

Part (b) Discuss, with reference to the Imagination Beyond purchase price allocation, whether AE has adequately performed its duties in accordance with ISA 620 <i>Using the Work of an Auditor's Expert</i> with regard to the work carried out by Stephen.		Marks
For each matter that has not been performed adequately, recommend one procedure to be performed by AE to obtain sufficient appropriate audit evidence with regard to Stephen and the work carried out by him.		
1.	AE should not have limited its procedures to telephonic discussions but should have agreed in writing (written agreement) . (ISA 620.11)	1
	AE should have agreed all necessary matters: <ul style="list-style-type: none"> • by concluding a written agreement with Stephen, which should have taken into consideration amongst others the following: <ul style="list-style-type: none"> ○ the nature, scope, and objectives of Stephen's work; ○ the respective roles and responsibilities of AE and Stephen; and ○ the nature, timing, and extent of communication between AE and Stephen, including the form of any reports to be provided by Stephen. 	Max 1
2.	There was only a virtual call on the approach and therefore AE did not evaluate the competence (adequacy) of Stephen as they hired him solely on the recommendation of Infinite Structures' financial director. (ISA620.9)	1
	AE should have evaluated Stephen's competency by: <ul style="list-style-type: none"> • inspecting copies of Stephen's qualifications, or membership of a professional body or industry association, license to practice, or other forms of external recognition. • reviewing published papers or books authored (written) or co-authored by Stephen. 	Max 1
3.	There was only a virtual call on the approach and therefore AE did not evaluate the capability of Stephen as they hired him solely on the recommendation of Infinite Structures' financial director. (ISA620.9)	1
	AE should have evaluated Stephen's capability by: <ul style="list-style-type: none"> • enquiring from / discussing with other auditors or others who are familiar with Stephen's work to determine if Stephen has been conducting purchase price allocations (PPAs), or if this is the first PPA in which he is involved. 	Max 1
4.	The fact that Stephen was recommended by Infinite Structures' financial director, may possibly indicate that there could be objectivity concerns (bias, independence, conflict of interest or influence of others) that may influence Stephen's professional or business judgment that was not considered by AE. (ISA620.9)	1
	AE should have evaluated Stephen's objectivity, including his independence, by: <ul style="list-style-type: none"> • enquiring from the management of Infinite Structures regarding any known interests or relationships with Stephen. • enquiring from / discussing with Stephen regarding any possible interests and/or relationships that may create threats to Stephen's objectivity. • obtaining / inspecting a written representation from Stephen about any interests or relationships with Infinite Structures of which he is aware. • discussing with Stephen any relevant safeguards, including any professional requirements that apply to Stephen. • evaluating whether the relevant safeguards are adequate to reduce any possible threats to an acceptable level. 	Max 1

5.	There was only a virtual call on the approach and therefore AE did not consider whether Stephen will observe confidentiality as they hired him solely on the recommendation of Infinite Structures' financial director. <i>(ISA620.11(b))</i>	1
	<p>AE should have agreed all necessary matters:</p> <ul style="list-style-type: none"> • by concluding a written agreement with Stephen which should have included the responsibility of Stephen to respect the confidentiality of information about Infinite Structures: • by concluding a written agreement with Stephen which should have included the expectations with regard to compliance to the Code of Professional Conduct. 	Max 1
6.	No further audit procedures were conducted by AE, apart from an email received from Stephen in which he listed how the purchase price was to be allocated to the various identifiable assets and liabilities. It therefore appears that AE did not evaluate the work performed by Stephen as is required by ISA620.12 before one can rely on it. <i>(ISA620.12)</i>	1
	<p>AE should have evaluated the work performed by Stephen, including his findings, assumptions, methods, and source data, by performing the following procedures, for example:</p> <ul style="list-style-type: none"> • inspecting Stephen's working papers to verify the relevance and reasonableness of the findings and its consistency with other audit evidence. • inspecting Stephen's working papers to verify the relevance and reasonableness of the assumptions and methods used. • inspecting Stephen's working papers to verify the completeness, relevance and accuracy of the source data used. • agreeing any calculation with the source data included in the consolidation calculations to verify the accuracy, completeness, and relevance of the work. • comparing the amounts included in the Stephen's workings to Infinite Structures' schedule of calculation of the allocation of the purchase price and following up on differences through enquiry from management. • inspecting the formal documentation Stephen used to document his inputs and which reference where the inputs were derived as well as other supporting documents (to verify the origin of data used) from for the auditor to consider the reasonability of the outcomes. • re-performing the calculation using the inputs used by Stephen to verify the accuracy thereof. • assessing whether the method employed by Stephen to perform the calculation is in line with the acceptable methods in terms of IFRS. 	Max 1
7.	Based on the matters described above, AE did not adequately perform its duties.	1
	Available	13
	Maximum	8
	Total for part (b)	8

	<i>quality management and controls and any IRBA inspection report findings, etc.).</i>	
4.	<p>AE failed to interact with the component auditor in the manner prescribed by ISA 600R – specifically the following:</p> <ul style="list-style-type: none"> • AE was not involved in the component auditor’s risk assessment process to identify significant risks of material misstatement in relation to the consolidated financial statements. • AE was not involved in determining the component materiality figures used in performing the audit and concluding on the audit evidence gathered in relation to the consolidated financial statements. AE was also not involved in determining the threshold above which misstatements cannot be regarded as clearly trivial to the group. • AE did not communicate its requirements to the component auditor on a timely basis – covering the work to be performed, the use to be made of that work, and the form and content of the component auditor’s communication with the consolidated engagement team. <p><i>[Mark awarded for reference to communication and not what communication shall include as listed in ISA 600R on the basis of the marks].</i></p>	<p>1</p> <p>1</p> <p>1</p>
5.	Based on the matters described above, John’s response is not appropriate.	1
	Available	13
	Maximum	6
	Total for part (c)	6

<p>Part (d) Compile, with reference to section 9, a report to the management of Imagination Beyond in which you –</p> <ul style="list-style-type: none"> • discuss the weaknesses; and • provide recommendations <p>with regard to the preparation of the consolidation reporting pack and reporting process followed by Imagination Beyond to Infinite Structures</p>			
<p>Report to Management of Imagination Beyond</p> <p>Regarding: Consolidated Reporting</p> <p>Good Day</p> <p>The following is a report on the weaknesses and recommendations identified in the preparation of your consolidation reporting pack and group reporting process.</p> <p>Yours sincerely ITC candidate</p> <p>xx January 2024</p>			
Weakness		Recommendation	
1. There is no segregation of duties as the financial manager prepares and reviews the financial information included in the consolidation reporting packs which may lead to errors and fraud.	1	There should be adequate segregation of duties as the financial manager should not be preparing and reviewing the financial information included in the consolidation reporting pack. <i>OR</i> The financial information should be prepared by the financial manager and then reviewed by the CFO or should be prepared by a financial accountant and reviewed by the financial manager.	1
The financial manager does not work directly on the system as he/she exports the information from the accounting system to Microsoft Excel and these amounts can be adjusted by hand before being printed and captured, which could result in unauthorised, invalid or inaccurate changes being made to the financial information.	1	The trial balance must be printed directly from the accounting system to limit manual intervention and changes to any trial balance accounts.	1
The financial information is manually captured in the consolidation reporting packs, which could lead to the information being incorrect, invalid or incomplete.	1	To limit the risk of the financial manager making an error, data should be digitally extracted from the trial balance and mapped into the consolidation reporting pack (through an interface).	1
No one reviews the data in the consolidation reporting packs that the financial manager has captured, as the information might be incorrect, invalid or incomplete.	1	A second person should review the data captured for accuracy, completeness and validity.	1
2. The trial balance is mapped to the consolidation reporting packs /	1	The financial manager should consider any changes from the prior year before	1

financial statements based on the prior-year mapping and the financial manager did not consider the mapping for the 2023 current year-end (the appropriateness of the prior year mapping or whether any changes were necessary / how to map the new accounts after the various acquisitions), which may lead to inaccurate financial reporting or the misclassification of accounts.		mapping or there should be guidance for the mapping of the general ledger accounts that did not exist in the prior year. The financial manager should verify that all items in the trial balance have been mapped (completeness) and mapped to the correct financial statement line item in the consolidation reporting pack (accuracy), to ensure that all changes from the prior year mapping have been incorporated.	1
The trial balance is mapped manually without the system, which may result in errors in the presentation and disclosures in the consolidation reporting pack.	1	The system should be updated so that the trial balance is mapped automatically through a set configuration to minimise error in presentation and disclosure.	1
The financial manager does not sign off on the consolidation mapping after done, which may lead to no one being accountable for the work performed or the content in the consolidation reporting pack.	1	The financial manager should sign off that the mapping was done according to company policy and accepting responsibility for the work done.	1
No one reviews the mapping performed by the financial manager to ensure that it has been mapped correctly, which may lead to inaccurate financial reporting or the misclassification of accounts.	1	A second person should review and verify that all items in the trial balance have been mapped and that it has been mapped to the correct financial statement line item in the consolidation reporting pack.	1
3. All outstanding balances and transactions with other subsidiaries are confirmed telephonically which means there is no reliable evidence of confirmation in terms of ISA500.	1	A confirmation template should be completed between the entities confirming the transactions and outstanding balances in order to have sufficient and appropriate evidence in terms of ISA500.	1
		Internal controls should be put in place to identify other subsidiary transactions and balances (e.g., by flagging them in the system), to ensure that transactions with other subsidiaries are identified and accounted for purposes of elimination on consolidation.	1
The financial manager does not follow up on differences in amounts after confirming the outstanding balances and transactions, result in errors in the presentation and disclosures in the consolidation reporting pack.	1	The financial manager must investigate and follow up any differences identified in the outstanding balances and transactions to ensure the consolidation reporting pack is valid, accurate and complete.	1
The financial manager assumes he is correct without performing reconciliations and follow-ups to	1	The financial manager must reconcile all errors with the other entities rather than assuming his amount is correct.	1

identify and correct the errors between the subsidiaries, which the consolidation reporting pack might include inaccurate amounts.			
The financial manager authorises the reversal of intercompany balances and transactions and does not treat it as consolidation entries, which may lead to amounts not appropriately eliminated, as such reversal might be recognised in another type of account, such as a suspense account.	1	Intercompany transactions and balances should be eliminated at consolidation level in Infinite Structure and not in the financial statements of Imagination Beyond. At group level there needs to be clear communications / training must be provided on the procedures on what must be eliminated / not eliminated, before the information is sent.	1 1
There is no segregation of duties as the financial manager confirms the accuracy of the transactions and outstanding balances and he/she also authorises the outstanding balances, which may lead to errors and fraud.	1	There should be adequate segregation of duties as the financial manager should not be confirming and authorising the transactions and outstanding balances included in the consolidation reporting pack. <i>OR</i> The transactions and outstanding balances should be prepared by the financial manager and then authorised by the CFO or should be confirmed by a financial accountant and authorised by the financial manager.	1
4. The consolidation reporting pack is sent via email, and it is not encrypted, or password protected which may lead to the email being altered or intercepted.	1	The consolidation reporting pack should be encrypted, sent via a secured server and should be password protected.	1
5. No checks regarding the completeness of all data fields, are performed to ensure that totals transfers accurately from notes to the primary statements and/or balance sheet balances, which may result in errors in the presentation and disclosures in the consolidation reporting pack.	1	Checks need to be incorporated that validates that all required fields are filled / data elements are present and populated (<i>e.g. mandatory field / missing data check</i>). Any incomplete datasets that are flagged by the checks, should be followed up with the finance team.	1 1
6. There are no formal documented company policies and procedures that should be followed regarding the consolidation process to minimise the risk of inaccurate, incomplete or invalid information.	1	There should be a company policy setting out the consolidation procedures and these should be regularly reviewed and updated as necessarily.	1
Available			36
Maximum			14
<i>Communication skills – appropriate style; layout and structure</i>			<i>2</i>
Total for part (d)			16

<p>Part (e) Discuss, supported by calculations, the normal tax consequences for Imagination Beyond arising from the loan received from HBCS Bank and the interest paid to HBCS Bank for the year of assessment ended 31 December 2023.</p> <ul style="list-style-type: none"> Ignore withholding tax. Ignore the provisions of the double tax agreements between South Africa and China and South Africa and the United Kingdom. 	<p>MARKS</p>
<p>Normal tax</p>	
<p><i>In terms of s 24J(2), the issuer of an instrument will be allowed a deduction for interest if the interest is incurred in the carrying on of a trade and is in the production of the income. Instrument means any interest-bearing arrangement or debt. Issuer, in relation to any instrument, means any person who has incurred any interest or has any obligation to repay any amount in terms of such instrument.</i></p>	
<p>Imagination Beyond's loan from HBCS Bank is an interest-bearing arrangement and is therefore an instrument as defined.</p> <p>Imagination Beyond incurred interest on the loan and has an obligation to repay the loan to HBCS Bank on 30 June 2023. Therefore, Imagination Beyond is the issuer of an instrument.</p>	<p>1</p> <p>1</p>
<p>Imagination Beyond is carrying on a trade in the construction industry and used the loan to finance the construction of its warehouse to be used in its trade.</p> <p>The warehouse is used for storage and distribution, which is part of its process for earning income. The interest is therefore incurred in the production of the income.</p>	<p>1</p> <p>1</p>
<p>Therefore, the interest incurred on the loan is deductible in terms of s24J(2).</p>	<p>1P</p>
<p>In terms of s24J, the interest will be apportioned for the accrual period (1 January 2023 – 30 June 2023) during the 2023 year of assessment:</p> <p>GBP500 000 x 6,75% x 181/365 = GBP16 736</p> <p>It is assumed that the market-related interest rate of 6,75% is the same as the yield to maturity rate.</p>	<p>1</p> <p>1</p>
<p>As Imagination Beyond is a company, the interest is translated at the spot rate on the day it was incurred in terms of s25D(1).</p> <p>Alternative: s24J deems interest to be incurred on a daily basis, therefore the average exchange rate is used to translate the interest as a proxy for the daily exchange rate.</p>	<p>1</p>
<p>Therefore, the interest deductible in terms of s24J(2) is GBP16 736 x R24,40 = R408 366 based on the spot rate on 30 June 2023.</p> <p>Alternative: Therefore, the interest deductible in terms of s24J(2) is GBP16 736 x R22,89 = R383 087 based on the average exchange rate for 1 January 2023 – 30 June 2023.</p>	<p>1</p>

In terms of s24l(1), exchange item means an amount in a foreign currency owing by that person in respect of a debt incurred by such person Imagination Beyond holds debt (loan and interest payable) denominated in GBP , which are exchange items .	1
In terms of s24l(2), because Imagination Beyond is a company , s24l will apply to all its exchange items .	1
No exchange difference arises in FY2023 in respect of the interest incurred from 1 January 2023 – 30 June 2023 because the spot rate on the date it was incurred (30 June 2023) is the same as the spot rate on the realisation date . Alternative: An exchange loss of R25 271 [GBP16 736 x (R24,40 - R22,89)] arises in FY2023 on realisation date in respect of the interest incurred from 1 January 2023 – 30 June 2023, which is deductible [P] .	1
FY2022 interest payable would have been translated at the spot rate of R20.49 on 31 December 2022 (year-end) for the accrual period 1 July 2022 – 31 December 2022 and a further exchange difference arises when the interest is settled on 30 June 2023 .	1
An exchange loss of R66 524 (GBP500 000 x 6,75% x 184/365 = GBP17 014 x (R24,40 – R20,49 = R3,91) is deducted from income	1P
On 31 December 2022 (year-end) the loan would have been translated at the sport rate of R20.49 and a further exchange difference arises when the loan is settled on 30 June 2023 .	1
An exchange loss of R1 955 000 [GBP500 000 x (R24,40 – R20,49)] is deducted from income .	1P
Available	16
Maximum	11
<i>Communication skills – logical argument</i>	<i>1</i>
Total for part (e)	12

Part (f) Discuss, with reference to relevant case law, whether Imagination Beyond may deduct the management fee and local shareholder contribution fee in terms of section 11(a) of the Income Tax Act for the year of assessment ended 31 December 2023.	Marks
All the requirements of s11(a) read together with s23(g) must be met for an amount to be deductible. The issues to specifically address here are whether the management fees and local shareholder contribution fees are incurred 'in the production of the income' for Imagination Beyond and 'not of a capital nature' . As the terms 'in the production of income' and 'capital' are not defined in the Income Tax Act, case law should be referred to for guidance.	½ ½
In <i>Port Elizabeth Electric Tramway Co Ltd v CIR</i> it was held that expenditure is incurred 'in the production of the income' where the expense is closely connected to the income-earning activities of the business .	1
In <i>New State Areas Ltd v CIR</i> , it was held that expenditure relating to the income-earning structure is of a capital in nature and not deductible. Whereas expenditure relating to the income-earning operations (activities) is not of a capital nature and is deductible. Alternative: In <i>BP Southern Africa (Pty) Ltd v CSARS</i> it was held that where an expenditure does not create an enduring benefit, it is not capital in nature and is deductible.	1
<i>In the production of the income</i>	
It is submitted that the services provided by Future Afrika (technical and management services) and the local shareholder contribution fee are closely related to Imagination Beyond's income-earning activities , as it relates to the construction industry (building materials, restoration of historical buildings and government infrastructure tenders) and Imagination Beyond operates in the construction industry.	½ ½
Regarding the local shareholder contribution fees, the principle from the <i>Warner Lambert SA (Pty) Ltd v CSARS</i> applies because the fees are incurred to ensure that Imagination Beyond does not lose out on possible earnings from government contracts . The fees are therefore incurred in the production of income .	1B
<i>Not of a capital nature</i>	
The management fees and local shareholder contribution fee are incurred as part of normal operations, not to create, improve or add to the income earning structure of Imagination Beyond. Alternative: The management fees and local shareholder contribution fee are incurred on an annual basis to enable Imagination Beyond to earn income from its construction and infrastructure development activities and therefore do not create an enduring benefit .	½ ½
<i>Management fees</i>	
As Imagination Beyond is a company, the CNY1 million will be translated to ZAR by applying the spot rate in terms of s25D(1) on 15 December 2023. Therefore, the total expense amounts to ZAR2 742 200 (CNY1 million x R2,7422). <i>Note to markers: the mark is awarded for the application of s25D(1).</i>	1B
The invoice relates to the services rendered to the entire Infinite Structures group. However, Imagination Beyond may only deduct R1 645 320 (R2 742 200 x 60%) of the management fees for the 2023 year of assessment in terms of s23(g), as that is the portion relating to Imagination Beyond's trade.	1

<i>Local shareholder contribution fee</i>	
As the local shareholder contribution fee only relates to Imagination Beyond, Imagination Beyond may deduct the R3 500 000 (100%) of the local shareholder contribution fee in terms of s11(a) during the 2023 year of assessment.	1
The burden of proof rests with Imagination Beyond (the taxpayer) to prove that the management fee and local shareholder contribution fee are deductible for normal tax purposes in terms of s102 of the Tax Administration Act.	1
Available	10
Maximum	8
Total for part (f)	8
TOTAL FOR PART II	50