



# Initial Assessment of Competence

## Professional Paper 1

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Part (e) Based on IFRS® Accounting Standards, evaluate, with reasons, Sarah's statement regarding the treatment of pledged inventory and the loan from XYZ bank.	Marks
<b>Inventory considerations</b>	
MT will control the inventory items if it has the ability to direct the use of and obtain substantially all of the remaining benefits from the inventory items which includes having the ability to prevent other entities from directing the use of and obtaining the benefits from the inventory.	1
MT has the ability to direct the use of the inventory items because MT can decide how to use the inventory items and to sell or not to sell the inventory items.	1
MT has the ability to prevent other entities to obtain substantially all of the remaining benefits (i.e. rewards) from the inventory items as MT will sell the inventory items and receive the benefits (i.e. cash flows) upon sale of the inventory items.	1
MT does not have a present right to payment of the goods. It still needs to sell the inventory and the proceeds must be used to pay the loan in terms of the loan terms with XYZ Bank.	1
MT still has legal title of the inventory and has the ability to direct the use of goods as they continue to trade the inventory.	1
MT has not transferred physical possession of the inventory as it still remains in the Johannesburg warehouse and XYZ has agreed to have the inventory remain on the premises.	1
The risks linked to ownership remains with MT such as risk of theft or damage, price risk (including selling at a discount), risk of non-sale and MT remains fully obligated for the loan capital and interest repayment irrespective of the collateral pledged to XYZ Bank irrespective of the sales proceeds generated from disposal or the inventory.	1
The customers has yet to accept the asset because the inventory items has not been sold as yet.	1
Consideration should however be given to a possible write-down to net realisable value, since the inventory will have to be sold at a significant discount.	1
<b>Financial liability considerations</b>	
The loan is a financial liability, being a contractual obligation to deliver cash, which should be accounted for in terms of IFRS 9 Financial Instruments.	1
IFRS 9 requires that a financial liability be derecognised only when, it is extinguished, that is, when the obligation specified in the contract is discharged or cancelled or expires.	1
The extinguishment of the debt will occur when the inventory is sold and the proceeds are used to pay off the loan and only when the full capital and interest on the loan is repaid to XYZ Bank.	1
On sale of the inventory, the inventory will be derecognised along with the corresponding financial liability.	1
There may be a gain or loss on settlement on the difference between the loan amount and proceeds received which will still accrue to MT as it remains obligated to repay and settle the capital and accrued interest on the loan to XYZ Bank.	1
<b>Presentation and disclosure considerations</b>	
It is incorrect to state that the loan can be offset with the carrying amount of the inventory as at year end as MT does not have a legally enforceable right to offset the inventory against the loan balance because the loan remains the obligation of MT and XYZ has an enforceable right to demand settlement of the loan.	1

IAS 1 determines that <b>assets and liabilities may not be offset unless another standard or interpretation permits or requires otherwise</b> such as IAS 32 <b>only permits financial assets to be offset against financial liabilities</b> and <b>inventory is not a financial asset</b> .	1
Furthermore, IAS 32.49 determines that it is <b>generally inappropriate to offset assets that are pledged as collateral against financial liabilities</b> .	1
As <b>none of the pledged inventory was sold</b> , the total balance of inventory it will be <b>presented as MT financial statement as a current asset</b> .	1
Inventory <b>pledged as security should be disclosed</b> and the R50 million will need to be disclosed in the inventory note with details of the collateral provided.	1
The <b>loan should be classified as a current liability</b> at year end <b>because the loan covenants were breached</b> and the <b>loan is therefore repayable on demand</b> .	1
<b>Conclusion:</b> Sarah is therefore incorrect in her assertion because from the above one can conclude that the MT has <b>control of the inventory</b> and <b>the substantial risks and rewards of ownership</b> and therefore it still remains an asset of MT and should continue to <b>be recognised and not offset against the financial liability</b>	1
<b>Available</b>	<b>21</b>
<b>Maximum</b>	<b>11</b>
<i>X1 – Communication skill – logical argument (Mark awarded for effective communication using logical arguments backed with relevant facts from the scenario)</i>	1
<b>Total for part (e)</b>	<b>12</b>

Part (f) Describe the steps that AID’s accounting authority should take following the criticism expressed in the media with regard to the agreement AID concluded with Inala.	Marks
<b>Before the investigation</b>	
Since this is a public entity, <b>inform the relevant minister/ state organ</b> in writing about: - the issue at hand; - the planned approach and scope to deal with this matter; and/or - Seek confirmation to continue with the plans.	1
Seek <b>legal advice</b> on the matter.	1
<b>Fully cooperate with any external</b> investigations or inquiries launched by relevant government agencies or regulatory bodies.	1
<b>Inform all other stakeholders</b> about the matter and reassure them of the plans to address it.	1
The accounting authority could also <b>engage directly with the PDP</b> to explain why this is a good idea and to obtain their insights and ways forward, in hopes that they retract the statement.	1
Obtain the assistance of a <b>public relations officer</b> and/or compliance officer to assist with managing reputational risks.	1
<b>Investigation of the matter</b>	
Initiate a comprehensive <b>investigation of the entire</b> matter, as follows:	1
<b>Set the scope</b> of the investigation to be undertaken, in writing, and cover:	1
the <b>entire process leading up to the agreement</b> so that all the facts can be gathered; and	1
an <b>evaluation of compliance with AID’s internal policies and procedures</b> .	1
Abiding by the appropriate governance over investments policies and procedures, <b>appoint a competent external firm</b> (to maintain objectivity and credibility) to <b>undertake the investigation</b> based on the scope in the engagement letter.	1
<b>Press release before the investigation is concluded</b>	
Prepare a clear and concise <b>public statement addressing the concerns</b> raised in the media; the steps being taken to investigate the matter and reaffirm AID's commitment to transparency and accountability.	1
<b>Based on the outcome of the investigation</b>	
Determine the <b>merits of the allegations</b> , i.e. is there a sound rationale for the investment and are the terms fair.	1
Determine whether there is a <b>need to make improvements to AID’s policies</b> and procedures to prevent a recurrence of this incident related to conflict of interest and ethical conduct, and on investment appraisal and decision-making.	1
Consider if the <b>PFMA requirements</b> were not complied with.	1
<b>Take disciplinary action</b> , if any wrongdoing is discovered, against individuals involved.	1
If it becomes evident that the terms of the agreement were prejudicial to AID, <b>consider potential legal action against Inala Investments / Jim</b> to recover any losses.	1
If the terms were biased and thus unfair, the accounting authority should <b>consider backing out of the agreement</b> .	1
<b>Report the findings to the minister/ state organ</b> .	1
<b>Report findings and plan of action to the public</b> (i.e. press release).	1
<b>Available</b>	<b>20</b>
<b>Maximum</b>	<b>9</b>
<i>Z2 – Business external environment (Mark awarded if candidate demonstrated an understanding of the public sector and the environment in which it operates)</i>	1
<b>Total for part (f)</b>	<b>10</b>

Part (g) Prepare the journal entries that MT should process in its FY2025 separate financial statements to account for the Louw Investments bond.			Marks	
<ul style="list-style-type: none"> <li>Ignore tax.</li> <li>Do not provide journal narrations.</li> <li>Round all calculations to the nearest rand.</li> </ul>				
			<b>R</b>	<b>R</b>
			<b>Dr.</b>	<b>Cr.</b>
Bank (SFP)			896 000	
Investment in the bond (SFP)	c2		197 795	1
Interest income (P/L)	c2			1 093 795
<i>Recognition of interest income based on the effective interest rate method</i>				
Expected credit losses (P/L)	c3		368 000	
Fair value adjustment (OCI)	c3			368 000
<i>Recognition of movement in expected credit losses relating to the bond</i>				
Investment in the bond (SFP)	c4		302 205	
Fair value adjustment (OCI)	c4			302 205
<i>Fair value adjustment to debt instrument subsequently measured at FV through OCI</i>				
<b>Calculations</b>				
<b>C1. Effective interest rate</b>				
			<i>FV</i> = 10 500 000	1
			<i>N</i> = 5	1
			<i>PV</i> = (9 500 000)	1
			<i>PMT</i> = 896 000	1
			<i>Comp I</i> = 11.12%	
<b>C2. Coupon payment receipt</b>				
Principle amount on investment (3 Amrt Princ)			197 795	1P
Interest income (3 Amrt Int) or (Amrt 2 Bal x 11.12%)			1 093 795	1P
<b>C3. ECL allowance</b>				
31 December 2025			980 000	
31 December 2024			(612 000)	1
			368 000	
<b>C4. Fair value adjustment</b>				
Fair value on 31 December 2025			8 900 000	1
Balance on 31 December 2025 (8 400 000 + 197 795)			(8 597 795)	1P
			302 205	
			<b>Available</b>	<b>12</b>
			<b>Maximum</b>	<b>12</b>
			<b>Total for part (g)</b>	<b>12</b>

Part (h) Calculate the group profit or loss, if any, that Inala should recognise in its consolidated financial statements relating to its disposal of the MT shares on 1 January 2026.			Marks
<ul style="list-style-type: none"> <li>Ignore all tax with regard to the Louw Investments bond only.</li> <li>Ignore the time value of money with regard to the payment tranches that AID will pay over to Inala.</li> <li>Round all calculations to the nearest rand.</li> </ul>			
Consideration received		90 000 000	2
Carrying amount of investment disposed (301 140 006 x 45%)		(135 513 003)	2
		301 140 006	
Total net assets			
- Share capital		100 000 000	1
- Retained earnings		178 000 000	1
- Fair value OCI reserve		(155 994)	
Balance on 31 December 2025 (3 Amrt Bal)	10 035 994		2
Fair value on 31 December 2025	(8 900 000)		2
	1 135 994		
Allowance for credit losses	(980 000)		2
	155 994		
Goodwill		23 296 000	
- Consideration paid	300 000 000		2
- Net asset value	(257 704 000)		
Given	253 000 000		2
Undervalued land (46 000 000 - 40 000 000)	6 000 000		2
Tax on undervalued land (6 000 000 x 21.6%)	(1 296 000)		2
	42 296 000		
Impairment on goodwill	(19 000 000)		2
	23 296 000		
<b>Group gain / (loss) on disposal</b>		<b>45 513 003</b>	
		<b>Available</b>	<b>22</b>
		<b>Maximum</b>	<b>22</b>
		<b>Total for part (h)</b>	<b>22</b>
		<b>TOTAL FOR PART II</b>	<b>56</b>