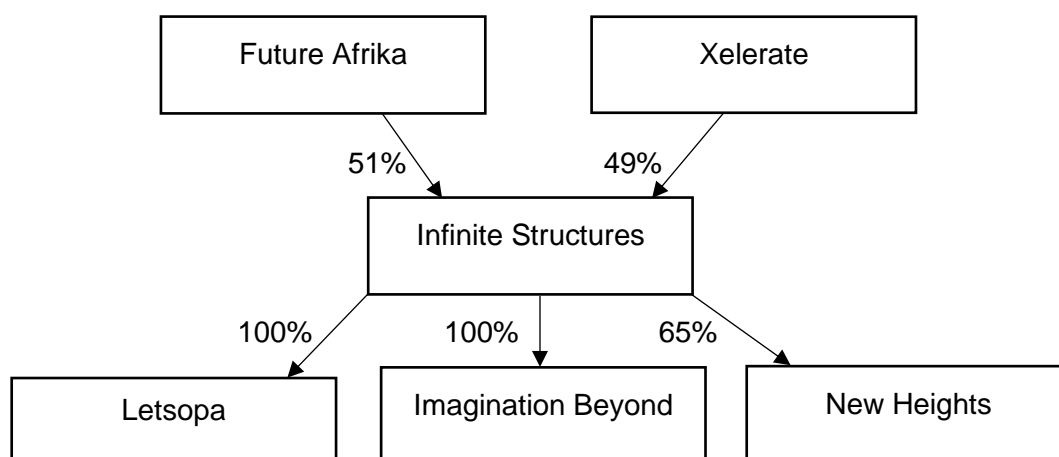


Ignore valued-added tax

**1 Background**

The Future Afrika Group is structured as follows:



Future Afrika is a Chinese company and exclusively a tax resident of China. Future Afrika holds a controlling interest in Infinite Structures. Xelerate is the Broad-Based Black Economic Empowerment (B-BBEE) partner of Infinite Structures.

Infinite Structures is a South African investment holding company with controlling interests in construction and infrastructural development companies operating on the African continent. Infinite Structures does not trade. All trading activities are undertaken by its subsidiaries. Infinite Structures has the South African rand (ZAR) as its functional and presentation currency.

New Heights is a Nigerian company. Infinite Structures obtained its controlling interest in New Heights in 2018. New Heights presents its financial information in the Nigerian naira (NGN), which is its functional and presentation currency. New Heights is exclusively a tax resident of Nigeria.

The remainder of the companies within the group are South African resident companies.

All entities have a 31 December financial year end and prepare their financial statements in accordance with International Financial Reporting Standards (IFRS).

**2 Investment in Imagination Beyond**

On 1 January 2023, Infinite Structures acquired a 100% controlling interest in Imagination Beyond (Pty) Ltd ('Imagination Beyond'), a South African-based company in the construction industry. Imagination Beyond has the ZAR as its functional and presentation currency.

The acquisition of Imagination Beyond was financed as follows:

- Issue of 10 000 8% ZAR1 000 bonds to third parties for cash.

- The bonds were issued on 1 January 2023 at their nominal value, which is equal to their fair value.
- Interest is payable annually on 31 December.
- The bonds will be settled at a premium of 5% of the nominal value on 31 December 2027.
- Own available cash reserves of ZAR7,5 million.

Infinite Structures paid legal, consultancy and broker fees of ZAR170 000 to third parties for the acquisition of Imagination Beyond and ZAR96 000 to third parties for the issue of the bonds. These payments were made from available cash reserves.

On 1 January 2023, the cash balance of Imagination Beyond amounted to ZAR2,7 million and the carrying amount of Imagination Beyond's land amounted to ZAR4,1 million. On the acquisition date, all the assets and liabilities of Imagination Beyond were fairly valued, except for land that was considered to be ZAR500 000 more than the carrying amount. Imagination Beyond did not process any adjustments in respect of the land on 1 January 2023. Imagination Beyond subsequently revalued the land on 31 December 2023 by ZAR620 000. During the financial year ended 31 December 2023 (FY2023), Imagination Beyond purchased a section of land amounting to ZAR1,5 million for cash.

The auditors of Infinite Structures are Auditors Extreme Inc. ('AE'), who have been the auditors since 2021. AE hired Mr Stephen Stew as the auditor's expert, on the recommendation of Infinite Structures' financial director, to assist AE in auditing the purchase price allocation of the identifiable assets acquired and liabilities assumed at their acquisition-date fair values in accordance with IFRS 3 *Business Combinations*. This included any goodwill arising from the acquisition of Imagination Beyond.

AE only had a virtual call with Stephen to discuss what approach he would follow. 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.

### 3 Investment in Letsopa (Pty) Ltd

On 30 November 2023, Infinite Structures acquired a 100% controlling interest in a cement-producing company, Letsopa (Pty) Ltd ('Letsopa'). Letsopa is a South African-based company with the ZAR as its functional and presentation currency.

GM & Partners Inc. ('GM') are the auditors of Letsopa and have served as the auditors since 2018. GM has finalised the audit of Letsopa for FY2023.

Ms Selma Williams is one of AE's first-year audit trainees. Mr John Donald, an audit senior of AE, sent Selma the following email regarding the audit GM performed in respect of Letsopa:

**To:** SelmaW@AE.com  
**Date:** 05 January 2024 8:45 AM  
**From:** JohnD@AE.com  
**Subject:** Re: Audit of Letsopa

Hi Selma

Thank you for your question as to whether we would be able to rely on the work performed by Letsopa's auditors regarding the latest Infinite Structures acquisition. Based on our group audit strategy Letsopa is considered to be a significant component of the group.

With respect to the audit of the consolidated reporting pack (which includes the consolidated financial statements) of Infinite Structures, we may rely on the unqualified audit opinion issued by GM without conducting any further audit work on the results of Letsopa that have been consolidated. We have already contacted GM's audit partner in charge of the Letsopa audit, and he has completed the required checklist we have sent him and has stated that GM adheres to the International Standards on Auditing. Therefore, we can rely on the audit of Letsopa's separate financial statements which have been used in the preparation of Infinite Structures' consolidated reporting pack.

If you have any further questions, please feel free to email them to me.

Kind regards

John Donald  
Third-year audit senior

#### **4 Contract with PlantHire to lease specialised machinery**

On 1 March 2023, Imagination Beyond entered into a contract with PlantHire, an unrelated third party, in terms of which Imagination Beyond leased specialised, expensive and high-demand cranes.

Imagination Beyond incurred and paid the following costs with regard to the lease:

	<b>Notes</b>	<b>ZAR</b>
Legal fees, commission, and lease documentation preparation costs for the execution of the lease	1	102 000
Installation of the cranes and fixing them to the ground at designated construction sites		73 500

#### **Notes**

- 1 An amount of ZAR36 000 relating to the fixed salary of Imagination Beyond's full-time internal legal counsel is included in the amount of ZAR102 000. This amount would be payable to the legal counsel irrespective of whether the contract is successfully signed or not.

The terms of the lease contract included the following conditions:

- Imagination Beyond is required to pay annual lease instalments of ZAR1,2 million in advance, starting on 1 March 2023.

- Imagination Beyond is required to remove the cranes, return them to PlantHire, and to restore the land surrounding the construction site to an environmentally friendly landscape at the end of the lease on 28 February 2026. On 1 March 2023, it was estimated that the removal and restoration costs would amount to ZAR470 000.

The rate implicit in the lease is 12% per annum.

At the commencement date of the lease, the average remaining useful life of the leased items was estimated to be ten years.

## 5 Distribution warehouse

Imagination Beyond owns a distribution warehouse in the Coega Industrial Development Zone in Gqeberha, which has been used as a storage and distribution channel for its construction material around Southern Africa. The construction of the distribution warehouse commenced on 1 July 2013, the same day that the funds from HBCS Bank were paid into the bank account of Imagination Beyond (see details below about the loan). The construction was completed in December 2013.

To finance the construction of the distribution warehouse for its own use, Imagination Beyond took out a foreign loan of British pounds (GBP) 500 000 from HBCS Bank in the United Kingdom. All the loan funds raised were earmarked and used specifically for the construction of this distribution warehouse. The distribution warehouse is a qualifying asset in terms of IAS 23 *Borrowing Costs*. The loan bears interest at a market-related interest rate of 6,75% per annum, payable annually in arrears. The loan capital is repayable after ten years, on 30 June 2023.

The construction of the distribution warehouse took place on land owned by Imagination Beyond, acquired in 2011 for ZAR2 million. Until 1 July 2013 it was held for undetermined future use. The fair value of the land was ZAR3,1 million on 1 July 2013 and it had not changed by FY2023.

All the relevant costs for the construction were financed from the HBCS Bank loan and the full loan amount was used for this construction. In addition, abnormal wastage costs resulting from construction delays amounting to ZAR200 000 were incurred and paid in December 2013. Following the completion of the construction of the distribution warehouse, ZAR80 000 was incurred and paid for an opening celebration of this new facility. Various relevant government officials and industry and business experts were invited to the celebration. These additional costs were financed from Imagination Beyond's cash reserves and not from the funds obtained from HBCS Bank.

On completion of the construction of the distribution warehouse in December 2013, Imagination Beyond estimated that the distribution warehouse would have a useful life of 30 years and a residual value of ZAR2 million. The distribution warehouse was available for use as intended by management on 31 December 2013. However, it was only brought into use on 1 February 2014 when business had returned to normal after the summer holidays.

Management of Imagination Beyond decided to sell the distribution warehouse, and all the requirements of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* were met on 1 July 2023. The fair value less costs to sell of the distribution warehouse, including the value of land on 1 July 2023 and 31 December 2023, amounted to ZAR9 million and ZAR8 875 000 respectively. The distribution warehouse is expected to be sold by March 2024.

The following exchange rates were obtained from a reputable financial institution:

<b>Date</b>	<b>GBP1 : ZAR</b>
1 July 2013	15,07
31 December 2013	17,31
31 December 2022	20,49
30 June 2023	24,40
Average rate 1 July 2013 – 31 December 2013	15,11
Average rate 1 January 2014 – 31 December 2022	19,12
Average rate 1 January 2023 – 30 June 2023	22,89

## **6 Management fees and local shareholder contribution fee**

Future Afrika charges Imagination Beyond an annual management fee for technical and management services for the benefit of the entire Infinite Structures Group. Future Afrika is regarded as an expert in the Chinese building industry and provides the Infinite Structures Group with advice relating to environmentally friendly building materials and the preservation and restoration of historical buildings.

Future Afrika charged Imagination Beyond an amount of Chinese yuan (CNY) 1 million on 15 December 2023 for the FY2023 management fee. Imagination Beyond settled the invoice on 15 December 2023. It is reliably estimated that 60% of the management fee relates to advice provided for the benefit of Imagination Beyond, and the remaining 40% relates to New Heights. Imagination Beyond does not receive any reimbursement from New Heights in respect of the management fees. The Commissioner for the South African Revenue Service accepted that the fee charged by Future Afrika is at arm's length.

Xelerate charges Imagination Beyond an annual local shareholder contribution fee, which benefits Imagination Beyond exclusively. This fee, among others, improves Imagination Beyond's black ownership score for B-BBEE certification purposes, thereby enabling Imagination Beyond to compete for government infrastructure development contracts. Xelerate charged Imagination Beyond ZAR3,5 million on 30 November 2023 for the FY2023 local shareholder contribution fee. The invoice was settled on 7 December 2023.

The following exchange rates were obtained from a reputable financial institution:

<b>Date</b>	<b>CNY1 : ZAR</b>
15 December 2023	2,7422
31 December 2023	2,7714
Average rate 1 January 2023 – 31 December 2023	2,6850

## 7 Extract of the consolidated financial statements of the Infinite Structures Group

The following is an extract of the consolidated statement of profit or loss and other comprehensive income for FY2023:

	<b>ZAR</b>
Profit before tax	328 700 000
Taxation	(87 105 500)
Current	(95 670 550)
Deferred	8 565 050
Profit for the period	241 594 500

The consolidated profit before tax of ZAR328,7 million was calculated correctly after taking into account the effects of all the above transactions and the following items:

	<b>ZAR</b>
Profit on sale of land	220 000
Dividends received, from non-related parties	600 000

The following is an extract from the consolidated statement of financial position:

	<b>FY2023</b>	<b>FY2022</b>
	<b>ZAR</b>	<b>ZAR</b>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Land	3 350 000	2 200 000
<b>Current liabilities</b>		
Shareholders for dividends	1 995 000	1 210 000
Income tax payable	11 120 000	8 750 000

The working capital for the Infinite Structures group increased by ZAR176,45 million during FY2023.

## 8 Dividends

Dividends amounting to ZAR1 million and ZAR252 500 have been taken into account in computing the consolidated retained earnings and non-controlling interest respectively.

## 9 Procedures followed by Imagination Beyond in the preparation of its consolidation reporting pack

In order to prepare its consolidated financial statements, Infinite Structures has to obtain the financial results from each of the subsidiaries it controls. Each subsidiary is required to complete and submit a 'consolidation reporting pack' to Infinite Structures, which comprises the following:

- Separate statement of financial position;
- Separate statement of profit or loss and other comprehensive income;
- Separate statement of changes in equity; and
- Certain detailed notes / disclosures.

The consolidation reporting pack is prepared from the detailed trial balance of each subsidiary and each of the general ledger accounts in the trial balance is mapped to a specific financial statement line item. For example, all the general ledger accounts relating to revenue are aggregated and mapped to the revenue financial statement line item in the statement of profit or loss and other comprehensive income.

The purpose of the consolidation reporting pack is to ensure that all subsidiaries are aligned with the format which is used to prepare the consolidated financial statements of Infinite Structures. Infinite Structures then aggregates the information in the consolidation reporting packs it receives from each subsidiary and processes the necessary consolidation journal entries in order to prepare its consolidated financial statements.

Process followed by the management of Imagination Beyond for the preparation of the consolidation reporting pack that is sent to Infinite Structures:

- 1 The financial manager of the subsidiary exports the trial balance into Microsoft Excel from the accounting system and then prints out the trial balance and reviews the financial information. He/she then manually captures (inputs) the information into the consolidation reporting pack.
- 2 The financial manager maps each general ledger account in the trial balance to the consolidation reporting pack based on prior-year mapping.
- 3 Because they need to be eliminated, all intercompany receivables and payables as well as the total of various types of transactions with other subsidiaries in the Infinite Structures Group are identified and listed in the detailed note relating to intercompany balances and transactions.
  - 3.1 The note must include the name of the counterparty subsidiary, balance outstanding and total transaction values.
  - 3.2 The financial manager confirms the accuracy of the amounts of transactions and outstanding balances with such subsidiaries by means of telephonic conversations.
  - 3.3 Where there is a difference, the financial manager accepts that his/her amount is correct and leaves it at that.
  - 3.4 The financial manager then authorises the intercompany outstanding balances and transaction values (as confirmed) to be reversed in the consolidation reporting pack.
- 4 Once completed, the consolidation reporting pack is sent via email to the group financial manager and the chief financial officer of Infinite Structures, to ensure that they both receive the financial information timeously.
- 5 The packs only include the following validation checks:
  - 5.1 Verification that the numeric data adheres to specific formats and that any data entries that do not meet the specific format criteria (e.g., brackets for negative amounts and decimal places) are flagged.
  - 5.2 Automatic population of the total from the statement of profit or loss and other comprehensive income into the statement of financial position and the statement of changes in equity. The statement of changes in equity totals are automatically used to populate the statement of financial position. All sub-totals and totals in the consolidation reporting pack are automatically cast.

## **10 Additional information**

- The only investments that were made during the year were the investments in Imagination Beyond and Letsopa.
- For all financial years under consideration, assume a normal tax rate of 27%.

- Investment property is measured using the fair value model in accordance with IAS 40 *Investment Property*.
- All property, plant and equipment except for land is measured using the cost model in accordance with IAS 16 *Property, Plant and Equipment*. Land is measured using the revaluation model.
- Where applicable, assume an after-tax discount rate of 8,76% per annum (compounded annually).
- It is the policy of Infinite Structures to measure the non-controlling interest at the proportionate share of the acquiree's identifiable net assets at the acquisition date.
- It is the policy of Future Afrika to present cash flows related to dividends and interest in operating activities.
- Ignore any effects of the interest income on the GBP500 000 loan.
- All payments due were made on dates stipulated in the contract or agreement.
- All transactions and amounts are material.



**INITIAL TEST OF COMPETENCE, JANUARY 2024**

**PROFESSIONAL PAPER 3**

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

<b>PAPER 3 PART I – REQUIRED</b>		<b>Marks</b>	
		<b>Sub-total</b>	<b>Total</b>
(a)	Prepare, using the indirect method, an extract from the consolidated statement of cash flows of the Infinite Structures Group for FY2023 in accordance with IAS 7 <i>Statement of Cash Flows</i> , in so far as the given information allows. <ul style="list-style-type: none"> <li>• Do not prepare notes to the statement of cash flows.</li> <li>• Round all amounts to the nearest rand.</li> <li>• Do not provide comparative figures.</li> <li>• Ignore the reconciliation at the bottom of the statement that shows the opening balance and the closing balance of cash and cash equivalents as well as the net increase (decrease) in cash and cash equivalents.</li> </ul>	48	
	<i>Communication skills – presentation; layout and structure</i>		2
<b>Total for part I</b>			<b>50</b>

**INITIAL TEST OF COMPETENCE, JANUARY 2024**
**PROFESSIONAL PAPER 3**

This paper consists of two parts. Answer each part in a separate answer book.

<b>PAPER 3 PART II – REQUIRED</b>		<b>Marks</b>	
		<b>Sub-total</b>	<b>Total</b>
(b)	<p>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.</p> <p>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.</p>	8	8
(c)	<p>Discuss, with reference to the information in section 3, whether John's response on the audit of the Infinite Structures' consolidation reporting pack is appropriate with respect to Letsopa.</p> <ul style="list-style-type: none"> <li>Do not provide any details that should be included in the communication with the component auditor.</li> </ul>	6	6
(d)	<p>Compile, with reference to section 9, a report to the management of Imagination Beyond in which you –</p> <ul style="list-style-type: none"> <li>discuss the weaknesses; and</li> <li>provide recommendations</li> </ul> <p>with regard to the preparation of the consolidation reporting pack and reporting process followed by Imagination Beyond to Infinite Structures.</p> <p><i>Communication skills – appropriate style; layout and structure</i></p>	14 2	16
(e)	<p>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"> <li>Ignore withholding tax.</li> <li>Ignore the provisions of the double tax agreements between South Africa and China and South Africa and the United Kingdom.</li> </ul> <p><i>Communication skills – logical argument</i></p>	11 1	12
(f)	<p>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.</p>	8	8
<b>Total for part II</b>			<b>50</b>
<b>TOTAL FOR PAPER 3</b>			<b>100</b>

