Part (a)(i) Discuss whether Barista was liable for any penalty(ies) in respect of the underestimation and late payment of provisional tax for FY2021.	Marks
Barista's taxable income is above R1 million, and it will therefore be subject to an underestimation penalty if its estimated taxable income used in the calculation of the second provisional payment is less than 80% of the assessed taxable income for the year.	1
Barista's final assessed taxable income is R1 954 100, and 80% of this amount is R1 563 280; therefore, the estimated taxable income of **R1 540 500 is less than 80% of the assessed taxable income** (para. 20(1)(a) of the Fourth Schedule to the Income Tax Act). *Alt: Barista's estimated taxable income is **78.83%** (R1 540 500/R1 954 000) of the assessed taxable income.*	1
Therefore, Barista will be liable for an **underestimation penalty** in terms of para.20(1)(a) of the Fourth Schedule to the Income Tax Act of 20%.	1
The second provisional tax payment was **late:** the amount was payable on **31 December 2021** (the last day of the year of assessment) and it was paid **20 days later**, i.e**., on 20 January 2022**.	1
The **late payment penalty will be imposed** at 10% of the amount not paid (par 27) of the Fourth Schedule to the Income Tax Act)**.**	1
The **underestimation penalty** should be **reduced** by the 10% **late payment penalty** imposed in terms of par 20(2B).	1
Available	**6**
Maximum	**5**
Total for part (a)(i)	**5**

Part (a)(ii) Assuming that Barista is liable, calculate the amount of the penalty(ies) that would be payable.	Marks
Late payment penalty Amount paid late x 10% = [(**R1 540 500** x **28%)** = **R431 340 – R259 700**]	1
x **10%** = R17 164	1
*Alt: R1 954 100 x **80%** = **R1 563 280 x 28%** = R437 718 less 1st payment of R259 700 = R178 018*	*1*
*x **10%** = R17 802*	*1*
Underestimation penalty Difference between [Normal tax on 80% of provisional taxpayer's taxable income AND amount of provisional tax paid] x 20% = R1 954 100x **80%** x **28%** = R437 718	1
– R259 700	1
x 20% = R35 603	1
– R17 164* (*late payment penalty*) = R19 439	1P
Available	**6**
Maximum	**5**
Communication skills – layout and structure	*1*
Total for part (a)(ii)	**5**
Total for part (a)	**11**

Part (b) Discuss whether the company has any grounds to request the remittance of the penalty imposed by SARS for the late payment of provisional tax.	**Marks**
A **delay in the audit of financial statements is not a valid ground** for a remittance request. The grounds for remittance are provided in s217 and s218 of the Tax Administration Act. *The request for remittance should have been submitted to SARS before the date for payment of the penalty as reflected in the penalty assessment.*	1
This is **not a 'first incidence'** as Barista has received penalty assessments in the past three years (36 months) for late payment of VAT (past two years). *Alt:* *If the VAT penalty **was remitted**, this would **be a "first incidence**".*	1
The duration of the non-compliance, in respect of this incidence, was for **20 days**, a **period of more than five business days**.	1
Late payment of the second provisional tax payment due to **low cash flow can qualify as 'serious financial hardship':** The continuity of business operations and continued employment of Barista's employees were jeopardised, and therefore Barista decided to rather pay their employees than SARS. This could qualify as **exceptional circumstances**. *Alt:* *Late payment of the second provisional tax payment due **to Covid-19** resulting in cash flow constraints **can qualify as a "natural or human-made disaster".** This could qualify as **exceptional circumstances**.*	1
The "***bona fide* inadvertent error" defence cannot** be used as Bruce used an **inaccurate estimate due to cash flow pressure** (might be intentional).	1
Conclusion: Brista can **request SARS to remit the penalty,** on the circumstances (grounds) of financial hardship or *natural or human-made disaster*, in terms of s218 of the TAA.	1P
Available	**6**
Maximum	**5**
Total for part (b)	**5**

Part (c) Discuss whether your firm could comply with Bruce's request that you write a letter to SARS in an attempt to persuade SARS to waive the penalties and interest on the late payment of provisional tax.	**Marks**
The client wants the auditor to write a letter to SARS indicating that the reason why the provisional tax was late was because the audit was not finalised.	
The audit partner is most probably a CA(SA) and most certainly a registered auditor, therefore he needs to comply with both the SAICA and the IRBA Codes of Professional Conduct	**1**
This is potential unethical conduct as this is not the true reason – the client made a late payment because of cash flow problems and the client also failed to make an accurate estimation of the taxable income for the year.	1
SET604 of the Professional Code of Conduct (CoPC) specifically mentions that assistance in the resolution of tax disputes might create a • advocacy threat to the auditors; and • self-review threat; to • independence (objectivity) **The threat is significant due to the management shifting the responsibility for the tax dispute solely to the auditor/management integrity is in question.** It is unlikely that a safeguard can be put in place; **the auditors must decline the request.**	 ½ ½ ½ **1** 1
The CoPC requires auditors to be independent and appear to be independent, as this can be perceived as non-assurance services and becoming involved in management functions or decisions.	1
Making a statement which the auditor knows is false will bring into question the: • integrity; and • professional behaviour	 ½ ½
The threat is significant as it is a breach of tax legislation and is unlawful/this could bring the firm's reputation into disrepute. **It is unlikely that a safeguard that can be put in place, the auditors must decline the request.**	**1** **1**
Should they carry out the requirement and it becomes public knowledge this would bring the CA / Auditing Profession into disrepute (as well as their own reputation)	**1**
<u>Conclusion:</u> The auditor should not comply with the client's request to write the letter.	1
Available	**11½**
Maximum	**6**
Communication skills – clarity of expression	*1*
Total for part (c)	**7**

Part (d) Discuss whether Barista applied the correct VAT treatment for the acquisition of the new manufacturing machine for the two-month tax period ended on 31 December 2021.	Marks
Barista will be entitled to **deduct the full input tax** on the acquisition of the machine as the **machine is used 100% for taxable purposes** (para. (a)(i) of the definition of input tax in s1(1) of the VAT Act).	1
Barista has to obtain and hold a **valid tax invoice (documentary proof)** from the supplier at the time that the VAT 201 is submitted to be able to make the deduction of input tax on the machine (s16(2)(a) of the VAT Act).	1
In terms of section 9(1), of the VAT Act, the **time of supply** is the earlier of the date of issue of the invoice or the date of payment. The **date of issue of the invoice is 5 January 2022** and Barista paid the supplier on **15 January 2022.**	1
It follows that the time of supply falls in the **two-month tax period ending 28 February 2022** and not in the two-month tax period ended 31 December 2021.	1
<u>Conclusion</u>: As the time of supply is only in the following tax period to Barista, the deduction of the **input tax by Barista was incorrect**. The correct treatment would have been to make the deduction in the February 2022 and not in the December 2021, tax period (s16(3) of the VAT Act)**.** ***Alt:*** *As Barista was not in possession of a valid tax invoice in December 2021, the deduction of the* ***input tax by Barista was incorrect****. The correct treatment would have been to make the deduction in the February 2022 and not in the December 2021, tax period (s16(3) of the VAT Act).*	1
Available	**5**
Maximum	**5**
Total for part (d)	**5**

Part (e) **Discuss the matters your audit firm should consider with regard to its reporting responsibility, based on the information in section 4.** • **Exclude the detailed steps to be followed when reporting the matter.** • **Exclude any impact this matter may have on the performance of the audit of Barista's financial statements.**	**Marks**
Where invoices are reversed and reinvoiced, it increases the risk of material misstatement relating to revenue for the cut-off assertion. However, as all were done within the same financial year, it has no impact on the financial reporting in financial statements (fair presentation of the AFS) and the audit opinion. **Note: A candidate could consider the matter being qualitatively material in line with ISA 450 A21 and the mark should be awarded if they consider this aspect (impact is still Rnil)**	1
In terms of s1 a 'reportable irregularity' means any unlawful act or omission • Reversing and reinvoicing clients in instances where it appears to be for the sole purpose of under-declaration of output VAT in a specific tax period is **unlawful. It is in breach of the VAT Act.**	1
committed by any person responsible for the management of an entity • As these transactions were **processed by, or with the knowledge of Bruce, the financial manager**, it has been committed by a person responsible for the management of the entity.	1
which — (a) has caused or is likely to cause material financial loss to the entity…; or • In this instance, it will result in the company being held liable for penalties and interest by SARS on the late payment of VAT (however, **insufficient information is provided to determine whether this will cause material loss to the entity).**	1
(b) is fraudulent or amounts to theft; or • Reversing invoices and reinvoicing clients for the purpose of concealing the actual reason (deferring payment of VAT) **is fraudulent**.	1
(c) represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law applying to the entity or the conduct or management thereof. • As the company still paid all the output VAT to SARS as required, **no material breach of fiduciary duty occurred; *OR*** • **granted that the VAT was paid, but in the wrong period which could lead to fines and penalties, furthermore this is fraudulent activity. This cannot be considered to be in the best interest of the company and therefore can be considered to be a breach of fiduciary duty.**	1
Conclusion: The reversal and reinvoicing of clients will be a reportable irregularity which the audit firm will have to **report to the IRBA** in terms of s45 of the APA Act.	1
Even if the reportable irregularity does not affect the fair presentation of the financial statements, the **auditor should still notify the reader of the auditor's report in the *Report on other legal and regulatory requirements* section** that the auditor has reported a reportable irregularity in terms of ISA 700.	1
The auditor would have to **consider whether this is a NOCLAR in terms of the Code of Professional Conduct** and report it accordingly.	1
The auditor must consider the reporting responsibilities in terms of ISA 265– Reporting to those Charged with Governance regarding this issue.	**1**
The auditor must consider whether this issue is / is not a Key Audit Matter (KAM) to be reported in 2021 Audit Report.	**1**
Available	**11**

Maximum	**6**
Total for part (e)	**6**

For purposes of required (f) and (g), assume that the following audit procedures have been successfully completed: • **Obtain schedules reflecting the computation of the VAT balance and deferred tax asset as at 31 December 2021.** • **Re-perform the calculations on these schedules.** • **Agree the total to the balances in the general ledger, trial balance and the financial statements.** • **Agree the opening balances to prior-year working papers and financial statements.**	
Part (f) Formulate the additional substantive audit procedures you would perform on the VAT balance in the statement of financial position as at 31 December 2021.	**Marks**
Obtain a signed management representation letter on all assertions for the VAT balance	**1**
Inspect the financial statements for the appropriate presentation and disclosure of the VAT balance.	**1**
Inspect the VAT control account in the general ledger/obtained schedule for any abnormal entries and obtain corroborating evidence for these entries.	**1**
Agree by inspection the VAT payable/receivable according to the schedule with the VAT201 form/correspondence from SARS/VAT return submitted to/received from SARS for the period to confirm that the balance reflect the returns submitted to SARS. **Obtain a statement of account VAT balance from SARS at year end and compare the VAT balance to the VAT control account / general ledger and follow up on any discrepancies**	1
Agree by inspection of the cut-off bank statement, the amount subsequently paid/received to the amount VAT payable/refundable in the financial statements to confirm cut-off and accuracy of the balance. Follow up on any differences.	1
Select a sample of sales transactions from the sales account in the general ledger, and follow them through to the VAT control account and the VAT calculation/schedule for the applicable period, noting the amounts and dates and that all statutory details (VAT registration number, etc.) agree to ensure that the transactions are **complete**, valid and accurate. Follow up on any differences. (Note to markers: mark either direction of testing)	1
Select a sample of input tax transactions from the schedule and follow through to supporting invoices, noting the amounts, dates and all statutory details (VAT registration number, etc. (Note to markers: mark either direction of testing) Inspect the schedule to ensure **that only 90% is claimed in accordance with the SARS approved apportionment ratio**) agree to ensure that the transactions are valid and accurate. Follow up any differences through discussion with management.	1 1
Obtain the cashbook for the period that corresponds with the last VAT201 form submitted to SARS and inspect any payments or receipts on which VAT was not included to ensure that transactions which should have a VAT effect have not been excluded in error or intentionally. **description in the cashbook should be corroborated against supporting documentation eg. Invoice**	1
Select a sample of zero rated and exempt supplies from the schedule and follow through to supporting documentation, noting the descriptions on invoices to confirm that these **were levied at 0% or** were not taxable supplies.	1
Review the trial balance**/fixed asset register/general** ledger for any transactions disposing of assets or **any additional purchasing of assets** and follow them through to the VAT control account and the VAT calculation/schedule to ensure that	1

output and input tax on those transactions has been raised and correctly included/deducted.	
Perform a substantive analytical procedure to confirm the validity/**occurrence** and accuracy of the VAT balance, for example • VAT output/Total sales; or • Vat input/(Cost of sales and capital purchases) (Note: only 1 mark for the description of a valid/reasonable substantive analytical procedure). **Any significant deviations from the expectations should be followed by through discussion with management and by obtain corroborating evidence for any unexpected differences.**	1 **1**
Select a sample of credit notes passed from the respective journal during the VAT period in question, be inspected to ensure that the descriptions and amounts thereon and the corresponding invoices align so as to determine the occurrence and accuracy of the credit notes passed and the related VAT impact.	**1**
Inspect the VAT calculation for the inclusion of the new manufacturing machine and inspect the invoice to confirm the details of the machine as well as the cost and the date as 5 January and that it was included in the correct period (January 2022 and not December 2021). **Request management to correct the error - If they refuse, consider qualitative and quantitative aspects of this (misstatement and fraud and amount) and the impact that this has on the audit report and opinion.**	**1** **1**
Available	**16**
Maximum	**5**
Total for part (f)	**5**

For purposes of required (f) and (g), assume that the following audit procedures have been successfully completed: • **Obtain schedules reflecting the computation of the VAT balance and deferred tax asset as at 31 December 2021.** • **Re-perform the calculations on these schedules.** • **Agree the total to the balances in the general ledger, trial balance and the financial statements.** • **Agree the opening balances to prior-year working papers and financial statements.**	
Part (g) Formulate the additional substantive audit procedures you would perform on the deferred tax asset balance in the statement of financial position as at 31 December 2021 pertaining to the manufacturing equipment.	**Marks**
Obtain a signed management representation letter on the deferred tax asset balance with specific representation on the recoverability of the deferred tax asset.	**1**
Inspect the notes to the annual financial statements for the disclosure made by the directors regarding their expectation of the recoverability of the deferred tax asset to ensure adequate disclosure of the level of uncertainty was provided.	1
Inspect the schedule / calculation to ensure that the deferred tax asset amount was calculated by applying the appropriate tax rate of 28% for assets realised through use to the temporary difference.	1
Agree the carrying amount of the asset to the carrying amount on the fixed asset register.	1
Agree the tax base of any additions during the year to the purchase documentation / sales invoices received or to the additions to the manufacturing equipment working paper to confirm the tax base is accurately determined.	1
Agree the tax base of any disposals removed from the schedule to prior year working papers to confirm the tax base is accurately removed.	1
Reperform the calculations of wear-and-tear allowances with reference to the relevant tax regulations, and agree the wear and tear allowance to the tax calculation to confirm the allowances are accurately calculated. **(This mark refers specifically to the Tax Practise Notes – specific calculations in terms of the tax regulations not overall or general calculations)**	1
Obtain budgets and forecasts to substantiate the generation of future taxable income as required by IAS 12 from management and: • Inspect the budget for future years to determine if there is sufficient estimated taxable income to be generated against which the deferred tax asset can be utilised. • **Consider, through enquiry of management, the further impact of COVID on the ability to generate future taxable incomeas demostrated bythe company's performance during the COVID pandemic and whether it has been accounted for in the budget – agree to supporting evidence.** • **Consider events after year end which could provide additional information in respect of the assumptions used in the budget**	1 **1** **1**
Through enquiry and inspection of the budgets, obtain an understanding of the budgetary process to ensure that the process results in a robust and realistic budget (dual purpose test). **Gaining an understanding as to who the preparer was, whether they have been reliable in past years etc.**	1 **1**
Inspect supporting documentation such as economic forecasts, contracts etc. to evaluate the assumptions made by management in preparing the budgets • **Compare previous budgets against real results.**	1 1

• **Consider the use of any discount rate used by management in the budgeting process and comparison with the ruling interest rate in the media or on the internet.**	**1**
Inspect the minutes of **management** meetings to ensure that budgets were approved by the board of directors **or that treatment of deferred tax asset was discussed (any valid discussion regarding minutes and related DTA)**	1
Inspect the notes to the annual financial statements for the disclosure made by the directors regarding their expectation of the recoverability of the deferred tax asset to ensure adequate disclosure of the level of uncertainty was provided.	1
Consider the possibility that the entity will qualify as a Small Business Corporation and accordingly a tax rate of zero to maximum 28 % should apply and not a standard rate of 28%.	**1**
Available	**16**
Maximum	**10**
Communication skills – clarity of expression	*1*
Total for part (g)	**11**