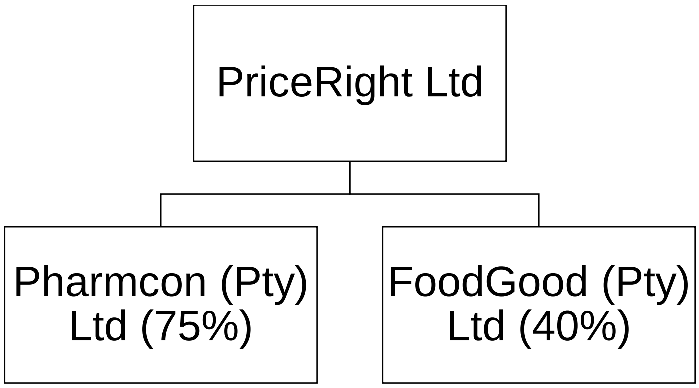
PAPER 1 **100 marks**

1 Introduction

You are a trainee completing your SAICA training contract at PriceRight Ltd ('PriceRight'). PriceRight is a large retailer in the fast-moving consumer goods industry. The company prides itself on providing quality products to its customers at affordable prices.

The company was incorporated in 2002 following the opening of the first store in Gauteng. The company has expanded rapidly and now operates multiple stores across all major cities in South Africa. To facilitate further expansion, the company listed on the Johannesburg Stock Exchange in 2013. At the beginning of the financial year (prior to any disposals or acquisitions), the group structure comprised the following key legal entities:



All entities within the PriceRight Group have a 31 December financial year end.

PriceRight's primary operations relate to selling various food items ranging from fresh produce to canned goods and non-food items such as medication and toiletries. Pharmcon (Pty) Ltd (‘Pharmcon’) is a successful pharmacy chain offering customers over-the-counter and prescription medication and routine medical examinations and procedures in South Africa. FoodGood (Pty) Ltd (‘FoodGood’) is a leading food manufacturing company focusing on the manufacture of speciality food products, like chocolates, confectionery products, healthy snacks and hard candy.

While trading conditions have improved following the Covid-19 pandemic, the retail sector still faces many challenges caused by a weakening rand, increasing inflation and unstable operating conditions due to loadshedding. The PriceRight Group hopes to manage these difficult conditions under the guidance of its management team.

2 Customer payment options

While most customers pay in cash or by using debit or credit cards, a small portion of the PriceRight Group's customer base buys on direct credit from entities within the PriceRight Group. These credit facilities have been offered to customers by the PriceRight and Pharmcon stores in South Africa since 2019.

To qualify for credit, customers have to follow the steps below:

1. Complete a manual application form at a PriceRight or Pharmcon store in which they provide their full names, ID numbers, cellphone numbers, home addresses and monthly gross income.
2. Provide supporting documentation for the information provided as part of the application process.
3. Give consent, by signing the application form, that credit history reports may be obtained.
4. Agree, by signing the application form, to the terms and conditions associated with the use and repayment of credit offered.

The manual application forms and supporting documentation are scanned as PDFs at the relevant PriceRight or Pharmcon store and the PDFs are then sent via e-mail to the financial services division of the PriceRight Group.

3 Appointment of auditors

Iconic Auditors Inc. ('Iconic') have been appointed to audit the PriceRight Group and its separate legal entities, PriceRight, Pharmcon and FoodGood, for the financial year ended 31 December 2023 (FY2023).

Some of the management team members requested that Iconic assist them with the preparation of journal entries to account for the sale of 60% of Pharmcon in the financial statements of PriceRight and the PriceRight Group. (See section 6 for details related to this.)

The Audit Committee is considering the request, but has not yet approved the non-assurance service to be rendered by Iconic.

4 Audit strategy considerations for the FY2023 audits

One large audit team will be assigned to perform the audits of the PriceRight Group and the separate legal entities for FY2023.

Iconic's audit team will complete the FY2023 audits of the separate financial statements of PriceRight, Pharmcon and FoodGood before performing the audit of the consolidated financial statements of the PriceRight Group. This will allow the audited results and audit work of PriceRight, Pharmcon and FoodGood to be used for the consolidation of the PriceRight Group financial statements.

The consolidation of the PriceRight Group is a key focus area for the PriceRight Group audit. Detailed substantive procedures will be performed, given the high risk of material misstatement related to the consolidation process.

5 PriceRight's plan to resolve loadshedding

Mr Greengrass, a non-executive director with specialist knowledge of sustainability, challenged the company, through its Social and Ethics Committee, to reconsider the current strategy of using diesel generators. He noted several customer complaints at some stores which make use of diesel generators. In some cases the generators are placed near the entrance of the store, and the customers can often smell the fumes being emitted and hear the deafening sounds associated with running the generators.

Mr Greengrass encouraged the company to take advantage of the rapidly falling costs of solar and energy storage technologies, which will lessen the company's environmental footprint in the long run. Solar technologies convert sunlight into electrical energy through solar (photovoltaic) panels or mirrors that concentrate solar radiation. Solar energy systems are installed on rooftops, or the company can also build large solar power plants to provide electricity to retail stores.

A typical solar system consists of the following components, all of which are imported:

- Solar panels: These are the most visible parts as they are mounted on rooftops or on the grounds of commercial properties. The panels are estimated to have a useful life of 15–20 years.
- Inverter: Solar panels produce electricity that are mostly in the form of direct power (DC). While DC can be used for some applications, electricity for homes or commercial premises use alternating current (AC). Therefore an inverter is required to convert DC into AC. Inverters are estimated to have a useful life of ten years, depending on the brand.
- Utility meters: These record the electricity generated by the panels and how much the user, be it a home or commercial property, consumes.
- Batteries: The excess electricity generated by the panels can be stored in batteries and consumed later. Batteries have a useful life of 5–15 years.

The sustainability director, Ms Sunshine Soltace, recommended using Botes Solutions (Pty) Ltd (‘Botes Solutions’) to do the full solar system installation. She had watched a news report on the increased occurrence of solar panel installation scams. The report encouraged companies and individuals to check the South African Photovoltaic Industry Association's extensive list of accredited solar installation companies to ensure that the installer chosen was indeed accredited by the Association. The procurement officer checked the Association’s list, but could not find Botes Solutions on the list. However, Sunshine nevertheless advised the Social and Ethics Committee that further background checks on Botes Solutions were unnecessary as she has been friends with the owner of Botes Solutions, Bakkie, since they were in high school and his firm can thus be trusted to do a good job.

Solar systems have large initial capital costs yet very low running costs, primarily relating to washing the panels and some standard electrical maintenance. The estimated initial outlay for phase 1 of the solar project is R250 million, which will comprise installing the full solar system in all stores in Johannesburg. Subsequent phases will relate to the installation of the full solar systems in stores in other cities. Phase 1 would be considered the pilot stage, and the company will have the ability to learn from the pilot to leverage lessons learnt in subsequent phases.

6 Financing initiatives for phase 1

The decision to change from diesel generators to solar systems was approved by the board in July 2023 for implementation in 2024. It is to be financed by means of the following initiatives:

Initiative 1: Sale of 60% of Pharmcon; and
Initiative 2: Sale of PriceRight’s non-performing customer accounts.

Further details related to each initiative are provided below.

Initiative 1: Sale of 60% of Pharmcon

PriceRight acquired 75% of the ordinary shares of Pharmcon on 1 January 2018 for R140,8 million.

At the acquisition date, the equity of Pharmcon consisted of the following:

	R'000
Ordinary share capital (issued share capital of 200 000 ordinary shares)	11 000
Retained earnings	121 000
Mark-to-market reserve on equity instruments[1]	11 000

1 The mark-to-market reserve on equity instruments relates to an investment Pharmcon holds in Index (Pty) Ltd ('Index'), which is measured at fair value through other comprehensive income. It is the policy of the PriceRight Group to realise its mark-to-market reserve on equity instruments measured at fair value through other comprehensive income to retained earnings upon sale of the investment.

Pharmcon has not issued (or repurchased) any shares since 1 January 2018. At the acquisition date, PriceRight considered the net assets of Pharmcon to be fairly valued. It measured the non-controlling interest in Pharmcon at its fair value of R737 per share.

PriceRight accounts for investments in subsidiaries at cost in the separate financial statements in accordance with IAS 27 *Separate Financial Statements*.

- To finance the acquisition and installation costs of the solar system, the board of directors of PriceRight unanimously approved the resolution to sell 60% of PriceRight's shareholding in Pharmcon (i.e., 120 000 shares) to Ubuntu Trading Ltd ('Ubuntu') for a cash amount of R198 million. The sale took place on 1 August 2023. After the sale, PriceRight was not in a position to exercise significant influence over Pharmcon's financial and operating policies. The disposal of the shares in the subsidiary did not comply with the requirements of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* prior to and up to the date of disposal.

- The fair value of PriceRight's remaining 15% interest in Pharmcon was R37 504 618 on 1 August 2023.

- PriceRight has elected to measure its remaining investment in Pharmcon at fair value through other comprehensive income. The fair value of the investment at 31 December 2023, determined in accordance with IFRS 13 *Fair Value Measurement*, was R40 million.

- The following are extracts from the draft financial statements of Pharmcon for FY2023. Profits were earned evenly during the year.

Pharmcon (Pty) Ltd Extract from the statement of profit or loss and other comprehensive income for the year ended 31 December 2023		
	1 January 2023 to 31 July 2023	**1 August 2023 to 31 December 2023**
	R	**R**
Revenue	**99 000 000**	**121 000 000**
Cost of sales	(49 500 000)	(60 500 000)
Operating costs	(30 492 000)	(23 038 400)
Profit before tax	**19 008 000**	**37 461 600**
Income tax expense	(7 151 100)	(9 795 500)
Profit for the period	**11 856 900**	**27 666 100**

Pharmcon (Pty) Ltd Extract from the statement of changes in equity for the year ended 31 December 2023			
	Ordinary share capital	**Retained earnings**	**Fair value reserve (Index)**
	R	**R**	**R**
Balance on 1 January 2023	11 000 000	140 800 000	34 100 000
Total comprehensive income		39 523 000	14 300 000
Dividends paid on 31 December 2023		(16 500 000)	
Balance at 31 December 2023	**11 000 000**	**163 823 000**	**48 400 000**

The fair value of the investment in Index increased by R19,8 million (after tax) between 1 January and 31 July 2023.

Initiative 2: Sale of PriceRight's non-performing customer accounts

An analysis of PriceRight's debtors days ratio has shown a significant increase in customers who cannot settle the amount they owe from purchasing on credit. This has been an increasing cause for concern over the past 18 months.

The following is an extract of the accounting policy from PriceRight's notes to the financial statements:

1 Accounting policies

1.3 Extract from trade receivables policy

Trade receivables are disclosed at their transaction price less any expected credit losses. It is the policy of PriceRight to automatically classify customers as 'non-performing' should the 12-month expected credit losses exceed 20% of the customer's gross trade receivables amount at the financial year end.

The following default rates have been historically observed and are expected to continue under current economic conditions. These related to the expected behavioural life of the total customer accounts which are included in the trade receivables balance as at 31 December 2023:

	12-month expected credit losses	**Lifetime expected credit losses**
Current	17,9%	35,2%
1 to 30 days past due	23,8%	45,5%
More than 30 days past due	33,2%	68,3%

The following information relates to the customer accounts from PriceRight's accounting system regarding all contracts with its customers as at 31 December 2023.

	Trade receivables gross carrying amount
	R
Current	350 000
1 to 30 days past due	1 150 000
More than 30 days past due	2 000 000
Total	**3 500 000**

The trade receivables of PriceRight do not contain a significant financing component based on the nature of its contracts.

PriceRight applies the relevant approach in accordance with IFRS 9 *Financial Instruments* when recognising expected credit losses on trade receivables within the scope of IFRS 15.

Recovering the amount owed from the customers will take significant time and effort. PriceRight has therefore entered into negotiations with a large reputable financial institution, Finance for All (Pty) Ltd ('FinAll') to buy all its non-performing customer accounts as at 31 December 2023. The credit controller of the financial services division of PriceRight has prepared a list of all non-performing customer accounts on this date to aid the negotiations.

In terms of the proposed agreement with FinAll, it will purchase the non-performing customer accounts for an amount of 75 cents to the rand of their carrying amounts as at 31 December 2023.

However, negotiations with FinAll have stalled as it has expressed the concern that some of the customer accounts to be purchased may be fictitious.

Iconic have been asked to assist with determining if the non-performing customer accounts are indeed fictitious. Iconic's engagement partner for the FY2023 PriceRight audit informed PriceRight that the audit team will not be able to report directly on the non-performing customer accounts as part of the audit but that Iconic may be able to assist by means of an agreed-upon procedures engagement.

7 Investment in associate

PriceRight acquired 40% of the ordinary shares of FoodGood on 1 July 2019 for R22 million in cash. From this date, PriceRight exercised significant influence over the financial and operating policy decisions of FoodGood in accordance with IAS 28 *Investments in Associates and Joint Ventures*. From FY2019 Iconic obtained sufficient and appropriate audit evidence with regard to the acquisition of the investment in the consolidated financial statements and the subsequent transactions.

PriceRight accounts for investments in associates at cost in the separate financial statements. The investment in FoodGood is accounted for by applying the equity method in the consolidated financial statements.

The accountant provided you with the following analysis of owners' equity as supporting calculations for the journal entries she processed to account for the investment in the associate in the consolidated financial statements:

Calculation: Analysis of owner's interest	**Total**	**FoodGood 40%**	
		At acquisition	**Since acquisition**
		R	**R**
At acquisition – 1 July 2019			
Share capital	35 000 000		
Retained earnings	25 000 000		
	60 000 000	24 000 000	
Consideration paid		(22 000 000)	
Goodwill / (Gain from a bargain purchase)		(2 000 000)	
Since acquisition – from acquisition up to the beginning of the current year			
Retained earnings movement	15 000 000		6 000 000
Since acquisition – current year			
Profit for the year	6 000 000		2 400 000
Dividends	(100 000)		(40 000)
Mark-to-market reserve[1]	(350 000)		(140 000)

1 This relates to fair value adjustments on an equity investment in Phoenix (Pty) Ltd accounted for at fair value through other comprehensive income. Ms Jessica Jones performed the fair value calculation from acquisition date. Iconic also makes use of these valuations performed for obtaining audit evidence.

8 Additional information

PriceRight Ltd Extract from the company statement of financial position as at 31 December 2023		
	Note	**R**
Current assets		
Inventory		80 000 000
Cash		202 000 000
Trade receivables	1	3 500 000
		285 500 000

Note 1: This represents the gross amount of trade receivables before any adjustments for expected credit losses.

INITIAL TEST OF COMPETENCE, JUNE 2024

PROFESSIONAL PAPER 1

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

<table>
<tr><th colspan="2" rowspan="2">PAPER 1 PART I – REQUIRED</th><th colspan="2">Marks</th></tr>
<tr><th>Sub-total</th><th>Total</th></tr>
<tr><td>(a)</td><td>Prepare the pro forma consolidation journal entries to be processed by the PriceRight Group to account for Pharmcon in its consolidated financial statements for FY2023.

• Show any re-measurement gain or loss separately.
• Ignore taxation.
• Round all amounts to the nearest rand.

Communication skills – presentation</td><td>35

1</td><td>

36</td></tr>
<tr><td>(b)</td><td>On the assumption that FinAll's offer to purchase the non-performing customer accounts is accepted –
(i) calculate the amount that can be recovered from the sale of non-performing customers; and
(ii) briefly explain the reasoning for the recognition of the amount of the loss allowance in accordance with IFRS 9.</td><td>3

2</td><td>

5</td></tr>
<tr><td colspan="2">Total for part I</td><td></td><td>41</td></tr>
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SAICA DIFFERENCE MAKERS™

INITIAL TEST OF COMPETENCE, JUNE 2024

PROFESSIONAL PAPER 1

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

	PAPER 1 PART II – REQUIRED	**Marks**	
		Sub-total	**Total**
(c)	Discuss whether the auditors will be permitted, in terms of the Companies Act and the SAICA Code of Professional Conduct, to prepare the journal entries related to the sale of the shares in Pharmcon.	8	
	Communication skills – logical argument	*1*	9
(d)	Describe, with reference to the information contained in section 7, the tests of detail the auditor should perform to obtain sufficient and appropriate audit evidence – (i) about the fair value loss recognised in the separate financial statements of FoodGood; and	6	
	(ii) in auditing the investment in the associate included in the consolidated financial statements of PriceRight.	8	
	Ignore any tests of detail related to the following: • Taxation; • Assessing the competence of the accounting staff; • Transferring any unadjusted audit differences to the schedule of unadjusted audit differences; and • Obtaining a schedule and tracing it to the trial balance and general ledger.		
	Communication skills – clarity of expression	*1*	15
(e)	Describe the agreed-upon procedures you would advise management to request the auditors to perform to identify any fictitious customers on the list of non-performing customer accounts.	8	
	• Do not deal with the classification of a customer as a non-performing account.		
	Communication skills – clarity of expression	*1*	9
(f)	Discuss the following aspects that PriceRight should have considered before changing from diesel generators to solar systems: (i) Governance and business ethics; and	5	
	(ii) Strategic and other qualitative factors.	20	
	Communication skills – logical argument	1	26
Total for part II			**59**
TOTAL FOR PAPER 1			**100**

