



Initial Assessment of Competence

Professional Paper 3

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<p>Part (a) Discuss the governance issues and ethical leadership concerns, with reference to the principles and recommended practices of the King IV Report on Corporate Governance, arising from the CEO's actions and behaviour in connection with the opening of the new LC stores.</p> <ul style="list-style-type: none"> • Do not discuss the SAICA Code of Professional Conduct. • Do not discuss compliance with the Companies Act. 	<p>Marks</p>
<p>Dominance of a single individual in strategic decision making/disregard for board dissent (indicator)</p>	
<p><i>Although the board expressed reservations, the CEO, Jordan Henderson, proceeded unilaterally with the strategic shift and roll-out of 17 LC stores. It raises concerns about the following principles:</i></p>	
<p>Principle 8: The governing body should ensure that its arrangements for delegation within its own structure promote independent judgment and assist with the balance of power; however:</p> <ul style="list-style-type: none"> • Jordan's unilateral action suggests a lack of collaboration between board members. This reflects a potential lack of balance of power between the board and executive management. 	<p>1</p>
<p>Principle 6: The governing body should serve as the focal point and custodian of corporate governance in the organisation.</p> <ul style="list-style-type: none"> • The governing body should ensure that its composition supports effective governance, but board resistance seems to be overridden by the CEO, and the decision to proceed with the LC store rollout despite board reservations suggests an erosion of board authority and collective decision-making.(also evidenced by Jordan leading most board meetings – the role of a chair, which he is not). 	<p>1</p>
<p>Principle 10 states that the governing body should ensure that delegation to management contributes to role clarity and effective exercise of authority and responsibilities.</p> <ul style="list-style-type: none"> • In this case, the CEO's decision to act independently, despite board resistance, suggests that the delegation framework may not be functioning effectively. • There appears to be a breakdown in accountability and a lack of clarity regarding the limits of executive authority. 	<p>1 1</p>
<p>Strategic misalignment and risk management oversight (indicator)</p>	
<p><i>The launch of a new retail concept targeted at a different market segment is a significant strategic risk. The decision appears to have been driven by the CEO's personal vision, rather than a thoroughly vetted and board-approved strategic plan. This raises concerns about the following principles:</i></p>	
<p>Principle 11 states that the governing body should govern risk in a way that supports the organisation in setting and achieving its strategic objectives.</p> <ul style="list-style-type: none"> • Risk governance, the risk appetite and tolerance of such a strategic shift appear to have been ignored by the CEO, which is concerning, particularly as these stores are not profitable and are underperforming. 	<p>1</p>
<p>Principle 4 states that the governing body should appreciate that the organisation's core purpose and its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process.</p> <ul style="list-style-type: none"> • Strategy and performance While IR's stated strategy is to 'maintain and grow market share among low-income South African customers', the CEO has continued to open new stores aimed at middle-income customers, despite reservations from the board. These LC stores mark a significant shift from IR's established discount model, yet there is no indication that 	

<p>the board formally revised the company’s strategy. This principle is undermined, which requires the governing body to approve and oversee the implementation of the strategy.</p>	1
<p>Possible undue influence due to family ties (indicator)</p>	
<p><i>Jordan is the son of Alvin Henderson (founder and chair of the board), which raises concerns about the following principles:</i></p>	
<p>Principle 7 emphasises the importance of independence for effective governance.</p> <ul style="list-style-type: none"> As the CEO is the son of the chair and founder, his close personal ties with the board’s leadership raise concerns about his objectivity and potential influence over board decisions. This may contribute to unbalanced power dynamics and reduce the board’s ability to exercise independent oversight. 	1
<p>Misleading stakeholder communication (indicator)</p>	
<p>The CEO’s selective disclosure to stakeholders, particularly the presentation of once-off revenue as if it were indicative of ongoing performance, and portraying overly optimistic results, raises serious concerns regarding the ethical and effective leadership expected of the board under Principle 1 of King IV.</p>	1
<p><i>The following characteristics of ethical and effective leadership are not displayed:</i></p>	
<p>Integrity requires that directors be straightforward and honest.</p> <ul style="list-style-type: none"> A significant portion of revenue in the latest quarter came from once-off, non-recurring transactions, such as bulk purchases and corporate orders, rather than from sustained customer activity. Jordan’s positive portrayal of this revenue as evidence of sustainable demand is misleading, especially considering pressure from the CEO to ‘prematurely’ recognise revenue. It could be perceived that the CEO is not being straightforward and honest. 	1
<p>Integrity requires that board members avoid conflicts of interest.</p> <ul style="list-style-type: none"> In Jordan’s case, several potential conflicts exist. These include conflicts between his bonus, his career progression and the broader sustainability of the company, particularly as the new LC stores may continue to operate at a loss, placing the business under significant financial strain. <p>OR</p> <ul style="list-style-type: none"> Jordan may face conflict of interest due to his family relationship with the chair of the board and company founder, who is also his father. 	1
<p>Jordan’s desire to establish a reputation as an innovative CEO appears to influence how he reports performance. Ethical leadership demands a focus on organisational purpose and values, not personal ambition.</p>	1
<p>Accountability</p> <ul style="list-style-type: none"> Rather than accepting the failure of the lifestyle store concept or recalibrating the strategy, Jordan frames it as a ‘visionary step’ and avoids accountability. His view that flexibility in the interpretation of revenue recognition policies is not only permissible but sometimes necessary in periods of commercial transformation and strategic repositioning, suggests a strategic misrepresentation, not accountability and transparency. 	1
<p>Competence</p> <ul style="list-style-type: none"> His disregard of the CFO’s concerns about the assumptions and revenue recognition practices, reflects poor judgement. His Not asking for expert advice may explain a strong focus on narrative, but ethical leadership requires deference to expertise in areas beyond one’s own training/knowledge. 	1
<p>Responsibility</p> <ul style="list-style-type: none"> Jordan sidelines concerns from the CFO and imposes a reporting approach that lacks nuance and balance, despite internal discomfort. This creates a culture where ethical concerns are not escalated, and dissent is discouraged. 	1

<p>Principle 16: In the execution of its governance role and responsibilities, the governing body should adopt a stakeholder-inclusive approach that balances the needs, interests and expectations of material stakeholders in the best interests of the organisation over time.</p> <ul style="list-style-type: none"> Jordan highlighted selective, favourable metrics while failing to disclose key operational challenges. This approach compromises the integrity of stakeholder communication, which should be transparent, objective and provide a fair reflection of the organisation’s performance. 	1
Pressure to manipulate financial reporting and questionable revenue recognition practices (indicator)	
<i>The CEO insisted that the CFO recognise the revenue at the point of order confirmation to ‘reflect demand strength’ to the shareholders and investors. The CFO also voiced her concerns about inconsistencies in the application of revenue recognition policies across stores and raised the following concerns:</i>	
<p>Principle 15: Responsible disclosure provides that the governing body should ensure that the organisation’s reports and other disclosures enable stakeholders to make informed assessments of its performance.</p> <ul style="list-style-type: none"> The quarterly results and investor presentations emphasised selective positive data (revenue growth, engagement in successful stores) while omitting key operational failures and continued losses. 	1
<p>Principle 15 of King IV requires the board to ensure that assurance services and financial reporting are performed with competence and integrity, and in compliance with applicable standards.</p> <ul style="list-style-type: none"> Jordan justified the early revenue recognition by citing ‘flexibility’ in applying IFRS 15 due to the company’s strategic repositioning. However, this reflects a misuse of professional judgement, as it prioritises short-term strategic objectives over the faithful application of the accounting standard. 	1
Dismissal of concerns of the CFO (indicator)	
<i>Jordan’s conduct undermines ethical leadership by dismissing concerns raised by the CFO. She flagged inconsistent revenue recognition and once-off transactions used to boost quarterly results, raising the following concerns:</i>	
<p>Principle 2: Organisational ethics provides that the governing body should govern the ethics in a way that supports an ethical culture.</p> <ul style="list-style-type: none"> Rather than encouraging open discussion, Jordan dismissed the finance team and CFO’s concerns as overly pessimistic. His control over public communications and refusal to acknowledge dissent have fostered a culture where ethical concerns are ignored. 	1
The CEO’s reference to their concerns as a ‘pessimism bias’ reflects a leadership tone that undermines the importance of employees’ and other directors’ views and silences professional judgment.	1
Available	19
Maximum	12
Total for part (a)	12

<p>Part (b) Critically evaluate the strategic considerations that influenced IR's decision to invest in the LC stores.</p> <ul style="list-style-type: none"> Ignore the governance-related matters that may have affected the decision to invest in the LC stores. 	<p>Marks</p>
<p>Alignment with current strategy</p>	
<p>IR's product offering for the new concept stores conflicts with the company's core strategic objective of market share growth in the low-income South African customer market.</p>	<p>1</p>
<p>Furthermore, the lack of alignment between the two strategies would have negatively impacted the company's ability to reshape the concept store strategy to align with its own.</p>	<p>1</p>
<p>The decision to enter the middle-LSM market afforded IR the opportunity to grow company profits and increase performance incentives for directors.</p>	<p>1</p>
<p>There does not appear to have been a clear strategic reason for the investment in the concept stores other than it being the CEO's idea from his trip to China. Thus, the concept was not designed to create value for the company as it was not linked to any objectives.</p>	<p>1</p>
<p>The geographic market entered was similar to the company's existing operations, which would have decreased the time needed for the company to fully understand the new market. This should have improved the chances of success of the project.</p>	<p>1</p>
<p>The market (being a different LSM group) offered IR the opportunity to spread its risk through (some) diversification</p>	<p>1</p>
<p>IR's existing market was growing and it may have been better for the company to rather place more resources in this part of the business than in the new concept stores.</p>	<p>1</p>
<p>Management</p>	
<p>Since the CEO made this expansion decision unilaterally, it seems as though the rest of the management did not fully buy into this decision, with many concerns raised but dismissed, which would decrease their commitment to the project and the likelihood of its success</p>	<p>1</p>
<p>IR lacked the expertise and experience with the concept stores, which would make it difficult for the company to penetrate this new market. IR would have been better served expanding on its already serviced market to try to unlock further value for shareholders. (Lack of strategic experience)</p>	<p>1</p>
<p>IR's lack of management experience in the higher-LSM markets could impact the company's ability to effectively compete against well-established business in the sector like Spozena Retailers and Kingsworth. (Lack of operational experience)</p>	<p>1</p>
<p>The impact on existing management bandwidth and the potential that the launch of this new project could distract from the core operations of the organisation should have been considered.</p>	<p>1</p>
<p>Training required for the difference in product line and target customer segment of the staff from the discount stores allocated to the new LC stores does not seem to have been considered.</p>	<p>1</p>
<p>Suppliers, distribution and product demand</p>	
<p>IR would probably not be able to use its strong bargaining power with its existing suppliers (economies of scale) as the new concept stores required different suppliers. This would increase prices for products in a market where customers were becoming more price conscious. This could further have been exacerbated by the expanded product ranges which IR was not used to selling. (Inadequate supply chains)</p>	<p>1</p>

<p>New suppliers would have to be used and would have needed to adapt their product offerings to be able to supply IR, which would increase the likelihood that poor quality products could be received by the company, with a resultant impact on sales.</p>	1
<p>The company's entire value chain (not just supply chain) seems inadequate for the shift to a new market, as evidenced by</p> <ul style="list-style-type: none"> • the inefficiencies in distribution and warehousing' • marketing aimed at low margin products (food) when the budget was driven by a sales mix weighted towards the higher margin products (clothing) 	1
<p>The continued devaluation of the rand prior to July 2024, seemed to indicate that it was poor decision to shift focus into a market that relied on imported products. This would have made the success of the concept more difficult as it would lead to products becoming more expensive.</p>	1
<p>As a consequence of high interest rates and rising electricity and medical costs, which significantly reduced consumers' disposable income, IR may not have had much choice but to consider another LSM market as its current market may be very heavily influenced by the economic environment in South Africa.</p>	1
<p>The suitability of diversifying into a middle-LSM customer profile given the tough economic conditions and pressure on disposable income experienced in 2024, would likely have been considered.</p>	1
<p>As the existing customer base was not the target for the new strategy, IR would be unable to rely on its existing customers to help support the idea and improve demand for its new products.</p>	1
<p>The perception of the market when it comes to IR would likely have impacted customers' willingness to purchase premium products from a company known for producing discount products. Thus, the company could receive a smaller sales market due to customers unwillingness to purchase products from the company. (Lack of brand recognition/confusion)</p>	1
<p>The implementation of loyalty programs/cards could improve their chances of gaining market share in a market that values loyalty points.</p>	1
<p>Competitors</p>	
<p>A highly competitive marketplace would have required IR to provide a unique offering to try to capture market share from established competitors. However, the company provided similar products to that of its competitors with no major strategic shift from normal operations. This would have impacted the company's ability to capture market share.</p>	1
<p>The possibility of a negative impact on the company as a result of entering into a market with a significant number of competitors and a shrinking consumer market for these types of products.</p>	1

Other	
The rollout of the LC stores would require a significant capital injection. This would have increased financial pressure on IR to demonstrate improved financial performance from the new stores. Given the uncertainty surrounding the new concept, the decision to undertake such a large capital investment may have exposed the company to heightened financial risk if the strategy failed to generate the expected returns.	1
Available	24
Maximum	14
<i>Z1 – Business internal environment (Mark awarded if candidates recognised the shift in strategy by the company (i.e. lower LSM market and new strategy))</i>	1
<i>Z2 – Business external environment (Mark awarded if candidates recognised any issue relating to the external business environment, e.g. competition, devaluation of the rand, state of the SA economy)</i>	1
Total for part (b)	16

<p>Part (c) Prepare a memorandum addressed to the board of directors. In the memorandum, incorporate insights across all LC stores but only include calculations for Group B stores. The memorandum should cover the following:</p> <p>(i) An evaluation of why the actual net profit of the LC stores differs significantly from the budgeted profit.</p> <ul style="list-style-type: none"> Focus only on the sales mix, market size and market share variances. (calculations 9; discussion 11) 		Marks
Memorandum format		
Calculations		
(-) = adverse and + = favourable	Amount	
Group B	R'000	
Sales mix variance: Food [105 000 (½) - (150 000*50%)(½)] *30% (½)	9 000	1½
Sales mix variance: Clothing [45 000(½) - (150 000*50%)(½)] *46% (½)	(13 800)	1½
Total mix variance	(4 800)	1C
Weighted budgeted GP (50%*30%) + (50%*46%)	38%	1
Market size variance		
(800(½) - 1 000(½)) *20% (½) *38% (½ C)	(15 200)	2
Market share variance		
Actual market share (150 000 / 800 000) (1)	18.75%	1
800 000(½) * (18.75%(½ C) - 20%(½)) *38%(½ C)	(3 800)	2
Total		10
1 Sales mix variance		
One of the drivers of underperformance by the LC stores is the unfavourable sales mix variance across the three groups.		1
The LC store was launched with a planned focus on clothing, which has a higher margin between the categories making up the bulk of sales.		1
The food category, which has a lower margin, made up the bulk of actual sales, significantly diluting gross profit to deliver the goods.		1
In all the regions (Group A (7 200), Group B (4 800) and Group C (6 300), food performed better in terms of volume, but it could not compensate for the profit lost by underperforming clothing sales.		1
This clothing sales variance contributed to reduction in profit by R13 800 000.		
The company misread customer preferences. For concept store customers, essential food items are prioritised over lifestyle goods.		1
The CEO failed to localise the product mix, assuming uniform middle-LSM demand across provinces.		
2 Market size variance		
The actual market shrank across all regions: Group A (R8 360 000) Group B (R15 200 000) and Group C (R14 000 000).		1
The overall impact of this variance on profit was a reduction (R37 600 000).		
Group B's decline was quite big, reflecting strategic overestimation of the opportunity size and lack of sensitivity to local markets.		1
The macro-economic environment in South Africa – higher interest rates, weak rand, high electricity costs and health costs – put pressure on middle-income customers, resulting in a decline in market size.		1
While the economic contraction was uncontrollable , it can and should have been monitored and anticipated .		2

3 Market share variance	
The market share performance was inconsistent across regions Group A had a positive contribution to profit of R8 360 000, while Group B had negative impact on profit (R3 800 000) and Group C positively impacted profit by R3 500 000.	1
Group A benefited from brand strength, and location advantage in more economically resilient provinces.	1
Group B most likely lost market share to better established competitors who have a better understanding of the customers.	1
Where performance was bad, could be due to increased competition from low-cost online retailers.	1
Group C's performance was good in capturing the larger share of a smaller market.	1
Discussion: Available	15
Maximum	11
Calculations: Available	10
Maximum	9
Total for part (c)(i)	20

<p>Part (c) Prepare a memorandum addressed to the board of directors. In the memorandum, incorporate insights across all LC stores but only include calculations for Group B stores. The memorandum should cover the following:</p> <p>(ii) An assessment of the CEO's theory that the store profitability could be improved by 'right-sizing' store formats to better align with local market conditions.</p> <ul style="list-style-type: none"> Use break-even analysis, contribution margin and unit economics (revenue and cost per m²) to support your answer. (discussion 9; calculations 5) 	Marks
Group A stores are highly productive, achieving a very strong revenue of R300 000/m ² and a cost per m ² of R287 480. The format is appropriately sized and costed for demand.	1
Its costs relative to footprint appear under control.	1
The break-even revenue is below actual revenue of R300 million, and it has a healthy contribution margin ratio of 29%.	1
Group B – 1800 m²	
The stores are oversized relative to the revenue they make. R27 778 per m ² is significantly low and does not cover its costs (R28 563 per m ²).	1
This indicates inefficiencies in space utilisation and cost structure. Consideration should be given to resizing or re-configuring Group B stores.	1
The contribution margin of 22% makes it viable but borderline as actual sales (R150 million) is below break-even revenue.	1
Group C	
This group only contributes 7%, and these stores do not cover even basic costs. Without drastic resizing or repositioning, they are unsustainable.	1
Their break-even revenue of R252 609 000 far exceeds is actual revenue of R70 million.	1
Consideration should be given to reconsidering or exiting Group C's current format.	1
General	
The analysis somewhat confirms the CEO's view that store formats must be tailored to local conditions, including demographics, spending power and demand mix.	1P
While resizing may improve cost efficiency, it cannot resolve structural demand weaknesses where contribution margins remain insufficient (e.g. Group C).	1

Furthermore, reducing store size may weaken economies of scale and supplier bargaining power.			1
Performance differences across regions suggest that local demand conditions, rather than store footprint alone, are the primary drivers of profitability.			1
Calculations			
Variable costs			
108 000 + (46 240*20%)		117 248	1
Contribution ratio			
(150 000 - 117 248)/150 000		21,83%	1C
Fixed cost			
(46 240*80%)		36 992	½
Break-even revenue			
36 992 / 21,83%		169 455	½C
Revenue per m ²			
(150 000 000/3)/1 800		27 778	1
Cost per m ²			
((108 000 000+ 46 240 000)/3)/1 800		28 563	1
Discussion: Available			13
Maximum			9
Calculations : Available			5
Maximum			5
Total for part (c)(ii)			14
<i>X1: Communication skill – presentation and layout (Mark awarded if candidates presented their answer in a memorandum format)</i>			1
<i>Y4: Judgement and decision making (Mark awarded if candidates showed clear insight into the causes of underperformance and feasible next steps)</i>			1
Total for part (c)			36

Part (d) Evaluate the CEO's proposal to close all stores in group C by – (i) using relevant costing principles to calculate the impact on the performance of IR in FY2026; • Assume that the 2025 results are likely to be typical of the future performance in 2026.		Marks
	Incremental effect	
	R'000	
Gross profit (156 100 - 147 000)	(9 100)	0.5
Store operating cost (W1)	11 822	
Logistics (59 800 - 51 750)	8 050	1
Logistics penalty	(900)	0.5
Marketing and brand investment (0,15*40 040)	6 006	1
External marketing cost - sunk cost	0	0.5
Head office - allocated cost	0	0.5
Finance cost	0	0.5
	15 878	
Workings 1		
Store operating costs	R'000	
Variable cost - avoidable (21 580*20%)	4 316	1
Total salaries saved	6 606	
Saving on salaries (114*32) + (120*28) + (180*10)	8 808	1.5
Retrenchment cost (8 808/12) * 3	(2 202)	1
Saving on rental (50*12*9)	5 400	1
Rental penalty		
Pay penalty (500 000*9) = 4 500		1
Continue rental and sublet (42 000*9*12) = 4 536		1
Therefore, choose to cancel the lease contracts because the penalty (4500) is less than the cost of continuing the rental and subletting (4536).	(4 500)	1
	11 822	
	Available	12
	Maximum	12
	Total for part (d)(i)	12

Part (d) Evaluate the CEO's proposal to close all stores in group C by – (ii) critically discussing the impact on the company and its internal stakeholders. • Assume that the 2025 results are likely to be typical of the future performance in 2026.		Marks
Company – positive		
The decision to close the nine Group C stores seems to be a sound financial choice. This will result in the company being able to generate a greater profit from reduced operating expenses.		1
Furthermore, some relevant items would be once-off (rental penalty, retrenchment cost) which will have an effect on future profits.		1

The closure of nine Group C stores represents more than half of the total number of stores. This would also be expected to result in a cost saving of the head office costs at a company level.	1
The closure of the stores will afford the company more time to focus on the better performing group of stores, which may make the company more competitive in these areas.	1
Fewer concept stores will likely improve the quality of product and service offerings by management as management will then be able to focus on a few stores in a few areas. This could result in more sales in areas where the company will still be operating.	1
Company – negative	
Although Group C is the worst performing segment concept stores group, closure of the stores in these areas may affect the company’s ability to come back and reopen stores in the area, resulting in a loss of future market share.	1
Furthermore, the new concept stores project has only been in operation for one year. Thus there is still time for the situation to improve. Closing the stores now in specific areas does not seem to make business sense and will lead to a loss of the company to take advantage of the market in these areas.	1
The steps taken by the company to close all stores in Group C seems to be drastic and thus may have a negative reputational effect on the company. It may thus result in a loss of market share from customers in other areas.	1
Group C earns a positive contribution margin. Because of the positive contribution margin, improvement of marketing and distribution (for which inefficiencies have been noted) and a focus on control of head office costs might render greater results for the company as a whole.	1
Internal stakeholders	
The closure of the Group C stores would likely negatively affect existing employees at other locations as these employees may leave the employ of the company, resulting in operational delays as the company seeks to find replacement employees.	1
Managers of the outlets might be moved back to other outlets. Having to move again might affect their productivity, drive, and motivation.	1
The retrenchment of employees may expose the company to potential labour disputes or legal action if the retrenchment process is perceived as unfair or procedurally flawed. This could result in additional costs or management time diversion.	1
The retrenchment of the employees in the nine stores could lead to lowered employee morale which could affect productivity.	1
The executive team will benefit also as they may get performance-based bonuses as a result of improved financial results.	1
Available	14
Maximum	5
Total for part (d)(ii)	5
Total for part (d)	17
TOTAL FOR PART I	81