

IGNORE VALUED-ADDED TAX**1 Background information**

Sibahle Gifts (Pty) Ltd ('Sibahle') is a company that sells branded corporate gifts, clothing, and merchandise. Sibahle comes from humble beginnings as a small business that started in Nyanga, Cape Town. Sibahle has grown into a globally recognised market leader in merchandise, custom branding, and printing. Sibahle has offices in Johannesburg, Nairobi, Gaborone, and Lagos. It prepares annual financial statements in accordance with International Financial Reporting Standards (IFRS) and has a 30 June financial year end.

A corporate gift is a gift that is custom branded with the client's logo or a unique design and forms a key part of an effective marketing strategy. Personalised gifts are unique and show the client's appreciation to key stakeholders, such as team members, clients, customers, and suppliers. Research has proven that corporate gifts can enhance a brand's reputation and boost long-term relationships and productivity in an organisation.

Sibahle has an energetic and highly creative team that is always ready to make extraordinary moves. The team consists mainly of marketing and sales personnel.

2 Challenges faced during the Covid-19 pandemic

Sibahle was affected by the Covid-19 pandemic and, although the company is recovering, its turnover for the financial year ended 30 June 2022 (FY2022) was still below the pre-Covid levels. To save costs, the company put in place some cost cutting/payment deferral measures that included the following:

- The reduction of office space after work-from-home policies were introduced;
- The renegotiation of payment terms with lenders and key suppliers;
- The reduction of non-essential expenditure such as training and business travel; and
- The reduction of payroll expenses by using part-time workers and limited work days.

Although some of these measures were not ideal, they helped the company weather the difficult period.

3 Proposed recovery strategy

Sibahle's management team believes that the worst is over, as profits have started to increase. Nevertheless, it wants to be more proactive about the recovery strategy and put together three options for presentation at the next board meeting:

Option 1: Hire additional sales personnel and source specialised printing equipment

According to the management team, one of the easiest ways to increase profits is to increase the number of sales personnel. It therefore proposed that new sales personnel, who will work full-time from Sibahle's smaller premises, be appointed.

The team put together the following estimated impact that the increase in sales personnel will have on annual profit before tax going forward (this did not include the impact of the specialised printing equipment – see discussion below):

	Probability	Increase in profit before tax
Low recovery	10%	R1 500 000
Average recovery	30%	R2 300 000
Full recovery	60%	R3 100 000

The management team expects sales volumes to increase because of the larger sales team. Sibahle would therefore need to purchase specialised printing equipment, known as an SPE1, for R2 225 000 from a Chinese supplier, to cope with the higher sales volumes. The equipment uses solar energy, by means of its own solar panel system (S) that needs to be attached to it (collectively known as the SPE1+S). Sibahle would be able to locally source a solar panel system for R186 000, bringing the total cost for the equipment to R2 411 000. The SPE1+S incorporates state-of-the-art 3D printing technology.

The SPE1+S would be depreciated over six years and have a residual value of R750 000. The South African Revenue Service (SARS) allows a write-off period of five years on the SPE1+S.

Alternatively, Sibahle could enter into a lease agreement with Severite Electronics (Pty) Ltd ('Severite') to lease a similar SPE1+S.

The terms of the lease would be as follows:

- Commencement date 1 July 2023
- Lease payments R360 000 payable annually in arrears on 30 June
- Lease period Four years with a two-year renewal period on the same payment terms. The term would be non-cancellable.

Severite will pay R22 000 towards administration costs.

Severite includes a maintenance plan for the SPE1+S with the lease agreement. Sibahle will elect to apply the practical expedient of not separating non-lease components from lease components for equipment.

If the lease and non-lease components were separated, the lease payment would be allocated based on the following selling prices:

	Four-year lease R	Six-year lease R
Equipment leasehold interest	1 200 000	1 450 000
Maintenance: Equipment	46 000	46 000
Maintenance: Solar panel	18 000	18 000

Industry experts anticipate that load-shedding will continue for the next decade as South Africa's electricity provider does not have any viable plans to resolve the power shortages. The government has been encouraging corporates to invest in alternative energy sources. It is therefore likely that Sibahle will renew the lease.

Sibahle has an 'intelligent' accounting package that requires the finance staff to select from a list of inputs, leading it to automatically generate the necessary journal entries. Based on the inputs provided by the finance staff, the system has proposed the following journal entry for the initial recognition of the lease transaction:

1 July 2023	Note	Dr R	Cr R
Right of use: Equipment (SoFP*)	1	1 093 446	
Right of use: Initial direct costs (SoFP)	2	22 000	
Other expenses (P/L*)	3	64 000	
Lease liability (SoFP)	4		1 093 446
Payables (SoFP)	5		86 000

* SoFP = Statement of financial position; P/L = Profit/loss

Notes

- 1 Equals the lease liability on initial recognition.
- 2 These are the administration costs paid by Severite.
- 3 Other expenses comprise the maintenance costs relating to the SPE1+S.
- 4 Lease liability is the present value of future lease payments over a four-year lease term, discounted using Sibahle's incremental borrowing rate as the interest rate implicit in the lease cannot be readily determined.
- 5 A liability/payable was raised in respect of the costs referred to in notes 2 and 3.

Option 2: Radio advertisements

Sibahle's research on advertising strategies has shown that radio is still the top advertising medium because radio listeners do not skip the radio advertisements as they do when reading an article or watching a video on social media. The management team does not believe that any additional equipment would be required for this option.

Sibahle could approach a provider, which specialises in radio advertising, for assistance. The radio advertising company will custom design a suite of radio campaigns that will ensure maximum exposure across the leading radio stations in South Africa at the best possible rates. The following packages would be available to Sibahle:

	Package 1	Package 2
Total stations	1 Mastro FM 2 TrueFriend FM 3 Treeway Radio 4 Buybuy FM 5 Book Radio	1 ZA FM 7 2 912 Radio 3 Treeway Radio
South African provinces	GP NW FS KZN EC WC	GP KZN WC
Expected incremental gross profit in year 1	R1 120 000	R700 000
Expected incremental gross profit in year 2	R900 000	R500 000
Total additional cost for the two-year campaign, payable upfront	R1 480 000	R950 000

Option 3: Partnership with an influencer

The marketing director, Charles Ursh, was in favour of using an influencer on social media to increase Sibahle's sales. With the growing popularity of unfiltered content and 'everyday' influencers, companies are looking to build relationships with satisfied customers who can advertise for them. Influencer campaigns are a popular and cost-effective way of marketing.

Charles identified AllOut Entertainment (Pty) Ltd ('AllOut'), a company owned by Colleen Hunks, as a suitable marketing partner. AllOut has a 30 June year end.

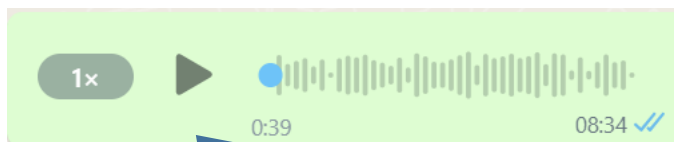
Colleen is the founder and sole shareholder of AllOut and is a well-known South African singer, comedian and digital content creator who receives more than three million views on Instagram per post. Colleen has won several music awards, and one of her albums is a certified gold album seller and has also won the people's choice awards for the influencer of the year, for three years running. She is a close friend of Charles and he was sure he could get her to agree to act as Sibahle's influencer on favourable terms.

AllOut has two permanent employees. They are unrelated to Colleen. The income that AllOut would earn from the agreement with Sibahle is not expected to be material in relation to the income earned from its existing clients.

Sibahle's management team suggested an agreement with AllOut for Colleen to become its brand influencer for a two-year period. In terms of the proposed agreement (see appendix A for extracts of the proposed agreement), AllOut would be responsible for managing the content of Colleen's posts on Instagram. On average, 1% of Colleen's followers are expected to follow the links she posts and thus purchase Sibahle's products.

A complication to this option relates to Colleen's involvement in a robbery at the home of a well-known comedian, who was also rumoured to be dating Colleen at the time of the robbery. Charles discovered that Colleen has been charged and is being prosecuted for masterminding the robbery. There are also allegations that she tampered with the crime scene and defeated the ends of justice. Charles is concerned that the pending court case, and her conviction, could result in Colleen no longer being a suitable influencer. Because Charles would like to help Colleen, he would do everything in his power to get Sibahle to choose this option. He is sure he could then convince them to invest in providing the best legal expertise possible to make the case 'disappear' and protect Colleen's reputation.

Charles sent Colleen the following voice note:



Hi dearest, I know this trial is taking up most of your valuable time and I have an offer you won't be able to resist. If my company chooses you as an influencer, I am sure I could convince them to pay a consulting fee of R1,5 million to Judge Mlulameleni, who's an old friend of mine and a presiding judge in your court case. He has agreed to accept this lump sum as a once-off and final payment. All you have to do is to promise me that you will dedicate your time to making sure you fly our flag high. The more publicity we get, the more money we make, which means more money in your pocket and ours. This matter doesn't have to go through your company as it is a direct incentive to you.

AllOut issued an official statement that it intends to honour all its business obligations despite the pending court case. It assured its clients that Colleen would honour all the prior engagements in between court appearances. The statement was made in response to the rumours and comments that if Colleen were convicted, she would receive a jail sentence.

4 Additional information

The following information on Sibahle is available:

- Pre-tax discount rate (which equals the incremental borrowing rate): 12% per annum.
- Company tax rate: 27%.
- All cash flows occur at the end of the year unless stated otherwise.
- All persons are South African residents for tax purposes.

Appendix A Extracts of the proposed agreement

INFLUENCER MARKETING AGREEMENT

The INFLUENCER MARKETING AGREEMENT ('Agreement') is entered into by and between ALLOUT ENTERTAINMENT (PTY) LTD ('AllOut'), and SIBAHLE GIFTS (PTY) LTD ('Sibahle')

2 DESCRIPTION OF SERVICES

During the term (as defined in clause 3), AllOut agrees to deliver the following services to Sibahle:

- 2.1 One Instagram story per week as well as analytics from this story. Sibahle shall provide AllOut with a story, created by Sibahle, that AllOut shall post as an Instagram story. Each story shall be deleted twenty-four hours after being posted.
- 2.2 One Instagram feed post, as saved on Colleen's page or feed, per week featuring Sibahle and its products and/or services. Each feed post shall only be deleted one year following its publication. The content shall clearly identify Sibahle by stating its name and tagging its official Instagram account.
- 2.3 Four appearances by Colleen at Sibahle's events.

3 DURATION

The duration of this agreement shall be twenty-four months. It shall commence on the effective date of this agreement and shall terminate on the last business day of the twenty-four -month period, during which time AllOut shall deliver the services described in clause 2 of this Agreement.

5 RELATIONSHIP OF PARTIES

This Agreement does not create an employee/employer relationship between the parties. It is the parties' intention that AllOut shall be an independent contractor for this purpose.

7 COMPENSATION

- 7.1 At the end of each month of the agreement duration, AllOut shall issue a tax invoice to Sibahle for the amount of R10 000.
- 7.2 In terms of clause 2.2, AllOut shall issue a tax invoice to Sibahle –
 - 7.2.1 for the amount of R15 000 per story posted; and
 - 7.2.2 for the amount of R7 500 per 100 000 views per feed post on Instagram. The number of views shall be determined one year after posting.
- 7.3 Sibahle shall pay AllOut on presentation of an invoice.
- 7.4 ...
- 7.5 ...
- 7.6 AllOut shall receive a sales performance bonus of 2,5% for every sale if a customer follows the link and uses the 'COLLEEN10' code.

12 TERMINATION

Either AllOut or Sibahle may terminate this Agreement in writing at any time, for any reason. Termination shall come into effect on the date of such notice.

INITIAL TEST OF COMPETENCE, JANUARY 2023

PROFESSIONAL PAPER 4

**This paper consists of two parts
Answer each part in a separate answer book**

PAPER 4 PART I – REQUIRED		Marks	
		Sub-total	Total
(a)	On the assumption that Sibahle chooses option 1 and enters into the lease with Severite on 1 July 2023 – (i) discuss the errors in the journal entry proposed by Sibahle with regard to the initial recognition of the SPE1+S lease; and (ii) provide the journal entry(ies) to correct the errors identified and to record the finance costs and the payment for FY2024. <i>Communication skills – presentation</i>	5 7 1	13
(b)	Discuss whether the compensation in clause 7 of the agreement (see Appendix A) will constitute gross income of AllOut, for the year of assessment ending 30 June 2023. • Assume that Sibahle chooses option 3. • Assume that the agreement was entered into on 1 January 2023.	5	5
(c)	Advise Sibahle on whether it has an obligation to withhold employees' tax on the amounts paid to AllOut. • Assume that Sibahle chooses option 3.	6	6
(d)	Discuss how AllOut would recognise revenue if the agreement with Sibahle is entered into. • Limit your answer to the first two steps of the five-step revenue approach in IFRS 15, <i>Revenue from Agreements with Customers</i> . <i>Communication skills – appropriate style</i>	20 1	21
Total for part I			45

INITIAL TEST OF COMPETENCE, JANUARY 2023

PROFESSIONAL PAPER 4

**This paper consists of two parts
Answer each part in a separate answer book**

PAPER 4 PART II – REQUIRED		Marks	
		Sub-Total	Total
(e)	Critically discuss the strategic risk factors and other relevant qualitative factors that Sibahle should consider with regard to each of the three options proposed for the recovery strategy before making a decision. <i>Communication skills – logical argument</i>	20 1	 21
(f)	Based on the information in the scenario, quantitatively evaluate options 1 and 2 proposed for the recovery strategy and recommend which option should be selected. • Use discounted cash-flow techniques where necessary. <i>Communication skills – presentation</i>	23 1	 24
(g)	Discuss any ethical concerns you may have with regard to the voice note sent by Charles to Colleen and how these can be mitigated. • Assume that Sibahle chooses option 3. <i>Communication skills – appropriate style</i>	9 1	 10
Total for part II			55
TOTAL FOR PAPER 4			100