running again, they will have a five-year operating period.
- The average redesign cost per locomotive is expected to be EUR95 000, payable immediately. The redesign cost will be deductible for tax purposes in the year in which it is incurred.
- The average manufacture and fitment cost is anticipated to be EUR184 000 per locomotive. Half is payable at the start of the project, and half when installed at the end of the first year. The South African Revenue Service (SARS) will allow deduction of these repair component costs of 50% in year 1, 30% in year 2, and 20% in year 3 after being brought into use. The repair component will have a zero fair value and tax value at the end of the operating period.

- The original cost of one locomotive was R19 million. It can be sold for R12 million in its current condition, which is the same as its current tax value. The tax deduction on the locomotives will be claimed on a straight-line method after the locomotives are placed back in service.
- The locomotive will have a tax value of R6 million at the end of the five years of operation, and a fair market value of R11 million.

Once fully repaired, the locomotives will be placed back in service on the original route. The company expects to earn a contribution of R4,3 million per annum per locomotive once fully repaired. The additional average fixed costs per locomotive that will be incurred on route maintenance will amount to R250 000 per annum once operations resume.

The proposal is to fund the repair cost using a debt instrument at an average interest cost of 8,5% per annum. The working capital required for each locomotive will need to be increased by R120 000 initially, and then maintained for inflationary increases.

Indirect impacts of having the trains back in service for the government include increased collections by SARS from the rail customers, who will be able to resume their operations, and therefore earn additional profit that can be taxed. It is anticipated that SARS will collect additional tax revenue per annum once the trains are running again. Additional mining royalties that could be collected by SARS are estimated at R600 000 per locomotive per annum.

According to management, Inpahla's target rate of return for rail operations is 13%.

Additional information

- The Euro to rand exchange rate on the implementation date of the project of 1 April 2026 was EUR1 : ZAR20.
- Forecast exchange rates are as follows:
 - March 2027 EUR1 : ZAR20,40
 - March 2028 EUR1 : ZAR20,80
- The current and projected inflation rate in South Africa is 5%.
- The tax rate applicable to Inpahla is 27%.

5 Green initiatives

During FY2026, Inpahla invested in green technologies to minimise its impact on the environment. The green initiatives are aligned to the aims of the United Nations Sustainable Development Goals 6 (clean water and sanitation) and 7 (sustainable and clean energy).

Inpahla installed solar panels on the rooftops of its buildings. This initiative not only reduces Inpahla's carbon footprint but also decreases its reliance on Eskom to power the operations at its warehouses. In addition, traditional lighting systems were replaced by LED lighting. The warehouses were also insulated and equipped with energy-efficient climate control systems. The initiatives also resulted in a decreased monthly energy cost.

A rainwater harvesting system to collect and store rainwater for non-drinkable uses has also been implemented. The harvested rainwater is used for the washing of vehicles, local community irrigation and flushing of toilets.

6 Governance and assurance

The Inpahla board of directors and those charged with governance in all material aspects subscribe to the principles of sound governance and ethical conduct. Inpahla has accordingly adopted the *King IV Report on Corporate Governance*. It also strives to comply with all relevant legislation and regulations.

As provided for in section 4(3) of the Public Audit Act, the Auditor-General of South Africa opted not to perform the audit of Inpahla. Inpahla decided to change its auditors in 2025. The board also wanted to enhance transparency and accountability and ensure rigorous adherence to regulatory standards. This decision was taken with the consent of its shareholder. The board also felt that a change in auditors might be warranted to mitigate conflicts of interest or perceived biases, thereby improving public trust in the entity's financial reporting.

After a rigorous audit tender process under the direction of Tomas Tank, the chair of the audit committee, Ngabane KpT Inc. ('NKT'), a medium-sized audit firm, was appointed as auditors for FY2026. The board resolved that since NKT has provided some accounting services to Inpahla during the past five years, there would be no need to sign a new engagement letter. It replaced BAC Inc., who had acted as external auditors for the last 35 years. John James, the audit partner in charge, is excited about this opportunity because the audit will bring a significant amount of revenue to NKT.

INITIAL ASSESSMENT OF COMPETENCE, JUNE 2026

PROFESSIONAL PAPER 1

This paper consists of one scenario and two required parts.
Answer each required part in a separate answer book.

PAPER 1 PART I – REQUIRED		Marks	
		Sub-total	Total
(a)	Prepare a SWOT analysis in view of the going concern challenges experienced by Inpahla. • Do not discuss the turnaround strategies in section 3. <i>Z1: Business internal environment</i> <i>Z2: Business external environment</i>	20 1 1	 22
(b)	Evaluate the two turnaround strategy financing proposals, based on the current situation of Inpahla. <i>Y4: Judgement and decision making</i>	10 1	 11
(c)	Prepare a capital budget, based on a single locomotive, to assess the viability of the proposal by Zug AG for the damaged locomotives and conclude whether Inpahla should go ahead with the proposal. • Include nil effects, where relevant.	27	27
(d)	Discuss how Inpahla's green initiatives align with the United Nations Sustainable Development Goals 6 and 7.	6	6
Total for part I			66

INITIAL ASSESSMENT OF COMPETENCE, JUNE 2026

PROFESSIONAL PAPER 1

**This paper consists of one scenario and two required parts.
Answer each required part in a separate answer book.**

PAPER 1 PART II – REQUIRED		Marks	
		Sub-total	Total
(e)	Discuss the business ethics and professional ethical considerations that NKT would need to consider about the alleged impact of defaults on loan covenants. - Include relevant safeguards. - Assume that NKT also performed the interim review for the year. <i>I2: Business ethics – ethical reasoning skills</i>	13	
		1	14
(f)	Discuss the factors that NKT should have considered before the firm accepted the audit of Inpahla for FY2026. Exclude the factors considered in part (e) from your answer. <i>X1: Communication skill – logical argument</i>	10	
		1	11
(g)	(i) Assess the risk of material misstatement at the financial statement level of Inpahla for the FY2026 audit; and (ii) Describe a suitable overall audit response for the FY2026 audit based on your risk assessment. Do not address the risks identified in part (g)(i) individually but describe the overall audit responses in general for all risks. <i>X1: Communication skill – clarity of expression</i>	12	
		6	
		1	19
(h)	Formulate the audit procedures to perform at the FY2026 year end to audit the going concern of Inpahla.	10	10
Total for part II			54
TOTAL FOR THE PAPER			120