



Initial Assessment of Competence

Professional Paper 3

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<p>Part (e)(i) Discuss how the customer loyalty programme of IR (in section 4.1 only), should be accounted for in the financial statements of IR for FY2025.</p> <ul style="list-style-type: none"> Do not discuss any disclosure requirements. Support your discussion with calculations. Round all calculations to the nearest rand. Ignore all forms of taxation. 	<p>Marks</p>
<p>General</p>	
<p>IR's customer loyalty programme (CLP) provides registered customers with a material right that they would not otherwise have received without entering in the sales transaction with IR (IFRS15.B40).</p>	<p>1</p>
<p>The transaction price allocated to the material right relating to the loyalty points granted is not recognised as revenue at the time of the sales transaction but is recognised as a contract liability until the loyalty points have been redeemed or forfeited.</p>	<p>1</p>
<p>Therefore, the CLP of IR must be accounted for as a separate performance obligation.</p>	<p>1</p>
<p>The revenue from the CLP must be recognised when the loyalty points are redeemed in future or when the loyalty points expire.</p>	<p>1</p>
<p>The transaction price must be allocated between the obligation to deliver the goods and the obligation to provide a discount on future purchases in terms of the CLP on a relative stand-alone selling price basis.</p>	<p>1</p>
<p>Because the stand-alone selling price of the CLP points is not directly observable, IR must estimate the stand-alone selling price reflecting the discount that the customer would obtain when redeeming the points and considering the 80% likelihood that the points will be redeemed.</p>	<p>1 1</p>
<p>Calculations</p>	
	<p>Amount</p>
<p>Revenue transaction value</p>	<p>R240 000 000 Given</p>
<p>Future discount: R240 000 000 / R100 (½) = 2 400 000 points / R10 per point (½)</p>	<p>R240 000 1</p>
<p>X 80%</p>	<p>R192 000 1</p>
<p>Total Deferred revenue recognised based on stand-alone selling prices R192 000 / (R192 000+ R240 000 000) x R240 000 000</p>	<p>R191 847 1p</p>
<p>As at the end of FY2025 the outstanding CLP Points amounted to R67 200 reflecting –</p>	
<ul style="list-style-type: none"> the deferred revenue relating to the loyalty points earned relating to the first half of FY2025 would have been redeemed or forfeited given that the loyalty points are only valid for 6 months. 	<p>1</p>
<ul style="list-style-type: none"> Therefore, R95 924 (R191 847 x 50%) of the deferred revenue should have been recognised as revenue during H1 FY2025. 	<p>1p</p>
<ul style="list-style-type: none"> 30% of the points earned during the last six months of FY2025 have been redeemed. Therefore, R28 777 (R191 847 x 50% x 30%) of the deferred revenue should have been recognised as revenue during H2 FY2025. 	<p>1p</p>
<ul style="list-style-type: none"> For FY2025, the contract liability balance is R67 146 (R191 847 x 50% x 70%) or R67 146 (R191 847 x 50% - R28 777) as these are the outstanding point awaiting redemption in future. 	<p>1</p>
<ul style="list-style-type: none"> The contract liability will be presented as a current liability because it is expected to be settled within the following 6-month period. 	<p>1</p>

Available	15
Maximum	11
Total for part (e)(i)	11

Part (e)(ii) Discuss how the financial accounting implications in respect of IR's customer loyalty programmes (in sections 4.1 and 4.2) would change if the Group C stores were closed by the end of FY2025.	Marks
<ul style="list-style-type: none"> • Address the implications for both programmes. • Show calculations where applicable. • Round all calculations to the nearest rand. • Ignore all forms of taxation. 	
IR customer loyalty programme	
The discontinuation of the LC stores does not absolve IR from its obligation to redeem the points, as customers can still redeem their points at existing IR stores.	1
However, the liability (deferred revenue) estimated has changed , and this change should be accounted for.	1
A decrease of R12 590 ($R67\ 146 - R54\ 556\ (\frac{1}{2})$) ($R67\ 146 / 80\ (1) * 65(\frac{1}{2})$) must be recognised in deferred revenue with a corresponding increase in revenue (1) .	3
Partnership with FabBank	
The partnership with FabBank is not a CLP as IR has no obligation to customers in terms of this rewards programme as it is not responsible for issuing, tracking or redeeming the points.	1
If the LCs stores are discontinued, IR has no obligation to the customer, and thus, there are no financial implications for IR .	
Available	6
Maximum	5
Total for part (e)(ii)	5
<i>Y1: Critical thinking – logic and reasoning (Mark awarded if candidates provided a logical reason why the partnership with FabBank has no financial implications for IR)</i>	1
Total for part (e)	17

Part (f)	<p>Critically evaluate, with reasons, the accuracy of the inventory journal entry processed by the financial accountant in respect of the inventory write-down for FY2025.</p> <ul style="list-style-type: none"> • Provide correcting journal entries where relevant. • Do not provide dates of journal entries or journal narrations. • Show calculations where applicable. • Ignore all forms of taxation. • Round calculated amounts to the nearest rand 	Marks			
General					
The financial accountant is correct to value the inventory (½) at the lower of cost and net realisable value (NRV)In terms of IAS 2.		½			
However, journal entries are correct (½) but the amount to which the inventory is written down is incorrect (1) as the cost should have been used as opposed to the inventory count value when comparing to NRV.		1 ½			
The incorrect goods that were delivered to Group B stores must be excluded from the inventory count value.		1			
The loss of inventory due to the civil unrest has been correctly included in the inventory count value at year end. The event took place after the end of the financial year and is a non-adjustment event		1			
Inventories are usually written down to net realisable value on an item-by-item basis. It may be inappropriate to consider impairment on a totality basis but may be beneficial to do so based on the product lines, geographical areas etc.		1			
Correcting journal entry – ALT 1					
	Dr.	Cr.			
Inventory write-down / Cost of Sales (P/L)	21 005				
Inventory (SoFP) (64 980 – 43 975 (given))		21 005			
		1P			
		1			
Calculations					
C1	Total	A	B	C	
	R'000	R'000	R'000	R'000	
Opening balance inventory	-	-	-	-	
Purchases	650 000	300 000	250 000	100 000	1
Less: Cost of sales	(363 900)	(195 000)	(108 000)	(60 900)	1
Balance at 30 September 2025	286 100	105 000	142 000	39 100	
Lower of	219 100	98 000	96 500	26 500	1P
Cost	285 980	105 000	141 880 ¹	39 100	
Net realisable value	221 000	98 000	96 500	26 500	
Inventory write-down	64 980	7 000	45 380	12 600	1
¹ 142 000 – 120					1
<i>Note: The cost of sales are carried over from the costing required.</i>					
Available					12
Maximum					10
Total for part (f)					10

<p>Part (g) Describe the additional substantive procedures that should be performed at year end by the AudSA audit team to obtain sufficient and appropriate audit evidence about the valuation, allocation, and accuracy of the contract liability resulting from the customer loyalty programme.</p> <ul style="list-style-type: none"> • Assume that an IT expert already verified all controls over the central IT systems, sales and loyalty integration system. • You can rely on all reports produced by these systems. • Ignore all forms of taxation. • All audit procedures to place reliance on the system and the work performed by the IT expert have already been performed by the audit team. 		Marks
General		
1.1	Obtain the contract liability calculation from management and the consolidated sales and loyalty system report and recalculate for mathematical accuracy.	1
1.2	Agree through inspection / ATTs the consolidated sales and loyalty system report balances (closing points) with management's contract liability calculations' points used to ensure they agree and therefore are accurate.	1
1.3	Agree through inspection / ATTs the contract liability calculation amount to the general ledger (GL), trial balance (TB), and the annual financial statements (AFS) to ensure they agree and are therefore accurate.	1
1.4	Obtained a signed management representation letter and inspect for the inclusion of the valuation, allocation and accuracy of the contract liability at year-end.	1
Verification of the points / inputs to the calculation		
2.1	Through inspection, agree the following inputs used in the calculation to the terms and conditions published as well as the internal authorised policy document (and / or minutes of director's meetings) related to the customer loyalty programme (CLP) being to confirm the <i>accuracy of the inputs</i> used in the calculation: <ul style="list-style-type: none"> • <u>Earn rate</u>: Every R100 spend would earn one point. • <u>Redemption value</u>: Points can be redeemed on future purchases at a rate of R1 for every ten points. • <u>Expiry date</u>: The points expire after six months. 	1 ½ ½ ½
2.2	Verify whether the loyalty points granted constitute a " material right " to the customer that it would not receive without entering into that contract (<i>i.e. a separate performance obligation through the terms and conditions of the contract</i>) through consideration of whether the recognition is consistent with IFRS 15 / the applicable revenue standard.	1
2.3	In order to verify the transaction price and that management has <u>allocated</u> the transaction price between the goods sold and the loyalty-points benefit/ obligation to provide a discount perform the following procedures: <ul style="list-style-type: none"> • Gross sales: Trace the transaction price back to the loyalty sales transactions for the period (R240 million); • CLP: Recalculate the stand-alone selling price of the CLP through taking into account the inputs (earn rate, redemption value, redemption rate) (R192 000); and • Recalculate the allocation of the transaction price between the goods sold and loyalty points benefit (R191 847). 	1 1 1

Reasonableness of management’s estimated redemption rate (80%)		
3.1	Enquire from management / inspect relevant documentation like minutes of director’s meeting on the methods and assumptions used in calculating the liability in order to obtain an understanding of the reasoning for the 80% redemption rate (including whether steps were taken to understand estimation uncertainty);	1
3.2	Through these discussions and enquiries, evaluate management’s estimates to determine whether there are any indicators of management bias in the estimation due to the overly optimistic assumptions Jordan used and the comments made by the CEO that there is flexibility in the interpretation of revenue recognitions and the apparent CFO ‘pessimism bias’.	1
3.3	Enquire and inspect management’s documentation and calculations that support the 80% redemption estimate and recalculate / evaluate the 80% against the following for reasonableness.	1
3.3.1	<ul style="list-style-type: none"> <u>Actual historical trends</u>: Obtain the consolidated output report and calculate the accumulated quantity of redeemed points as a percentage of the accumulated total points earned to the 80% (or 65%) used in total; (from month-to-month / cumulative average). 	1
3.3.2	<ul style="list-style-type: none"> <u>Industry averages</u>: Inspect documentation available on the industry averages and market trends and whether any changes in customer behaviour were noted after launching the LC stores to assess whether an expected redemption rate is reasonable. 	1
3.3.3	<ul style="list-style-type: none"> <u>Subsequent events</u>: Review redemption activity in the post-year-end period (e.g., October to December 2025) to assess whether the estimated redemption rate appears reasonable in hindsight. 	1
3.4	Assess the sensitivity of the contract liability to changes in the estimated redemption rate by performing a sensitivity analysis (e.g., calculating the liability using for example the 65% and 80% redemption rates or any other rate).	1
3.5	Enquire whether any stores were closed or are expected to be discontinued shortly after year end (possibly group C) and discussing with management whether any adjustments were made / should be made based on expected business closures or other events / Inspect minutes of director’s meetings after year-end or forecasts .	1
Independent calculation using the inputs verified / own inputs		
4.1	The audit team should independently calculate a year-end contract liability (auditor’s calculation / range) for unredeemed loyalty points by recalculating the contract liability by applying his/her own inputs based on knowledge obtained.	1
4.2	Compare the auditor’s independently recalculated amount with the amount recorded by IR in the general ledger/financial statements to identify any difference outside of the point estimate/ranges calculated.	1
Data analytics		
5.1	Perform ATTs / CAATs / software for analytics to identify anomalies in the calculations or accounting records (relevant examples) .	1

Follow-up procedures		
6.1	For any anomalies / differences identified / differences outside the point estimate (e.g. in reconciling or in data), follow up with management through enquiries.	1
6.2	For any differences or anomalies identified, obtain and inspect corroborative evidence.	1
Available		23.5
Maximum		12
Total for part (g)		12
Total for part II		39
TOTAL FOR THE QUESTION		120