

Part (a) Discuss, based only on the information provided in section 1, the factors that increase the risk of material misstatement at the assertion level for investment properties in the financial statements of Beeprop for FY2021.		Marks
1	<p>The risk that investment property is overstated as investment property is located across South Africa which may result in increased difficulties to manage or coordinate the properties (<i>existence</i>).</p> <p>The risk that not all investment property is accounted for, due to it being located across South Africa which may result in increased difficulties to manage or coordinate the properties (<i>completeness</i>).</p> <p>Since the properties are situated all over SA there is a risk that properties were affected/damaged by the looting- fair values are overstated if not adjusted (Valuation)</p>	1 1 1
2	<p>As Beeprop has a diverse investment property portfolio it increases the risk that the classification of the property may be done incorrectly between the different classes of assets in terms of the accounting standards. (<i>classification</i>)</p> <p>As some of the offices are vacant and occupied by Beeprop itself while seeking tenants for the buildings, it further increases the risk that the classification of the property may be done incorrectly in terms of the accounting standards, e.g. as investment property instead of property, plant and equipment and vice versa (<i>classification</i>).</p> <p>Risk that due to vacant properties, the properties may have been damaged/vandalized and the fair value may not have adequately considered in the fair value determination (valuation)</p>	1 1 1
3	<p>Because most of the investment properties in the portfolio is being developed and is owned by Beeprop, there is a risk that the initial cost (development cost) is not correctly capitalised in the cost of the building / expensed (based on the nature of the cost). This would result in the cost of investment property not being correct (resulting in an over- or understatement of profit/loss gain when re-measuring to the fair value) (“accuracy, valuation and allocation).</p>	1
4	<p>In addition, the controls around the accumulation of costs are not regarded as sound, which may result in inefficiencies and the inability to manage costs incurred and result in incorrect valuation of the investment property being developed. (Valuation and allocation)</p>	1
5	<p>Beeprop has one investment property that is held under a lease agreement, which results in the following:</p>	
5.1	<p>It increases the risk that lease property is not correctly classified and disclosed as an investment property but as a leased asset/right-of-use asset in terms of IFRS 16 (<i>classification and disclosure and presentation</i>).</p>	1
5.2	<p>There is a risk the initial measurement of lease property is not accurate because of the complexity in the determination of the present value of the lease and the rate implicit in the lease (<i>accuracy</i>).</p>	1
5.3	<p>There is a risk that the subsequent measurement of leased property (RoU asset) at year end is not done correctly in accordance with IAS 40, i.e. stated at cost (or cost less accumulated depreciation) and not fair value (<i>valuation, allocation and accuracy</i>).</p>	1
5.4	<p>There is a risk that the <i>carrying amount</i> of the right-of-use asset (classified as an investment property) <i>at year end</i> in terms of the fair value method adopted by Beeprop was not calculated/determined accurately because the determination of fair value for the right of use is complex - one</p>	1

	considers the cash flows from the use rather than the residual ownership of the property (valuation).	
6	As office buildings have been hit the hardest by the Covid 19 challenges, with many tenants that vacated the buildings to adopt a work-from-home model, there is a risk that this might result in a lower fair value of the investment properties, which was not adequately determined by Beeprop (valuation, allocation and accuracy).	1
7	As Delien (the financial director) is committed to strengthening Beeprop's statement of financial position, with the property most probably a significant account balance on the financial statements, there is a risk of overstating the investment property balance to achieve the company's goal of improving its financial position, despite the financial challenges of the industry (existence or valuation).	1
8	The view of Delien that the value of the property, with specific reference to the office buildings, should reflect that the office space will return to 'normality', increases the risk that the value of the property can be overstated (valuation, allocation and accuracy).	1
9	There is a risk that costs incurred to develop properties that are capitalised incorrectly include VAT as part of the capitalization overstating the investment property balance (valuation and classification).	1
Available		16
Maximum		8
Total for part (a)		8

Part (b) Describe the additional substantive procedures that should be performed by the JZK Auditors audit team to obtain sufficient and appropriate audit evidence with regard to the right-of-use asset with reference to only the following assertions:		
<p>(i) For the recognition and initial measurement of this transaction: existence, classification, accuracy, and valuation and allocation; and</p> <ul style="list-style-type: none"> • The following procedures had already been performed by the audit team: <ul style="list-style-type: none"> ○ Obtaining a management representation letter for all assertions relating to the right of use asset; ○ Agreeing, where applicable, all amounts in the schedules, reports and calculations to the general ledger, trial balance and annual financial statements; and ○ Casting of all totals and subtotals. <p><i>(Note to markers: consideration could be given to correct procedures listed under the incorrect heading (e.g. subsequent instead of initial)</i></p>	Marks	
Recognition and Initial measurement		
1	<p>Inspect the minutes of directors and capital expenditure committee meetings that authorised the head lease agreement for acquiring the right to use the property (the right-of-use (RoU) asset) (existence).</p> <p>Inspect the memorandum of incorporation to ascertain whether there are any prohibitions or limitations related to the lease transaction that would render this transaction as void and therefore threatens the existence assertion.</p>	1

2	Physically verify the office building subject to the lease and agree the details to the description/details in the contract to confirm that the property exists.	1	
Accuracy, valuation and allocation			
3	Obtain management's calculation of the initial amount recognised (cost) for the RoU asset (amortisation table) and by inspection of the head lease agreement/contract, confirm the following details used in the calculation:	1	
3.1	Commencement date of contract	½	
3.2	Duration of contract	½	
3.3	Rand amount of monthly payments	½	
3.4	Payable monthly in arrears	½	
3.5	Interest rates/escalation clauses, if any	½	
3.6	Confirm that it is duly authorised, by inspection of signatures (signed agreements) (<i>existence</i>).	½	
4	Re-perform the implicit interest rate calculations of the lease by using all the correct input factors.	1	
5	Recalculate the PV of the lease liability and right-of-use asset (initial measurement of the RoU asset) by using the abovementioned input factors and compare with management's calculation to assess the reasonability of the calculation upon recognition and initial measurement.	1	
6	Inspect supporting VAT documentation noting whether it was in the name of Beeprop, to determine whether Beeprop was entitled to claim input VAT (in terms of VAT Act).	1	
7	Recalculate the amount of VAT excluded from the transaction	1	
Classification			
8	Observe and have discussions with the tenant occupying the office building to confirm that the office building is not owner-occupied.	1	
9	Obtain the subleasing agreements to confirm the existence of the lease agreements, to provide evidence that the RoU asset has been correctly classified as an investment property.	1	
10	If the terms and conditions of the sublease agreements are complex, obtain the services of an expert (legal and IFRS expert) to determine whether these are valid lease agreements.	1	
		Available	13
		Maximum	8
		Total for part (b)(i)	8

<p>Part (b) Describe the additional substantive procedures that should be performed by the JZK Auditors audit team to obtain sufficient and appropriate audit evidence with regard to the right-of-use asset with reference to only the following assertions:</p> <p>(ii) For the subsequent measurement: accuracy, and valuation and allocation.</p> <ul style="list-style-type: none"> • The following procedures had already been performed by the audit team: <ul style="list-style-type: none"> ○ Obtaining a management representation letter for all assertions relating to the right of use asset; ○ Agreeing, where applicable, all amounts in the schedules, reports and calculations to the general ledger, trial balance and annual financial statements; and ○ Casting of all totals and subtotals. 	Marks
Subsequent measurement	

1	Inspect Beeprop's policies and confirm by enquiry from director to ensure that it has adopted the fair value method in measuring investment properties or Inspect that the basis of valuation of the investment property (in the previous years' AFSs) is consistent with the company accounting policy and the requirements of IFRSs.	1
Consider whether reliance can be placed on the work of an expert		
2	Inspect the engagement letter/other agreement between management and the expert assessing the nature, scope and objectives of the work to establish if it provides sufficient audit evidence on the NPV at year end.	1
3	Inspect for the valuers' competence and capabilities by considering/obtaining the following:	
3.1	• Obtaining evidence of valuers' membership/qualifications of an accredited professional body.	1
3.2	• Experience in doing fair value work of a similar nature by reading reports done/discussions with the valuers.	1
4	Evaluate the objectivity/independence by discussing with management to what extent the fact that the CEO is serving on the governing board of Expert Property Valuers would threaten this/consider a declaration of objectivity.	1
Procedures to be performed on the work of the expert		
5	Obtain the expert's reports/calculations and, by inspection, confirm the following amounts for the NPV calculations :	
5.1	Obtain the workings for the forecast of the expected receipts from the sub-lease contracts to verify the arithmetic accuracy of the calculations .	1
5.2	Agree the sources of data used in the forecast to underlying supporting documentation to verify the reasonability of the amounts. The following are examples of source data that should be verified against supporting documentation: inflation rates, vacancy rates and expected future discount rates.	1
5.3	Enquire from management whether appropriate steps to understand and address the estimation uncertainty regarding the lease receipts have been undertaken (and verify supporting documentation).	1
5.4	Request a sensitivity analysis from management and evaluate the effect of changes in key assumptions/data on the result of the calculation.	1
5.5	If management has not taken appropriate steps to understand and address estimation uncertainty, request that they perform additional procedures to sufficiently address and understand estimation uncertainty.	1
5.6	Through discussions with the expert, consider the relevance and reasonableness of the assumptions used in calculating the expected lease receipts from sub-lease contracts for the full duration of the head lease agreement.	1
5.7	As required by ISA 540, perform the 'stand back' test and evaluate whether audit evidence obtained as well as knowledge of the property industry support the calculation and assumptions by the expert .	1
5.8	Assess the market-related discount rate for reasonability by comparing with information available in the market.	1
5.9	If any material differences are identified in the testing performed, discuss with the expert and management and record any adjustment if necessary.	1
	Inspect the general ledger accounts relating to right-of-use asset for any abnormal/unusual entries and follow up with management.	1

6	Recalculate the fair value (NPV of expected lease receipts less lease payments under the head lease) (using the correct input factors as verified above) and follow up differences.	1
7	Agree property details on the experts report to the property details on the lease agreement to ensure the correct property is valued.	1
	Available	18
	Maximum	10
	Total for part (b)(ii)	10
	<i>Communication skills – clarity of expression</i>	<i>1</i>
	Total for part (b)	19

Part (c) Discuss the impact on the auditor's report if no changes were made to the classification of the full outstanding amount of the lease liability as non-current liabilities in the FY2021 financial statements (see sections 3 and 5).		Marks
1	The incorrect split between current and non-current liabilities is a factual misstatement as the full amount should not be classified and disclosed as long term (non-current), but the discounted short-term portion of R343 574 should be disclosed as current (payable within 12 months) as required by the accounting standards (IAS 1.60, 69).	1
2	<p>Consideration of materiality of the misstatement from a <i>quantitative perspective</i>:</p> <p>The uncorrected misstatement is not individually quantitatively material, as the amount of R343 574 is below the final materiality figure of R4,2 million. The amount should be transferred to the schedule of misstatements if it is above the clearly trivial threshold.</p> <p>The misstatement is considered to most likely be trivial, given that it is smaller than 10% of the final materiality rand value.</p>	1
3	<p>Consideration of materiality of the misstatement from a <i>qualitative perspective</i>:</p> <p>ISA 450: A20 provides that determining whether a classification misstatement is material involves the evaluation of qualitative considerations, such as the effect on key ratios. The audit partner should consider the extent of the impact on the key ratios if the current vs non-current split is not correct: it might impact the ratios used by investors to analyse the entity's performance and make investment decisions.</p>	1
4	ISA 450: A20 further provides that misclassification between line items in one statement, being the statement of financial position, may not be considered material if the misclassification is small in relation to the context of the financial statements as a whole or if the misclassification is small in relation to the whole balance and the misclassification does not affect the income statement (statement of profit or loss).	
4.1	The misclassification misstatement amounts only to R343 574 compared to the total lease liability amount at year end of R12,29 million.	1
4.2	In addition, it does not affect the statement of profit and loss, only the statement of financial position.	1
5	<p>Consideration of materiality of the misstatement from a pervasive perspective:</p> <p>The misclassification is confined to only one account in the statement of financial position, the lease liability account, excluding ratios. Accordingly, it is not pervasive to the financial statements as a whole.</p>	1
6	Therefore, based on the aforementioned, it does not appear as if the misstatement of the classification of short term vs long term could be regarded as a material misstatement (unless the impact on the key working capital ratios is material) and, therefore, there is no need to modify the audit report.	1P
7	Alternative	
	Qualitatively, the misstatement can be considered material based on non-compliance with IFRS (see point 1) as required by the Companies Act section 30.	1
	Therefore, there will be a need to modify the audit report.	1P

	Available	7
	Maximum	4
	Total for part (c)	4

Part (d) Discuss five concerns that you may have relating to the accounting treatment and disclosures in respect of Beeprop's investment properties. For each concern, provide the treatment that the management should have followed.		Marks
<ul style="list-style-type: none"> • Limit your discussion to issues in sections 2, 3 and 4 for which there is evidence of inaccuracies, inconsistencies, errors in application and/or non-compliance with IFRS in the scenario. • Exclude items not disclosed in the extracts. • Ignore all tax implications. 		
1	Major sources of estimation uncertainty	
1.1	The directors stated that there are no uncertainties in the measurement of the fair value of the investment properties, as the valuation of all properties is done by a firm of independent professional valuers. However, this statement is inappropriate, as various estimates (such as future market-related cash flows, discounts rates, expected vacancy, etc.) are needed to estimate the fair value.	1 1
1.2	The various sources of estimation uncertainty regarding estimating the fair value of the investment properties and the detailed disclosure in terms of IAS 1.125 should be made.	1
3	Abnormal waste in cost	
3.1	The abnormal costs incurred by the delays in construction due to the Covid-19 pandemic were incorrectly capitalised as part of the cost of investment properties.	1
3.2	Such abnormal amount of wasted material and labour may not be included in the cost (IAS 40.23(d)). The abnormal amount of wasted material and labour (R5,78 million) should be deducted from the costs capitalised (i.e. decrease the cost) and be expensed during FY2021.	1
4	Fair value hierarchy	
4.1	Categorising the fair value of the investment properties as 'level 2' within the fair value hierarchy (with the reason being that the fair values are observable from the independent valuation reports) is inappropriate, as the inputs are not developed using 'market data, such as publicly available information...' (definition of 'observable' – IFRS 13. Glossary). The open market value of properties in South Africa and other inputs needed to fair value the properties, such as future expected cash flows, discount rates, etc., are not publicly available.	1 1
4.2	The fair value hierarchy should be presented as level 3 within the fair value hierarchy, as various unobservable inputs are needed to fair value the investment properties (even if it is done by independent experts).	1
5	Fair value and accrued lease income	
5.1	The fair value of the investment properties represents the present value of expected lease payments receivable (as obtained from Expert Property Valuers), which implies that the accrued operating lease income may be double-counted (IAS 40.50(c)). <i>(The future expected cash flows were used to determine the accrued income when straight-lining the lease income, and also the PV used to fair value the investment properties.)</i>	1
5.2	The carrying amount of the investment properties should be reduced by R4 million, as a separate asset for the accrued lease income was already recognised. <i>(To avoid double-counting.)</i>	1
6	Fair value adjustment	

	After correcting all the items above, the resultant fair value loss on the investment properties will also need to be recalculated and appropriately disclosed in the note.	1C
7	Initial measurement of right-of-use asset	
	In the extract from note on the lease liability the new lease (liability) is disclosed as R12 498. This is net of an initial payment of R1 875 (correct). However, the right-of-use asset is recognised at the net amount of R12 498, which is contrary to IFRS 16.24 that requires that the right-of-use asset is initially measured at the amount of the initial liability plus lease payments made at the commencement of the lease. Therefore, the right-of-use asset should have been measured at R14 373 on initial recognition.	1 1
8	The investment property note discloses an increase (presumably an aggregate of new additions and subsequent expenditure that is included in the carrying amount) in investment property of R27 869, however note 6 shows that the cost of improvements is R8 574. IAS 40.76 (a) requires separate disclosure of additions resulting from acquisition of investment property and those arising from subsequent expenditure that will be included in the carrying amount.	1 1
Available		15
Maximum		10
<i>Communication skills – logical argument</i>		1
Total for part (d)		11

Part (e) Discuss five ethical concerns you may have in terms of SAICA's Code of Professional Conduct with regard to the actions of Delien.		Marks
<ul style="list-style-type: none"> Do not discuss any safeguards. 		
Approval before zoning approval is provided		
1	Delien is a CA(SA) in business and should comply with parts 1 and 2 of SAICA's code of Professional Conduct.	1
2	Granting approval to the building teams to commence with the development of a building when zoning approval has not been obtained yet, is not dealing fairly and with truthfulness .	1
	The approval by Delien before the zoning approval being granted results in a self-interest threat to integrity	½ ½
Providing permission for transactions with related parties (conflict of interest (s210))		
3	The fact that Delien granted permission for the use of townhouses to EMH Hunters, which is her husband's safari business, could be regarded as a conflict of interest between her husband and the company that employs her and she will have an indirect financial interest through her husband.	1

4	This conflict of interest creates a self-interest / familiarity threat to Delien's objectivity because she will not be deciding objectively to provide the townhouses.	½ ½
5	Delien should not allow this conflict of interest to compromise her professional and business judgement. This appears to be the case as Delien allows her husband's business to use the vacant townhouses for guests of his hunting business at no cost. By allowing this, Delien is not exercising objective business judgement.	1
6	The possible non-compliance with the Companies Act in terms of s75 – director interest in a contract – could be in breach of professional behaviour. It appears that she has granted permission without following the requirements of s75 OR The go-ahead to the property development without the rezoning approval amounts to non-compliance with the local authority's (Municipal) regulations and by-laws and therefore creates a self-interest threat to professional behaviour since these actions are non-compliant with laws and regulations. There is a self-interest threat to professional behaviour because Delien should comply with laws and regulations.	1 1 ½ ½
7	This means that the financial director (as a senior public accountant in business) must have complied with the NOCLAR provisions in terms of ET260. However, this was not followed as she is part of the non-compliance and consequently, she should respond by following these requirements to address the threat as per the guidance in in section 220.8 and 220.9 of the Code.	1
Preparation and presentation of information (s220)		
8	Conversion costs of buildings incurred to increase occupancy rates Delien requested the financial manager to deduct the entire amount of R8,574 million as repairs incurred in the production of income during the current year of assessment. The nature of the costs should be analysed to determine whether it is capital expenditure vs revenue expenditure incurred in the production of income.	1
9	Delien's request, therefore, to the financial manager to deduct the possible capital expenditure as expenditure incurred in the production of income is creating a self-interest threat to her integrity, because	½ ½
9.1	the instruction to deduct these costs as expenditure is intended to mislead SARS and is therefore further creating a threat to Delien's integrity as this is not honest.	1
10		
Section 220.4 section requires professional accountants to prepare financial information in accordance with the relevant framework		
11	Delien did not comply with IFRS as – <ul style="list-style-type: none"> • the amount owing in the next 12 months are to be recorded as current liabilities; and • abnormal costs were not expensed but instead capitalised. 	1
	This creates a self-interest threat to integrity and professional behaviour	½ ½ ½
	Delien's unwillingness to change the classification in the AFS relating to the current portion of the lease liability, where it will negatively impact ratios, means she is not preparing and presenting fair financial information . This may also disguise a breach of loan covenants and is not dealing fairly and with truthfulness .	1 1

Pressure to breach the fundamental principles (s270)		
12	Delien, who is the financial manger's superior , is providing instructions to the financial manager to make the incorrect deductions on the tax return and therefore pressuring him to include incorrect tax deductions on tax returns.	1
13	The CoPC provides that a CA is not allowed to put pressure on others to breach the fundamental principles. This is an self-interest / intimidation threat to professional behaviour and integrity ,	½ ½ ½
	This instruction violates the provisions of the Income Tax Act (deduction of expenses not incurred in the production of income per s11a) and as she is pressuring the financial manager to provide misleading information to the tax authorities.	1
Available		21
Maximum		10
<i>Communication skills – appropriate style</i>		<i>1</i>
Total for part (e)		11
Total for part I		53