Part (a)	**Discuss the key matters that the Panelli siblings should consider prior to accepting the buy-out offer from RVR, with regard to –** **(i) the impact for DentOut on its operations and growth; and** • **Ignore taxation.** • **Do not discuss any ethical matters.** • **Calculations are not required.**	**Marks**
Customer base of DentOut		
1.	DentOut currently has developed a loyal customer base which may be lost as a result of the replacement of DentOut branding (as car repair business) with RVR branding (as car rental business).	1
2.	However, the cash from the buy-out and subsequent ISO accreditation will result in a potential increase in revenue from major motor manufacturers and the car rental companies in the RVR Group as well as other opportunities, such as the refurbishment project.	1
3	The Panellis need to consider whether the potential increase in revenue post acquisition will offset the potential loss of current customers.	1
4	The DentOut brand may suffer irreparable harm as the allegations have aired on Blanche Carte and other disgruntled customers may come forward. Once all possible claims are settled, DentOut's branding may need to be replaced by RVR branding to attract further customers.	1
ISO accreditation		
5	The company should investigate whether the costs, requirements and the likelihood of success for ISO accreditation is reasonable before accepting the offer.	1
6	The offer contains no provisions relating to the exact date by when the accreditation needs to be achieved that could be considered to determine whether the timelines are reasonable.	1
7	If any further ISO requirements (e.g., process changes, appointment of staff with specific skills) are too onerous for the business to comply with, they will likely have a loan to repay, with no ISO accreditation to attract additional customers.	1
8	The ISO accreditation may not be obtained / there may be delays in obtaining the ISO accreditation due to factors beyond the control of DentOut and the Panellis. In these instances, would the investment still be converted to a loan?	1 1
9	The siblings should also consider whether the funds from RVR will be sufficient to fund all capital, training, administrative and other requirements of the ISO accreditation.	1
Conversion of purchase consideration to a loan		
10	The offer is currently silent on important aspects of the potential loan if the ISO accreditation is not received: • The interest rates attached to the loan. • Any surety or covenants attached to the loan • The term of the loan and the timing of capital and interest repayments • Any additional penalties for late/ non-payment of instalments.	1 0.5 0.5 0.5 0.5
11	If the purchase consideration is converted to a (shareholder) loan, will RVR retain any rights that give them effective control over DentOut?	1
12	How would the loan affect the levels of gearing of DentOut? Based on the current valuation, an R11m loan would imply a debt equity ratio of 42% (R11m/ 26m).	1 1

	Would the company be in breach of any existing covenants?	1
13	The additional loan could lead to financial distress, given the current balance of R3,5m (the majority of which is required for operations) vs the R11m loan that will need to be repaid.	1
14	The valuation indicates that there is very little excess cash in DentOut and increased capex expansion requirements were not considered in the valuation. Without additional funds for capex expansion, future growth may stagnate.	1 1
Access to funds		
15	Being part of a larger group of companies will allow DentOut to access a larger pool of funds, for future expansion, growth or funding of working capital. Capital expenditure would be critical for DentOut, given the move towards plant and equipment incorporating artificial intelligence.	1 1
Potential additional costs to be incurred to fulfill RVR's conditions		
16	RVR requires that DentOut comply with IFRS and implement structures and processes that enable better corporate governance. Therefore, investments into additional computer systems and staff will be required.	1
17	The additional costs / investments will be significant (e.g., in computer systems, creation of a board of directors with independent directors). The siblings therefore need to consider whether the additional revenue from RVR's car rental business would be sufficient to justify such large expenditure.	1
18	Should the decision be taken that used or reconditioned parts not be used in future, this will increase the cost base of the services provided and may negatively impact the prices charged to clients or the profitability of the business.	1
Human resources		
19	Would RVR require DentOut's entire staff cohort of 30 people? For synergistic benefits to be realised, RVR may require that some staff are retrenched or redeployed to different roles, or may want to bring in some of their own staff. This could impact the morale of the staff in DentOut.	1
20	If the additional requirements of the group regarding, for example corporate governance, require that additional staff be employed, the additional cost will impact the profitability of the business.	1
Other considerations		
21	Would they have to move premises? This may lead to relocation costs and not favourable to some of the staff members given their residences.	1
22	Will the 25% re-investment decision still hold – RVR may want more dividends? Or less which may hinder the cash needs of the siblings.	1
23	The company may benefit from other corporate synergies such as better governance, better insurance arrangements, larger suppliers, reduced credit risk, good control environment resulting in more efficient financial and tax administration	1
	Available	**30**
	Maximum	**14**
	Communication skills – logical argument	*1*
	Total for part (a)(i)	**15**

Part (a)	Discuss the key matters that the Panelli siblings should consider prior to accepting the buy-out offer from RVR, with regard to – (ii) considerations for the siblings as existing shareholders. • Ignore taxation. • Do not discuss any ethical matters. • Calculations are not required.	Marks
1	The offer from RVR is less than 51% of the value of the business, based on the valuation from Michaela's colleague. Therefore, the reasonability of the offer should be questioned.	1
2	The valuation was prepared by someone who has a personal relationship with Michaela and was paid by Michaela to do the valuation. Therefore, the colleague may have been biased towards the siblings and the valuation may not be realistic.	1
3	The reliability and competence of CorpTru should be evaluated – it was appointed by RVR which may cast doubt about its objectivity and independence from RVR.	1
4	The siblings have worked well together and have run the business according to their own preferences. With a controlling stake, the new shareholders will have control over the operations of the business, resulting in a loss of flexibility for the siblings to make quick decisions and possible increased bureaucracy.	1
5	The siblings need to consider how much of each of their shares of the business will be sold to RVR. Would each sibling's share be reduced proportionately, or would one sibling sell a greater share than the other?	1
6	Would Marcello's salary have to be adjusted after the acquisition to manage a larger business, or will his salary be reduced as certain corporate functions will be undertaken by the group?	1
7	Would Michaela be paid for the financial reporting functions that she fulfils?	1
8	Would Michaela be able to continue to fulfil the role on a part-time basis or will a full-time financial manager have to be appointed?	1
9	The siblings should also consider their own financial positions and personal goals – they are personally not receiving any cash from the buyout as the cash is to be reinvested.	1
10	Who would be responsible for the possible settlement of the claim for loss of life? Would RVR require the siblings to be personally liable after the acquisition?	1
11	Would the repairs of the vehicles of RVR group be at arm's length prices or will group discounts affect the profitability of the company?	1
12	Is there a retention bonus of some sort for the two key employees (Michaela and Marcello)?	1
13	RVR is prioritising the upgrades of equipment while Marcello believes that the existing machinery is best suited to the operations of DentOut. There is potential for a "culture clash" as these appear to be fundamentally different approaches to operations.	1
14	Are there other companies that may wish to invest in the business? Thus other alternative offers OR any other parties interested in a significant non-controlling stake which would avoid loss of controlling interest	1
15	Consider the synergies of being part of a larger corporate structure that can deal with claims, reputational matters, good corporate governance principles to avoid reputational damage resulting from claims,	1

16	Michaela may especially not be able to maintain her current position as she and her brother must oversee the (timeous) implementation of the ISO standards. Or how will they share the burden of this additional work? DentOut's operations and growth could be negatively impacted if the siblings' focus is detracted by the merger.	1
17	Consider what guarantees are there that RVR will keep Marcello on after their 'restraint of trade' period is over and thus how secure is his position?	1
18	Does the valuation assume the business continues to operate as is i.e. excludes any synergistic benefits in the growth rate and discount rate used or are they accounted for in the assumptions. The value could thus not be correct. Further considerations on inputted values (forecast period, terminal value, control premium, contingent liability (omitted).	1
20	Any other valid consideration	1
	Available	**20**
	Maximum	**8**
	Total for part (a)(ii)	**8**
	Total for part (a)	**23**

Part (b) **Determine, with reference to the percentage margin of safety, whether DentOut should accept the vehicle refurbishment project from RVR in section 5.** • **Ignore taxation.**		**Marks**
Fixed costs		
Generator (7000*12)	84 000	1
Power requirement evaluation	-	1B
Leather delivery charge		
Total leather requirement (26*20) or (300/20 = 15 vehicles)	520 metres	1
Cost for first 300 m^2 or 15 vehicles	6 250	1
Cost for next 220 m^2 (520 – 300) or (26 – 15 = 11 vehicles) *Alternative working: 2*20 = 2,2 parts of 100, rounded to 3 * R1 800	5 400	1
Total fixed costs	95 650	
Variable costs		
Leather (650*20)	13 000	1
Paint (500/2)	250	1
Labour (12*300)	3 600	1
Total variable costs	16 850	
Revenue	25 500	
Contribution per vehicle (25500 – 16850)	8 650	1
Break-even (95650/8650)	11.06 or 12	1
Margin of safety percentage ((26-11,06)/26)*100	57.46%/0.57	1C
Stepped Fixed cost included in calculation outside of Break-even range		1

Since the margin of safety is reasonable, DentOut should accept the project. *Mark awarded for providing reason*	1
Available	**12**
Maximum	**12**
Total for part (b)	**12**

(c)	**Discuss the appropriate accounting treatment arising from the faulty refurbished spares in note 1 of the 'additional material findings' in the due diligence report in the –** ○ **separate statements of DentOut for FY2023; and** ○ **at acquisition consolidated financial statements of RVR, on the assumption that RVR acquired a controlling interest in DentOut on 1 October 2023.** • **Do not discuss presentation and disclosure.** • **Do not discuss any implications of IAS 2 *Inventories*.** • **Do not discuss any implications of IAS 7 *Statement of Cash Flows*.**	**Marks**
In the individual financial statements of DentOut for FY2023		
1	Firstly, it would need to be determined whether the allegations and lawsuit by the Mondi family constitutes a **provision** or a **contingent liability** in terms of IAS 37.	1
2	A provision represents a **present obligation** (legal or constructive) because of a **past event**; that requires a **probable outflow** of resources embodying economic benefits to settle the obligation; and **a reliable estimate** can be made of the amount of the obligation.	
3	In contrast, a contingent liability is a **possible obligation** that arises from **past events or a present obligation** that arises from **past events** but is not recognised because it is **not probable** that an outflow of resources embodying economic benefits will be required to settle the obligation.	
Present or possible obligation from past events		
4	Consideration should be given to the **allegations** made by the public and the Mondi family regarding the use of old / refurbished parts by DentOut and whether this constitutes a **past obligating event**.	1
5	In accordance with IAS 37.15, it may not be clear that there is a present obligation.. With respects to DentOut, the **impending** lawsuit may be the past event that is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period.	1
6	The validity of the allegations being made against DentOut by the Mondi Family will only be confirmed through a legal process given that they are being disputed by DentOut and therefore it is not definitively clear a present obligation from a past event exists.	1
7	The legal team of DentOut indicated that repair and job card records indicate that it appears more likely than not that in some instances reconditioned parts were used by the repair technicians and therefore it is more likely than not that the allegations are indeed true. Accordingly, the allegation constitutes a **deemed present obligation from past events** in accordance with IAS 37.16. The internet reviews give evidence that DentOut uses reconditioned parts for new ones and even though there are no legal suits claimed, this may be an obligating event that DentOut may not walk away from.	1
B	There is a possible obligation from the lawsuit which will be confirmed by the result of the court case.	
Probable outflow of economic benefits		
8	According to the legal team, the probability of an outflow of economic benefits is **remote** given the burden of proof required and accordingly it is not probable that an outflow of resources will be required to settle the	1

	deemed present obligation.	
Reliable measurement		
9	The outflow of economic benefits can be reliably measured and has been quantified by the legal team as R3,4m (R2,5 in claims + R0,9m in fees). The legal fees are to be included as this constitutes direct incremental costs for DentOut stemming from the obligation under consideration.	1
Conclusion on the accounting treatment in the individual financial statements of DentOut for FY2023		
10	As the outflow of economic benefits to settle the deemed present obligation are not regarded as probable, a **provision should not be recognised** by DentOut in its individual financial statements for FY2023, as the recognition criteria have not been met. DentOut should accordingly consider disclosure as a contingent liability.	1P
11	DentOut should **not disclose a contingent liability** as the possibility is regarded as being remote.	1B
In the at acquisition date consolidated financial statements of RVR assuming that RVR acquired a controlling interest in DentOut on 1 October 2023.		
12	RVR acquired control of DentOut effective on 1 October 2023 and therefore needs to apply IFRS 3 *Business Combinations* in determining the accounting implications of the lawsuits.	
13	RVR should recognise as at the acquisition date a contingent liability assumed in the business combination if it is a present obligation. Therefore, contrary to IAS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.	1
14	As a present obligation exists at 30 September 2023 (as proven above) for DentOut regarding the allegations, the contingent liability of DentOut is thus an exception to the recognition principles in IFRS 3 and should be **recognised as a provision** at the acquisition date in the business combination. Alternative: As this is only a possible obligation, **there is no need** for a provision to be recognised.	1
15	The **fair value of the liability** must be determined reliably at the acquisition date based on any estimated costs provided by the lawyers and the likelihood of settlement. A provision of R3,4million (R2,5million plus R0,9million legal fees) should therefore be recognised by RVR after adjusting for the probability of settlement even if remote.	1
16	Therefore, **a provision should be recognised** pertaining to the lawsuit on the date of the business combination, in the accounting records of the group. Alternative: No adjustment is required from a a group's perspective.	1P
	Available	**11**
	Maximum	**8**
	Total for part (c)	**8**

Part (d)	Prepare the prior-year error note in the separate financial statements of DentOut for FY2023 relating to the software described in the due diligence report. • Assume that the tax was correctly treated in the income tax return. • Assume all amounts are material.	Marks
DentOut (Pty) Ltd Notes to the financial statements for the year ended 30 September 2023		
Note x – Prior period error		
The company incorrectly capitalised software to property, plant and equipment. The software is not considered to be integral to the property, plant and equipment and should be recognised separately as an intangible asset.		1
As a result, the carrying amount of the property, plant and equipment was overstated, and the carrying amount of the intangible assets were understated.		1
The financial statements for the year ended 30 September 2022 have been restated retrospectively to correct these errors. The effect of the restatement on those financial statements is summarised below.		1
	FY2022	
	R	
Effect on the statement of profit or loss		
Increase in cost of sales / other expenses (W1)	(340 667)	½
(Alternative if candidate split amortisation / depreciation as below)		
Decrease in income tax expense (W2)	91 980	½
Decrease in profit for the year	**(248 687)**	½C
Effect on the statement of financial position		
Decrease in property, plant and equipment (W3)	(2 044 000)	½
Increase in intangible assets (W4)	1 703 333	½
Decrease in deferred tax liability	91 980	½
Decrease in equity	**248 687**	½C
W1: Depreciation and amortisation		
Increase amortisation (R2 555 000 / 3)	851 667	1
Decrease in depreciation (R2 555 000 / 5)	511 000	1
Increase in cost of sales / other expenses	340 667	
W2: Income tax expense		
R340 667 x 27%	91 980	½C
W3: Property, plant and equipment		
Decrease in cost price	(2 555 000)	½
Decrease in accumulated depreciation	511 000	½C
Decrease in property, plant and equipment	(2 044 000)	
W4: Intangible assets		
Increase in cost price	2 555 000	½
Increase in accumulated amortisation	(851 667)	½C
Increase in intangible assets	1 703 333	
	Available	**10**
	Maximum	**10**
	Communication skills – presentation	*1*

Total for part (d)	**11**
TOTAL FOR PART I	**54**

