

QUESTION 2

50 marks

1 Background

Lilly Bloome incorporated Parlé Green (Pty) Ltd ('PG') in 2005. PG acquired a property located on a major tourist road close to Paarl in the Western Cape and opened a nursery that sells plants and gardening products to the public. The plants and gardening products are purchased from third-party suppliers. Due to the recent drought in the Western Cape, Lilly decided to diversify the company's operations to benefit from the natural beauty of the property.

PG raised funds from new shareholders, which it used to construct three new buildings on its property. It has operated the following businesses since 2019:

- *Green Fingers*, the nursery (PG's original business);
- *Green Room*, a restaurant housed in one of the new buildings, with a seating capacity of 60 people; and
- *Green Space*, a traders' market that operates in and around the other two buildings. Third-party traders (who sell paintings, sculptures, ceramic works, home decorations, and clothing) rent stalls from PG in which they sell their crafts and specialised products to the public. The rental periods vary from a day to up to 24 months.

Customers of Green Fingers and Green Room ordinarily pay by means of debit or credit cards, with cash receipts accounting for about 20% of the total takings – there are no credit sales. Green Space traders deposit their rental payments directly into PG's bank account. Traders who pay their rentals upfront qualify for discounts on the normal rental charges (the earlier the payment is made, the larger the discount received). In recognition of the challenging economic conditions experienced in South Africa, a few traders have been permitted to settle their rentals for periods of up to three months after the stall has been rented.

Although PG's trading volumes were low in 2020 and the early part of 2021 due to the Covid-19 pandemic, the PG businesses have since become very popular with locals and tourists alike. PG currently employs 20 full-time staff members, and a further 30 individuals are contracted on a regular basis for work over weekends and during peak times. The company's businesses are expected to continue to grow in the future.

2 Accounting

PG's accounting records are maintained by means of reputable cloud-based accounting software. Green Space also uses it for invoicing: these sales invoices are processed using the data on Green Space's stall booking application. Invoices are processed at the end of each month for the stalls that had been booked for the month. Traders who pay their rent upfront are invoiced, net of discounts, on the date their deposits are received. Green Fingers and Green Room use off-the-shelf purchased point-of-sale software, and the amounts extracted from this software are journalised into PG's accounting records by the company's financial director, Daisy Bloome CA(SA).

PG has a 30 September year end and has adopted International Financial Reporting Standards as its financial reporting framework. The company's annual financial statements are prepared by Daisy.

Rose, Bush & Associates, a firm of professional accountants, has undertaken an independent review of PG's annual financial statements since its 2018 financial year. However, at PG's annual general shareholders' meeting held in February 2022, the shareholders approved the following, based on recommendations made by Daisy:

- An external audit of PG's annual financial statements should be undertaken for the year ended 30 September 2022 (FY2022);
- Wize & Willow Inc. ('WW') should be appointed as the company's first Registered Auditors; and
- Daisy must agree the audit fees with WW, as she knows its methodology and can save costs by preparing most of the audit workpapers herself.

3 Board of directors

Despite being a private company, PG's shareholders recognise the importance of a well-constituted board of directors. The board of PG comprises the following members:

Name	Role	Date appointed	Brief background
Oswald Titus	Chairperson and non-executive director	31 October 2021	<ul style="list-style-type: none"> • Politician • Former mayor of Paarl
Palesa Mosala	Non-executive director	1 January 2018	<ul style="list-style-type: none"> • Well-known businesswoman • Major shareholder in PG
Pine Prins CA(SA)	Non-executive director	1 October 2019	<ul style="list-style-type: none"> • Managing partner of Prins Inc., a firm of professional accountants (but which does not provide any services to PG)
Lilly Bloome	Managing director	12 July 2005	<ul style="list-style-type: none"> • Founder of PG • An enthusiastic gardener
Daisy Bloome CA(SA)	Financial director	1 April 2021	<ul style="list-style-type: none"> • Daughter of Lilly Bloome (she has been dating Pine Prins since 2019) • Qualified as a CA(SA) in 2021 • Completed her training contract with WW • Responsible for PG's entire accounting function, including the banking of all cash receipts

As a private company, and relying on the 'proportionality' principle recognised in the King IV Report as an alternative option, the board agreed that no board committees should be established. All governance-related matters will be dealt with at the board level.

PG has the following shareholders:

Name	Shareholding
Lilly Bloome	40%
Palesa Mosala	40%
Oswald Titus	10%
PG Employee Share Trust	10%

The PG Employee Share Trust holds shares in PG on behalf of the company's 20 full-time staff members.

4 Summarised financial data

The following financial data has been extracted from PG's financial records at 30 September 2022:

	Unaudited FY2022 R'000	Reviewed FY2021 R'000
Revenue		
Green Fingers	6 962	5 754
Green Room	4 298	4 219
Green Space	4 754	3 011
Profit / (loss) for the year before taxation	1 128	(224)
	Unaudited 30 September 2022 R'000	Reviewed 30 September 2021 R'000
Property, plant and equipment	18 872	19 387
Current assets		
Inventory	752	586
Receivables	791	270
Cash and bank	59	56
	20 474	20 299
Current liabilities	701	788
Long-term liabilities	15 600	16 150
Equity	4 173	3 361
	20 474	20 299

5 Summary of the minutes of a board meeting and related information

The following is a summary of the minutes of a meeting of PG's board of directors held on 13 September 2022:

- Palesa and Pine submitted their apologies for not being able to attend.
- Lilly reported that she had long been searching for a suitable property to replicate the Paarl property business model. She has now identified a suitable property for sale near Ceres, which is on the market for R16 million. One challenge is that this property is zoned for agricultural use and, until it is suitably rezoned, it cannot be used for PG's intended purpose. She added that she had obtained pre-approval from PG's bankers to provide the required funding for PG's acquisition of the land, as well as for the construction of the buildings that would be needed.
- The board (with the full support of Oswald, Lilly and Daisy) approved the following:
 - To acquire the Ceres property at a price not exceeding R15 million.
 - If the seller of the Ceres property accepts PG's offer, the construction of the buildings was to commence as soon as possible. Oswald noted that he was friends with several key councillors on Ceres municipality's mayoral committee and he would persuade them to approve the property's rezoning quickly. He requested that an amount of R195 000 be allocated to him. He would use it at his discretion to pay any fees and other expenses of the councillors for the rezoning application.
 - To incentivise the executive directors of PG to maximise the company's profits, they will with effect from FY2023 be entitled to an aggregate annual bonus amounting to 20% of the profits earned by PG (to be shared equally by the two executive directors).
 - Some of the stalls in Green Space are empty even on busy weekends (which detracts from the customers' experience). To attract more traders, a late stall booking discount of 50% on the normal rental fee will be offered with immediate effect. Traders who book empty stalls within five days of the relevant rental date will qualify for the discount.

The above summary was extracted from the minutes of the board meeting, which were shared with all PG directors in early October 2022.

The company's offer for the Ceres property was accepted on 13 October 2022 and initial construction work started at the end of that month.

6 Daisy's entrepreneurial skills

Following the board's approval of the 50% discount for 'late stall bookings', Daisy recognised an opportunity. Daisy knew that many of the friends she had made at university and while she was a trainee at WW, were very creative and crafted products that could be sold at PG's traders' market.

Daisy accordingly contacted these friends and told them that she could negotiate special rental rates for them at Green Space. She proposed that she would book stalls using the Green Space booking application for the required dates using fictitious trader details. She would then cancel these a few days before the market date and then make 'last minute bookings' of the stalls for her friends. She would charge them 75% of the normal fee and ask that they pay the amount due into her personal bank account. She would thereafter deposit 50% of the normal fee (i.e. the late stall discounted rate) into PG's bank account.

7 Audit of PG's annual financial statements for FY2022

Following its appointment as Registered Auditors, WW commenced with planning the audit of PG's annual financial statements for FY2022 in early December 2022.

The engagement partner drafted the overall audit strategy, with a performance materiality figure set at R75 000. Next, the audit manager started preparing the audit plan.

INITIAL TEST OF COMPETENCE, JANUARY 2023

PROFESSIONAL PAPER 3

**This paper consists of two questions
Answer each question in a separate answer book**

PAPER 3 QUESTION 2 – REQUIRED		Marks	
		Sub-total	Total
(a)	Discuss whether Pine will have any obligations to report issues arising from the acquisition and rezoning of the Ceres property as reflected in the summary of minutes of the board meeting held on 13 September 2022, once he took note of the decisions taken. <ul style="list-style-type: none"> Do not provide a detailed description of how Pine should go about discharging any reporting responsibilities he may have. <i>Communication skills – clarity of expression</i>	7 1	 8
(b)	Discuss any concerns you may have about Daisy’s conduct with reference to the Companies Act and the SAICA Code of Professional Conduct.	10	10
(c)	Critically evaluate the appropriateness of the board composition of PG, as well as the suitability of the individual directors serving on the board.	9	9
(d)	Discuss the matters that Daisy should have considered before she could have recommended that an external audit is required for PG’s annual financial statements for FY2022.	6	6
(e)	In planning the audit of PG for FY2022 – <ul style="list-style-type: none"> discuss the effect of the information provided on the auditor’s assessment of the risks of material misstatement on the assertions for the revenue class of transactions; and describe the nature and timing of the audit procedures that are needed to respond to the risk of material misstatement in the completeness assertion for the revenue class of transactions. <i>Communication skills – logical argument</i>	9 7 1	 17
Total for question 2			50
TOTAL FOR PAPER 3			100