

Ignore all taxation.

1 Background

Beautha Shoes (Pty) Ltd ('Beautha') is a manufacturer and retailer of African branded sneakers. Theo Kganane, the chief executive officer, started Beautha in 2015. Beautha's business has grown substantially and now has 17 stores across South Africa, consisting of ten megastores in large cities and seven small stores in towns.

In 2017, Beautha acquired a 5 700m² factory and warehouse in Centurion that houses its manufacturing operations. The company has a 30 September financial year end. Beautha's functional and presentation currency is the South African rand (ZAR).

Beautha offers a range of sneakers, with selling prices varying from ZAR1 000 per pair for a standard design to ZAR8 000 per pair for an exclusive design.

2 Expansion into Europe

Interest in Beautha sneakers has been increasing in the European market. Theo decided that the safest way for Beautha to enter the European market was by means of a joint venture with Galleries Guillotine ('GG') (a famous French department store) and Saul Pagbo (a famous French soccer player). The parties formed a new company for the joint venture, Baskets (Pty) Ltd ('Baskets'). The company was incorporated and the shareholders' agreement concluded on 1 June 2021. The functional currency of Baskets is ZAR.

The joint venture shareholders' agreement contains the following relevant stipulations:

Contributions and shareholding

- Beautha will contribute ZAR8 405 000 in cash for a 35% interest.
- GG will receive a 35% interest in the joint venture. Instead of a cash contribution, GG will, for a period of three years, display Beautha's sneakers in prime spaces within its shops and advertise the sneakers. The fair value of these activities was correctly determined to amount to ZAR13 448 000 on 1 June 2021.
- Saul will receive a 30% interest in the joint venture for the use of his personal brand to market the sneakers for a period of three years. The fair value for the use of Saul's brand for three years of ZAR11 767 000 was correctly determined on 1 June 2021.

Activities

- The purpose of the joint venture is to bring together the parties to advertise, distribute and sell Beautha's sneakers and share in the profits of the sales.
- Beautha will provide sneakers on consignment to Baskets. Once sold, Baskets will receive the revenue on the sales and pay Beautha the cost price of the sneakers. Baskets will retain the profit. Any sneakers not sold within six months will be returned to Beautha. Beautha is responsible for all transportation costs of the sneakers and these costs may not be recovered from Baskets.

Beautha sent 2 500 pairs of sneakers, with a total cost of ZAR1 176 700 (ZAR470,68 per pair), to GG on 1 June 2021. Beautha incurred and paid transport costs of ZAR168 100 on 1 June 2021 to send the sneakers to France. By 30 September 2021, 2 300 pairs of these sneakers had been sold for a total consideration of EUR209 300. On the same date, the joint venture paid Beautha ZAR1 082 564, being the cost price of the sneakers sold. The sales took place evenly over the four-month period.

Apart from the cost of manufacturing, Beautha has not processed any journal entries in its financial statements in respect of the information contained in this section.

3 Offshore sole manufacturing

Theo wanted his sneakers to have a robust sole that could withstand tough conditions. Beautha, working with engineers, developed a manufacturing process and related specialised equipment that would produce such soles. Beautha owns the intellectual property over the manufacturing process and specialised equipment.

Since its inception, Beautha manufactured all its soles locally in its manufacturing plant. However, this is no longer feasible because of the rising costs and the unreliable supply of electricity. As a result, Beautha entered into an agreement with a Japanese sole manufacturer, Miyagi Hiro KK ('Hiro'), to manufacture soles for Beautha. Hiro has a 30 September financial year end. The functional currency of Hiro is the Japanese Yen (JPY).

Beautha subscribed for a 40% interest in Hiro on 1 April 2021. To acquire the 40%, Beautha transferred the specialised equipment mentioned above to Hiro and contributed ZAR1 million in cash. On 1 April 2021, the specialised equipment had a carrying (and fair) value of ZAR9 million. Hiro issued new shares to Beautha at fair value. The remaining 60% interest in Hiro is held by Aimi Tanaka. Aimi was the sole shareholder of Hiro before this transaction. All the assets of Hiro were fairly valued at 1 April 2021.

As part of the share subscription agreement, Beautha also advanced a loan of ZAR3,5 million to Hiro. The loan capital is repayable in a single instalment at the end of five years. Interest is levied at 2,95% per annum, compounded annually, and payable every six months in arrears. A market-related interest rate for the loan is 6% per annum, compounded annually. The lower interest rate was part of Beautha's contribution to the business when Beautha acquired the 40% interest in Hiro. No transaction costs were incurred to issue the loan.

The specialised equipment is accounted for in accordance with the cost model and depreciated on a straight-line basis over the useful life of the asset. On 1 April 2021, the specialised equipment had a remaining useful life of nine years with an insignificant residual value. The specialised equipment was immediately available for use as intended by Hiro's management.

All the above transactions in this section were correctly processed in Beautha's books. Hiro's accountant correctly processed the acquisition of the shares in Hiro by Beautha. However, the accountant processed the loan of ZAR3,5 million to a suspense account as he did not know how to correctly account for this transaction.

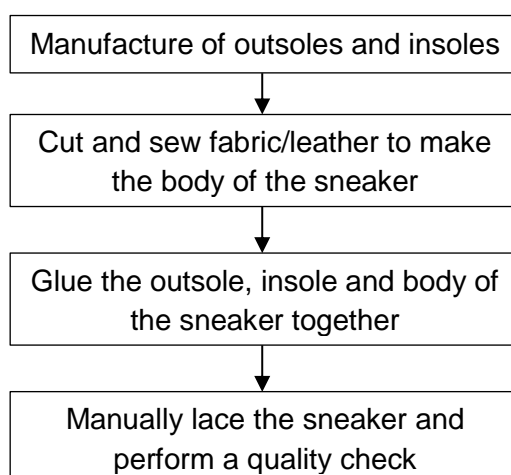
Beautha and Hiro agreed that all soles manufactured by Hiro must be sold at market value for a period of five years, commencing 1 April 2021. Beautha will determine this market value. Furthermore, all orders placed by Beautha must be manufactured first, after which Hiro may manufacture and sell soles to other customers. Beautha anticipates that it will purchase a maximum of 40% of the soles produced by Hiro.

Auditors Inc., Beautha's auditors, included extracts from the shareholders' agreement between Beautha and Hiro in workpaper L310 (see section 5).

4 Manufacturing process and inventory

4.1 Manufacturing process

The manufacturing process of the sneakers may be illustrated as follows:



4.2 Inventory

Beautha operates a perpetual inventory system. Beautha's inventories consist of raw materials, work-in-progress and finished goods. The cost of raw materials is assigned on a first in, first out (FIFO) basis. The cost of work-in-progress and finished goods is determined using the standard costing method. Inventories is a material balance in Beautha's financial statements.

Raw materials, comprising a plastic and rubber compound, rolls of fabric, and leather are kept on a consignment basis from local suppliers. Smaller items, such as the thread, glue, and shoelaces, are purchased free-on-board from international suppliers. Since 1 April 2021, Beautha has been receiving most of its soles free-on-board from Hiro. Each type of item is stored in boxes with each box containing a specific quantity.

Work-in-progress consists of soles and different fabric pieces that have been cut, but not assembled. These items are packed in boxes containing 100 items of the specific component.

All boxes are labelled with the following:

- A description of the items inside;
- A unique barcode;
- A picture of the item; and
- The quantity of items in the box.

Finished goods consist of the completed sneakers. Each pair of sneakers is individually wrapped and packed into a box which has a label and barcode. Twenty pairs of individually boxed sneakers are packed into large cartons containing the same size, colour and design, for delivery to stores. The value of finished goods kept at the warehouse is very low as most of the finished goods is delivered to the stores. The inventory value at each of the various megastores is more or less equal.

5 Year-end procedures and audit

You are a trainee accountant at Auditors Inc. and have been assigned to the 30 September 2021 audit of Beautha. Auditors Inc. is a medium-sized audit firm with offices in some of the metropolitan areas in South Africa. Its largest office is in Edenvale, Gauteng.

Auditors Inc.'s trainees are very eager to join the audit team of Beautha. Every year after the audit report has been issued, each member of the audit team (comprising the trainees and the engagement partner), receives a free pair of exclusive model sneakers from Beautha. The audit team receives this as a token of appreciation for the hard work during the audit and provided that the audit team does not ask Beautha staff any 'uncomfortable' questions. This is part of an arrangement between Theo and the engagement partner, and Theo has agreed that he will ask the engagement partner to remove any member who asks uncomfortable questions of the Beautha staff.

Beautha always performs the annual year-end inventory count on the first Sunday on or after 30 September. This is because Beautha does not want to close the shops over a weekend following a month end. You received Beautha's inventory count instructions, Annexure A, for the inventory count scheduled for 3 October 2021 as well as workpaper J500, which has been prepared by the junior trainee accountant responsible for the inventory count.

The following extracts are available from the trial balances of the separate financial statements of Beautha and Hiro:

Extract from the trial balances of Beautha at 30 September			
	Notes	FY2021	FY2020
		ZAR	ZAR
Retained earnings (opening balance)		(3 042 000)	(2 092 000)
Profit for the year	1	(1 017 000)	(950 000)
Raw materials – soles	2	100 000	95 000
Work-in-progress		800 000	510 000
Finished goods		7 700 000	5 400 000
Dividends declared on 30 September 2021		90 000	–

Extract from the trial balance of Hiro at 30 September 2021		
	Notes	JPY
Ordinary share capital – 1 October 2020		(26 320 000)
Retained earnings – 1 October 2020		(83 431 500)
Profit for the year	1	(4 010 000)
Inventories		705 000
Dividends declared on 30 September 2021		391 500

Notes

- 1 Except for the transactions in sections 2 and 3, all other profits were earned evenly throughout all financial years.
- 2 All the raw materials on hand at the end of FY2021 were purchased from Hiro on the last day of the financial year at a gross profit margin of 45%.

Additional information

Any non-controlling interests are measured at their proportionate share of the identifiable net assets.

The relevant exchange rates were as follows:

Date or period	Spot rate	
	EUR1 = ZAR	JPY1 = ZAR
1 October 2020	19,49	0,157
1 April 2021	17,23	0,133
1 June 2021	16,81	0,126
30 September 2021	16,89	0,128
Average for the period 1 October 2020 to 30 September 2021	17,52	0,139
Average for the period 1 April 2021 to 30 September 2021	17,22	0,130
Average for the period 1 June 2021 to 30 September 2021	16,90	0,130

Client: Beautha Shoes (Pty) Ltd	Year end: 30 September 2021	Workpaper J500 Page 1 of 1
Date prepared: 30 September 2021	Prepared by: T Rainee	
Date reviewed:	Reviewed by:	
Subject: Planning the attendance of the inventory count		

Objective

Documentation of the planning of the attendance of the year-end inventory count. The count will be performed to verify the existence of the inventory items.

Sites selected for attendance of inventory count

Site*	Auditors Inc. office	Inventory value at 30 September 2021
		ZAR
Warehouse and factory	Pretoria office	1 210 011
Megastore in Pretoria	Pretoria office	681 405
Megastore in Johannesburg	Edenvale office	702 810
Small store in East London	East London office	61 455
Small store in Gqeberha	Gqeberha office	54 030
Total		2 709 711

* The same stores are selected each year as these stores are located in cities where Auditors Inc. has offices. This saves on travel and accommodation costs.

Audit sampling

- Audit sampling was performed in terms of ISA 530 *Audit Sampling*. The sample size of 30 items was calculated based on the formula included in Auditors Inc.'s audit methodology.
- The inventory list across all sites as at 30 September 2021 contains 4 515 different types of inventory items. Inventory item codes A001–A018 are allocated to raw materials, B001–B4239 to work-in-progress and C001–C258 to finished goods.
- The abovementioned inventory list was sorted alphabetically based on inventory item codes and the first five raw material items, the first 20 work-in-progress items and the first five finished goods items (with a total value across all sites of ZAR78 742 for finished goods) were selected for testing at each of the applicable selected sites.

Procedures to be performed

- 1 Observe the counting process to ensure adherence to the inventory count instructions.
- 2 Perform test counts on the items selected by counting all the sealed boxes and agreeing the quantity of boxes to the inventory list received before the inventory count.

ANNEXURE A

BEAUTHA SHOES (PTY) LTD

INVENTORY COUNT INSTRUCTIONS FOR THE FACTORY AND WAREHOUSE

Confidential

Addressed to: Auditors Inc. and accountant only

Procedures to be followed for annual year-end inventory count on 3 October 2021:

- 1 All inventory items must be neatly packed and barcodes must be easily accessible.
- 2 All raw materials, including the plastic and rubber compound, rolls of fabric, and leather, must be grouped together in the raw materials section as per the warehouse floor plan. The same applies to the work-in-progress and the finished goods sections.
- 3 All open boxes must be sealed and the opening of boxes will not be allowed during the inventory count.
- 4 All inventory items will be counted using the company's barcode scanners.
- 5 The warehouse staff will be responsible for counting the inventory.
- 6 These counters will work on their own and can randomly decide which items they want to count.
- 7 The counters will scan the barcode on the label of each box.
- 8 Once a counter is of the opinion that he/she has counted enough items, he/she can go home.
- 9 If inventory items need to be moved between the two facilities during the inventory count, one of the counters must ensure that the barcodes of these inventory items are scanned before they are moved.
- 10 Inventory received during the inventory count must be placed in the correct section (i.e. raw materials, work-in-progress or finished goods) as specified on the floor plan.
- 11 The inventory system must be adjusted for inventory items where the quantities per the system are less than the actual quantities counted.
- 12 Inventory items where the quantities per the system are more than the actual quantity may be ignored, as it could possibly be ascribed to errors made by the counters.

Client: Beautha Shoes (Pty) Ltd	Year end: 30 September 2021	Workpaper L310 Page 1 of 2
Date prepared: 1 September 2021	Prepared by: T Rainee	
Date reviewed:	Reviewed by:	
Subject: Extracts from the Hiro shareholders' agreement		

4 HIRO'S BUSINESS

- 4.1 Hiro's business is the manufacture of shoe soles.
- 4.2 Except where shareholders agreed otherwise, each of the shareholders shall exercise its powers relative to its shareholding in Hiro.
- 4.3 Beautha may for a period of five years, from 1 April 2021 to 31 March 2026, instruct Hiro to alter the following activities, at Beautha's sole discretion:
- 4.3.1 Configuration and operation of the specialised sole manufacturing equipment. Hiro will implement the specialised equipment and manufacturing process of Beautha in Hiro's manufacturing plant.
- 4.3.2 Appointment, training and supervision of manufacturing staff.
- 4.3.3 Purchase agreements and storage of raw materials and inputs into the manufacturing process.
- 4.3.4 Quality control.
- 4.3.5 Any other activities related to the manufacture of soles.
- 4.3.6 Determination of the market value at which the soles should be sold.
- 4.3.7 Sales and growth targets.

9 SHAREHOLDERS' MEETINGS

- 9.1 Each shareholder undertakes that no business shall be transacted at any shareholders' meeting other than in accordance with the following provisions:
- 9.1.1 In respect of a quorum:
- 9.1.1.1 A quorum of shareholders must be present at the commencement of and throughout the meeting and shall –
- 9.1.1.1.1 for so long as there are less than four shareholders in Hiro, include Aimi and Beautha; and
- 9.1.1.1.2 for so long as there are four or more shareholders in Hiro, include at least three shareholders, of whom one must be Aimi and one must be Beautha.
- 9.1.2 In respect of the chairperson:
- 9.1.2.1 the chairperson of the board shall be the chairperson of a meeting of the shareholders.

Client: Beautha Shoes (Pty) Ltd	Year end: 30 September 2021	Workpaper L310 Page 2 of 2
Date prepared: 1 September 2021	Prepared by: T Rainee	
Date reviewed:	Reviewed by:	
Subject: Extracts from the Hiro shareholders' agreement		

10 MATTERS REQUIRING SHAREHOLDERS' UNANIMOUS APPROVAL

10.1 For as long as Beautha holds at least 40% of Hiro's issued share capital, Hiro may not without the prior written approval of all the Shareholders –

- 10.1.1 increase, alter or reduce any of Hiro's authorised or issued share capital;
- 10.1.2 effect any amendments to the Memorandum of Incorporation that specifically affect the rights of Beautha;
- 10.1.3 voluntarily wind up Hiro or enter into any general compromise with creditors, or initiate any liquidation or business rescue proceedings in respect of Hiro;
- 10.1.4 change the usual business of Hiro;
- 10.1.5 dispose of a material portion of Hiro's assets; or
- 10.1.6 list Hiro's shares on any stock exchange.

INITIAL TEST OF COMPETENCE, JANUARY 2022

PROFESSIONAL PAPER 3

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

PAPER 3 PART I – REQUIRED		Marks	
		Sub-total	Total
(a)	Discuss whether Beautha has control over Hiro for FY2021 in terms of International Financial Reporting Standards (IFRS). <i>Communication skills – appropriate style</i>	20 1	 21
(b)	Assuming that Hiro should be consolidated as a subsidiary of Beautha, prepare the consolidated statement of changes in equity of the Beautha group for FY2021. <ul style="list-style-type: none"> • Do not provide the total, share capital and non-controlling interest columns of the statement of changes in equity. • Do not provide comparative amounts and notes. • Round all amounts to the nearest ZAR. • Assume all amounts are material. • Your answer should comply with IFRS. <i>Communication skills – presentation; layout and structuring</i>	40 2	 42
Total for part I			63

INITIAL TEST OF COMPETENCE, JANUARY 2022

PROFESSIONAL PAPER 3

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

PAPER 3 PART II – REQUIRED		Marks	
		Sub-total	Total
(c)	Recommend improvements to the inventory count procedures in annexure A that were followed by Beautha’s employees during the year-end inventory count.	12	12
(d)	Criticise the appropriateness of the planning of the attendance of the inventory count detailed in workpaper J500. <i>Communication skills – logical argument</i>	11 1	 12
(e)	Discuss any ethical concerns you may have regarding the token of appreciation by Beautha to the audit team and the arrangement between Theo and the engagement partner, in terms of the SAICA Code of Professional Conduct. • Do not discuss how the concerns should be evaluated and addressed. <i>Communication skills – clarity of expression</i>	12 1	 13
Total for part II			37
TOTAL FOR THE PAPER			100