

Part (a) Prepare the journal entries (cash transactions included) of Breeze to account for the transactions and events in terms of International Financial Reporting Standards for the financial year ended 30 September 2020 and 30 September 2021 with reference to section 1.				Marks
<ul style="list-style-type: none"> • The Kenyan project meets all the requirements of a contract in terms of IFRS 15, <i>Revenue from Contracts with Customers</i>. • Round amounts to the nearest ZAR. • Indicate for each leg of a journal entry, which component of the financial statements will be affected (for example: P/L, SFP, OCI, equity). • Show all workings to support calculations, including revenue amounts. • Ignore expected credit losses. • Ignore all tax consequences. 				
	Dr	Cr		
Gross journals:	ZAR	ZAR		
Year ended 30 September 2020				
1 April 2020				
Bank (SFP)	16 000 000			
Deferred revenue / Contract liability (SFP)		16 000 000	1	
<i>Receipt of upfront deposit 1 April 2020</i>				
31 May 2020				
Bank (SFP)	10 000 000			
Deferred revenue / Contract liability (SFP)		10 000 000	1	
<i>Receipt of progress payment 31 May 2020</i>				
Inventories (SFP)	12 000 000			
Deferred revenue / Contract liability (SFP)		12 000 000	1	
<i>Non-cash consideration received</i>				
30 June 2020				
Deferred revenue / Contract liability (SFP)	29 333 333		1	
Revenue (P/L)		29 333 333	0.5	
[C2]				
<i>Revenue recognition – sale of wind turbines 30 June 2020</i>				
30 September 2020				
Contract asset (SFP) (balancing)	8 933 333		1	
Deferred revenue / Contract liability (SFP)	8 666 667		1C	
[26 000 000 + 12 000 000 – 29 333 333]				
Revenue (P/L)		17 600 000	0,5	
[C2]			(9,5C)	
<i>Revenue recognition – construction services for the year 30 September 2020</i>				
Cost of sales (P/L)	45 000 000			
Bank / Creditors (SFP)		45 000 000	1	
<i>Cost of sales for the year</i>				

<i>Year ended 30 September 2021</i>	Dr	Cr	
	ZAR	ZAR	
30 June 2021			
Bank (SFP)	50 000 000		1
Contract asset (SFP)		8 933 333	1
Revenue (P/L)		41 066 667	0,5
<i>Revenue recognition – guaranteed payment</i>			
Bank (SFP)	15 000 000		0,5
Revenue (P/L)		15 000 000	0,5
<i>Revenue recognition – Bonus payment</i>			
30 September 2021			
Receivable (SFP)	1 250 000		1
Revenue (P/L)		1 250 000	0,5
<i>Revenue recognition – Maintenance receivable</i>			
[C3]			(4,5C)
Other expenses (P/L)	1 200 000		0,5
Inventories (SFP) (12 000 000 x 10%)		1 200 000	0,5C
<i>Other expenses – sale of inventories</i>			
Bank (SFP)	2 000 000		1
Other income (P/L)		2 000 000	
<i>Sale of surplus materials</i>			
Cost of sales (P/L)	57 800 000		0,5
Bank/creditors (SFP)		47 000 000	0,5
Inventories (SFP)		10 800 000	0,5C
<i>Cost of sales for the 2021 year</i>			

Calculation 1: Allocation of transaction price			
	ZAR	ZAR	
Total consideration [116 000 000 + 12 000 000]		128 000 000	1
Stand-alone selling prices:		(133 000 000)	1
Wind turbines	31 000 000		
Construction (excluding performance bonus) [77 000 000 – 15 000 000]	62 000 000		
Construction performance bonus	15 000 000		
Maintenance	25 000 000		
Discount inherent in the contract		5 000 000	
<i>It is also possible to exclude the performance bonus from both the total consideration and the stand-alone selling prices to determine the discount in the contract.</i>			
Normal discount on turbine and construction bundle [(31 000 000 + 62 000 000) x 5,3763%]		4 999 959	1
<i>Therefore, allocate discount only to this bundle, as it is evident that the discount in the contract relates only to the wind turbines and construction services.</i>			
Allocation of transaction price:			
Total consideration		128 000 000	
Construction performance bonus (constrained and excluded)		(15 000 000)	0,5
Total transaction price		113 000 000	0,5
Maintenance (no discount)		(25 000 000)	0,5
Transaction price allocated to discounted bundle		88 000 000	0,5
Wind turbines [31 / (31 + 62) (1) x 88 000 000 (1) or balancing]		29 333 333	2
Construction (Mark awarded in calc 2 below) [62 / (31 + 62) x 88 000 000 or balancing]		58 666 667	
		88 000 000	
Alternative calculation:			
Wind turbines [31 000 000 – ((31 / (31 + 62)) x 5 000 000)]		29 333 333	
Construction [62 000 000 – ((62 / (31 + 62)) x 5 000 000)]		58 666 667	
Maintenance		25 000 000	
Total transaction price		113 000 000	

Calculation 2: Revenue recognition on 30 September 2020 (for further detail)			
		ZAR	
Revenue to be recognised for wind turbines [marks from C1]		29 333 333	(7)
Revenue to be recognised for construction		17 600 000	(2)
[58 666 667 (from C1) (1P) x 30% (1)]			
Total revenue to be recognised		46 933 333	
Deferred revenue recognised to date		(38 000 000)	(0.5)
[26 000 000 + 12 000 000]			
Contract asset to recognise		8 933 333	

Calculation 3: revenue recognition on 30 September 2021 (for further detail)			
		ZAR	
Revenue to be recognised for construction		41 066 667	1
[58 666 667 (C1) – 17 600 000 (C2)]			
Revenue for performance bonus		15 000 000	1
Revenue for maintenance contract		1 250 000	2
[25 000 000 / 5 (1) x 3 / 12 (1)]			
Total revenue to be recognised		57 316 667	
		Available	30
		Maximum	30
		<i>Communication skill – presentation</i>	<i>1</i>
		Total for part (a)	31
		Total for part I	31

Part (b) Advise Breeze on which country would be best for expansion with reference to section 2. Also include any other factors that Breeze should consider when selecting one of these countries for expansion.	Marks
1. Risks and opportunities to consider	
<p>1.1. Should Breeze wish to make use of any local debt financing, e.g. a bank overdraft, management should take note of the fact that the interest rates in Kenya are much higher than in South Africa. Interest rates in Namibia are closer to that of South Africa.</p> <p><i>Alternative: Interest rates in Morocco are much lower than especially Kenya, but also lower than South Africa and Namibia</i></p>	1
1.2. Currency risk	
<p>1.2.1. Once Breeze operates in more than one country, its operations would have greater exposure to foreign currency risk. The severity of this exposure is influenced by the exchange rates of the different countries.</p>	1
<p>1.2.2. In this regard, it is worth noting that expansion into Namibia would have less foreign currency risk, compared to the other two countries, as its currency is pegged to the rand.</p>	1
1.3. Distance	
<p>1.3.1. Expanding into Africa, with production of the wind turbines still taking place in Cape Town, could expose the wind turbines to delays and damage during transportation. This would imply that the further away from Cape Town, the greater the transportation cost and possible chance of damage.</p>	1
<p>1.3.2. As Namibia is located closest to Cape Town, geographically, it would suggest that it would be the cheapest (and easiest) from a transportation perspective, with the opposite true for Morocco.</p>	1
<p>1.3.3. A closer venue will also make managing the foreign office easier: it will be faster to travel to the site, the cost of travelling would be generally lower, and there are less time differences. All of these would favour expansion to Namibia.</p>	1
1.4. Language barriers	
<p>1.4.1. The fact that the main business language in Morocco is French, rather than English, presents a risk that miscommunication could occur when instructions are sent from the head office in South Africa, contract with customers could be more difficult and there could be possible miscommunication between supervisors and locally sourced staff</p>	1
<p>1.4.2. The miscommunication could lead to a loss of customers and/or reputational damage/incurring additional costs for translation or legal services.</p>	1
1.5. GDP per capita and higher GDP growth	
<p>1.5.1. Countries with higher GDP per capita and higher GDP growth have greater need and capacity to invest in new infrastructure. All of the countries being considered have higher GDP growth rates than in South Africa and are therefore more attractive for investment, although Kenya has the highest growth rate of the three (nearly three times SA's growth rate).</p>	1

1.5.2. By contrast, Namibia and Morocco should have greater immediate capacity to invest in new infrastructure as they have higher GDP per capita than Kenya.	1
1.5.3. The low GDPs also indicate a higher degree of poverty in the country: this could possibly indicate or lead to higher crime rates, more political unrest, more hijackings/piracy, etc. Kenya has the lowest GDP of the countries under investigation.	1
1.5.4. Morocco also has the lowest GDP growth rate, which seems to indicate that economic recovery may take longer / be slower than for the other countries.	1
1.6. Unemployment rate, skills and liveability	
1.6.1. Higher unemployment rates could be an opportunity, as governments in these countries are more likely to support new investments that create jobs, and Breeze is known for creating jobs in SA.	1
1.6.2. Morocco and Kenya have very low unemployment rates. This could mean that it may be difficult to find the right skilled people who are available to start working for the foreign office within the next year, or that premiums will have to be paid to acquire skilled workers. <i>Alternative: Namibia has a high unemployment rate</i>	1
1.6.3. High unemployment is, however, not useful if the local population does not have the skills to be employed within the wind farm industry. From this perspective, Kenya and Namibia have local skills scores more like South Africa than Morocco and should be easier to enter.	1
1.6.4. Given the similarity in the liveability index scores of Morocco and South Africa , it may be easier to convince SA staff members to work in Morocco to supplement a local skills shortage. / Given the relatively low liveability index score of Kenya and Namibia, it may be difficult to convince South African staff members to work and live there, even on a temporary basis. (for example: health, safety, quality of life, transport)	1
1.7. Regulatory risk	
1.7.1. Doing business in other countries with different laws and regulations could lead to increased regulatory risk. From the ease of doing business scores, Morocco and Kenya (which both rank lower than South Africa) would present higher regulatory risk than Namibia.	1
1.8. Current environmental performance	
1.8.1. Kenya has the highest environmental performance score but has seen no improvement in its environmental score over the past ten years.	1
1.8.2. In addition, Kenya already generates over 70% of its electricity from renewable sources. This reduces the need for urgency in investing in new renewable energy projects, such as wind energy (i.e. limited growth prospects).	1
1.8.3. With such a high level of renewable sources already being used in Kenya, it is also likely that competition between providers of alternative energy would be stiff – the market is nearly saturated. <i>Alternative: It might be an easier sell, as they are accustomed to the renewables landscape, and understand it better</i>	1

1.8.4. Countries with lower levels of renewable sources are likely to have less (but growing) competition levels . Breeze might be able to obtain a first-mover advantage in Namibia or Morocco.	1
1.8.5. Namibia has shown a better improvement in its environmental score over the past ten years and obtains only 26,5% of its electricity from renewable sources. This potentially presents a better opportunity for growth than Kenya.	1
1.8.6. Morocco has shown the most improvement in its environmental score over the past ten years. This suggests increasing government and societal support for investment in environmental activities.	1
1.9. Taxation of the African locations	
1.9.1. Morocco has the highest tax rate, which leads to the lowest return on investment for Breeze (all other factors being equal).	1
1.9.2. All countries' tax rates are higher than that of SA, but other taxes such as taxes on fuel, VAT, UIF, import duties, etc., also need to be considered.	1
1.9.3. Do any of the countries in question have double-tax agreements with SA? If so, this should be taken into account in assessing the expected net cash flows.	1
2. Other factors to consider	
2.1. Further investigation needs to be performed relating to the potential level of demand and pricing , as wind turbines are large capital assets that will not be for domestic (home) use. As such, for demand to exist, there must be government regulation to allow new wind farms to feed into / sell to the national electricity grid.	1
2.2. If the culture in other countries is significantly different to that in South Africa staff might struggle which could increase the rotation of staff members stationed in these countries	1
2.3. The political and socio-economic landscape needs to be investigated in more detail. For example: The level of corruption in the various countries. It could be tough to operate in countries where bribery and corruption is rife or where there is notable political instability.	1
2.4. What is the cost of operation in each country? If these are too high, it may not be viable to set up an office in another country.	1
2.5. Consider any exchange controls in the various countries. The risk of repatriating funds to SA should be taken into consideration.	1
2.6. The availability of resources (other than labour) and infrastructure in the prospective countries needs to be considered.	1
2.7. Does any of the countries have specific incentive schemes (e.g. low tax rates, rebates) for new operations (or new renewable energy operations) that are started by foreign investors?	1
2.8. In addition, Breeze has limited experience with construction timelines in the rest of Africa, except for Kenya , which may lead to variable consideration from performance bonuses being constrained. This could put pressure on revenue in the early years of expansion and thereby impact on the cash flows of the firm.	1
2.9. Consider whether other SA companies are operating in the identified country – if not, why not? For example: Local banking partner operating there?	1 1

2.10. Consider travel requirements for staff travelling to the foreign offices. For example, visas, medical requirement, COVID-19 vaccine passports (Kenya requires a yellow fever inoculation).	1
2.11. Consider the effect of Covid-19 and the effect of restrictions, lockdowns, government responses, etc.	1
3 Recommendation for in-depth consideration	
3.1 I would recommend that Breeze first considers Kenya in more depth for further African expansion, as its environmental credentials suggest better growth opportunities for wind energy while it has the most comparable resources and skills to South Africa for investment in this sector.	1C
<i>(Note to Marker: A candidate can effectively recommend any of the three countries (as all three meet the basic requirement of having areas with appropriate wind speed), provided that the recommendation flows logically from the discussion and the available information in the case study.)</i>	
Available	40
Maximum	20
<i>Communication skills – logical argument; appropriate style</i>	2
Total for part (b)	22

Part (c) With reference to section 2 only –		Marks
(i) calculate the minimum hourly rate that the foreign office should be charged for supervisors in the first year of operations (briefly motivate any amounts you exclude); and		
Current salary – unavoidable as fixed and skilled ('specialists')	-	1
Breeze could have earned a revenue from 300 of the 350 spare construction supervisor hours if the contract from the government was accepted. Setting up a foreign office will result in losing out on the revenue (Breeze would rather choose to sacrifice ZAR500 than to pay overtime of ZAR600).		1
Opportunity cost on 300 hours sacrificed (300 x ZAR500)	150 000	1C
No opportunity cost / incremental cost on 50 (350 – 300) spare hours	-	1
Overtime on 150 hours (500 - 350) short (150 x ZAR600)	90 000	1
Total incremental cost	240 000	
Hourly rate (240 000 / 500)	480	1C
Available		6
Maximum		6
Total for part (c)(i)		6

Part (c) With reference to section 2 only – (ii) identify other key factors that could impact the minimum hourly rate for supervisors.	Marks
1. Consider the tax implications arising from the payment by the foreign office to Breeze.	1
2. Breeze should consider the currency in which the transfer price will be denominated and who will be responsible for exchange rate losses.	1
3. Consider foreign exchange regulations of the foreign country : it may be easier to remit profits to South Africa through a higher transfer price.	1
4. A tiered rate based on the number of hours could be considered because it is more accurate : First 50 hours – no incremental cost 50 – 350 hours – minimum of R500 per hour > 350 hours – minimum of R600 per hour	1
5. Staff expectations (e.g., Breeze may need to pay an additional allowance for inconvenience, higher cost of living and time to travel to another country, etc.) / impact on staff morale of working away from home, etc.	1
6. Possibly consider other opportunities that Breeze might have for outsourcing – ZAR500 might be too low as an opportunity cost.	1
7. Consider with the time it takes to travel / exhaustion due to travel leading to lower productivity , thus whether 350 hours available in SA will equate to 350 hours available in a foreign country .	1
8. Consider labour regulations and/or demands by labour unions , such as legal maximum hours to work per person – is overtime of 150 hours feasible? This will also be a factor of the number of supervisors Breeze employ.	1
9. Overtime rate of R600 is set at 1.5 times the normal rate of R400 (R768 000 / 1 920).	1
10. Additional consideration would be the local laws that may require overtime rate to be double the normal rate on public holidays or Sundays .	1
11. Consider the local labour market , and what competitors would charge for such a service.	1
12. Consider other costs (travel, accommodation, stipends, etc.) .	1
13. Breeze also need to consider possible wage increases .	1
Available	13
Maximum	4
Total for part (c)(ii)	4
Total for part (c)	10

<p>Part (d) Critically evaluate, with reference to section 3, the sources of finance being considered. Your evaluation should include –</p> <ul style="list-style-type: none"> • a comparison of the costs of finance and the impact of each source of finance on the target debt ratio for all budgeted periods (round all final answers to two decimals); <u>and</u> • any other qualitative factors not dealt with. 	<p>Marks</p>
Bank loan	
<p>1 If interest rates rise (which they are expected to, due to the recent temporary drastic decreases in the interest rate due to the COVID-19 pandemic), the market value of the bank loan (which has a fixed rate) will decrease. If the debt ratio is measured on market values (as it ought to be), the decreasing market value would assist Breeze in potentially reaching its targets.</p>	<p>1</p>
<p>2 The bank loan requires upfront security whereas the issue of shares and corporate bonds do not. The latter two options enable more flexibility for providing security for future borrowings.</p>	<p>1</p>
<p>3 Are there sufficient accounts receivable and inventory available to pledge (i.e., not already pledged)?</p>	<p>1</p>
Green bonds	
<p>4 The green bond has the lowest cost, followed by the bank loan. The equity is different in nature and therefore significantly more expensive. (see w1 – w3).</p>	<p>1C</p>
<p>5 Despite having the lowest cost, the green bond has the most detrimental impact on the debt ratio because the loan is only repaid after seven years.</p>	<p>1</p>
<p>6 The green bond is a growing market and Breeze is likely to attract investors who want to invest in ESG initiatives.</p>	<p>1</p>
<p>7 Green bond might have additional terms and conditions attached to it, which might limit the way in which the bond is used, the reporting requirements, etc. OR Consider whether the green bond could be used for refinancing purposes as it could be expected that it is used to rather fund green / environmentally friendly projects.</p>	<p>1</p>
<p>8 The green bonds mature at the same time as the R750 million of existing debt, exposing Breeze to a risk of not being able to raise sufficient funding to repay all debt (refinancing risk).</p>	<p>1 1</p>
<p>9 The green bond exposes Breeze to the risk of interest rate increases (floating vs fixed rate bank loan).</p>	<p>1</p>
<p>10 The repayment of the green bond's capital, which is only repayable in seven years' time, provides more cash flow flexibility than the bank loan.</p>	<p>1</p>
Rights issue	
<p>11 The rights issue is the only source that results in the target debt ratio being achieved; and consequently, the debt covenants not being breached.</p>	<p>1</p>
<p>12 Given that the share issue is a rights issue, it will have a dilutive effect on existing shareholdings for shareholders that do not take up their rights.</p>	<p>1</p>
<p>13 Legal and governance considerations which could be more complicated for a rights issue than for loans.</p>	<p>1</p>
<p>14 Breeze has a high financial risk and did breach loan covenants which may cause current shareholders to have significant skepticism on future growth plans of the company. Therefore, they might not be willing to take up the rights issue.</p>	<p>1</p>
<p>15 The rights issue provides the most flexibility from a cash flow perspective as dividends do not have to be paid and the ZAR500 million is not repayable.</p>	<p>1</p>

16	Breeze will however need to consider shareholders' expectations of future returns (shareholders may pressure the company for the payment of dividends) and the signalling effect of the rights issue.	1
Other issues		
17	The cost of issuing the various instruments need to be considered , e.g., marketing costs for the rights issues, advisory fees, legal agreements for the loans, initial costs, meeting reporting requirements for the security, etc.	1
18	The crux of the matter is that Breeze is currently too highly geared . Not choosing the rights issue will mean that the target debt ratio will not be met, and the existing loan covenant will be breached complicating matters with existing creditors.	1
19	Although the financial risk may not increase because of the new loans (the total debt balance remains unaffected), the new forms of loans, the covenants and the costs, may affect the market's perception of the company's riskiness .	1
20	The company's expansion into the rest of Africa needs to be considered in terms of the existing financing options (e.g. impact on loan if taken out, covenants, etc.)	1
Conclusion		
21	It is recommended that Breeze must choose the rights issue based on the fact that the company is already highly geared and the debt covenants will be breached. <i>(Note to Marker: A candidate can effectively recommend any of the three sources of finance, provided that the recommendation flows logically from the discussion and/or calculations.)</i>	1C

Workings		
<i>Working 1: Cost of equity</i>		
Risk free rate (ten-year rate used due to the long-term nature of WACC)	9,75%	1
Debt / Equity (60/40)	150,00%	1
Use Hamada formula to calculate leveraged Beta: (0,85 x [1+[(1-28%)x 150,0%]])	1,77	1C
Cost of equity (9,75% + 1,77 (7%))	2 2,14%	1C
<i>Alternative working 1: Cost of equity (based on market value)</i>		
Risk free rate (ten-year rate used due to the long-term nature of WACC)	9,75%	1
Debt / Equity (3 250 / (20 x 100m))	162,50%	1
Use Hamada formula to calculate leveraged beta: (0,85 x [1+[(1-28%)x 162,50%]])	1,84	1C
Cost of equity (9,75% + 1,84 (7%))	22,63%	1C
<i>Working 2: After-tax cost of bank loan</i>		
12%x0,72%	8,64%	1
<i>Working 3: After tax cost of green bond</i>		
Present value	500 000 000	0,5
Future value	550 000 000	0,5
Period (7 years x 4 payments per annum)	28	1
Quarterly interest payments (ZAR550m x 8% / 4)	11 000 000	1
Pre-tax cost of debt (2,45% x 4)	9,81%	1C
Tax implications in accordance with Section 24J		
• Identification of the applicability of S24J		1C
• Calculating the annual interest (adding quarters)		1C
• Determining the IRR, after considering S24J		1C
<i>Note: Although Section 24J is applicable to the tax deduction on the green bond, a simplified accrual method has been used above. Additional marks are awarded however for the principal of noting the applicability of S24J and the correct calculation if attempted by candidates.</i>		
After-tax cost of green bond (9,81% x 0,72)	7,06%	1C

<i>Working 4: Impact of source of finance on the debt ratio</i>					
<i>Accrual calculation (use amort function on calculator)</i>					
Period	Open	Accrual	Coupon	Closing	
1	500,0	12,3	-11,0	501,3	
2	501,3	12,3	-11,0	502,6	
3	502,6	12,3	-11,0	503,9	
4	503,9	12,4	-11,0	505,2	
5	505,2	12,4	-11,0	506,6	
6	506,6	12,4	-11,0	508,1	
7	508,1	12,5	-11,0	509,5	
8	509,5	12,5	-11,0	511,0	
<i>Impact of source of finance on the debt ratio</i>					
	Rights issue	Green bond	Bank loan		
	2023	2023	2023		
Existing debt	3 875,0	3 875,0	3 875,0		1
Old loan repaid	(500,0)	(500,0)	(500,0)		0,5
New loan balance		505,2	500,0		0,5
Repayment			(100,0)		1
Revised debt	3 375,0	3 880,2	3 775,0		
Existing assets	5 700,0	5 700,0	5 700,0		
Cash raised (offset by repayment of debt)	0	0	0		
Repayment of loan			(100,0)		1
After-tax interest payment (11 x 4) x 0,72 ; 500 x 8,64%)		(31,7)	(43,2)		2
Revised assets	5 700,0	5 668,3	5 556,8		1P
Revised debt ratio (3375 / 5700; 3880,2 / 5668,3; 3775 / 5556,8)	59,2%	68,5%	67,9%		2C
	Rights issue	Green bond	Bank loan		
	2024	2024	2024		
Existing debt	3 630,0	3 630,0	3 630,0		1
Old loan repaid	(500,0)	(500,0)	(500,0)		0,5
New loan balance		511,0	500,0		0,5
Repayment			(200)		1
Revised debt	3 130,0	3 641,0	3 430,0		
Existing assets	5 630,0	5 630,0	5 630,0		
Repayment of loan			(200,0)		1
After-tax interest payment (11 x 4 x 2 x 0,72 ; (500 x 8,64%)+(400 x 8,64%)]		(63,4)	(77,8)		2

Revised assets	5 630,0	5 566,6	5 352,2	1P
Revised debt ratio (3130 / 5630; 3641 / 5566,6; 3430 / 5352,2)	55,6%	65,4%	64,1%	2C
Available				53
Maximum				35
<i>Communication skills – logical argument; layout and structure</i>				<i>2</i>
Total for part (d)				37
Total for part II				69