

Ignore value-added tax.

## 1 Background

Imfundo (Pty) Ltd ('Imfundo') is a company based in South Africa that offers high quality short courses to both companies and individuals. Imfundo's vision and mission are to build sustainable education models that will contribute positively towards taking the country forward during the digital transformation brought about by the Fourth Industrial Revolution (4IR).

Imfundo offers courses on, amongst others, coding, artificial intelligence (AI) and big data analysis. The courses are delivered in high-tech lecture venues.

You are the newly appointed junior business advisor at Imfundo and you are assisting the management team with various strategic decisions that need to be made. Imfundo has a 31 December financial year end. Its financial statements are prepared in accordance with International Financial Reporting Standards (IFRS).

Imfundo experienced a decline in the number of attendees in FY2020 because of the effect of the Covid-19 pandemic, such as lockdown restrictions, fear of face-to-face classes and restrictions on class sizes. However, Imfundo was already reporting a decline in its short course programme revenue and overall profits as a result of increasing competition in the market even before the lockdowns.

Imfundo applied for a loan during the financial year ended 31 December 2020 (FY2020) in terms of the Covid-19 loan guarantee scheme that was implemented by National Treasury. The proceeds from the loan enabled Imfundo to cover operating expenses, as revenue declined significantly in FY2020.

The board of directors is concerned about cost management, the company's revenue model and the business strategy, and has realised that a radical change is needed to ensure that the company returns to profitability. The board is considering two alternatives in this regard.

### Alternative 1: Online courses

The majority of Imfundo's competitors transitioned to online courses during Covid-19 to remain profitable. If this alternative is adopted, Imfundo would transition fully to online courses. Management is of the view that this would result in significant cost savings for the company.

To facilitate the potential move to the provision of online courses, Imfundo would need to develop and create an online portal. A detailed investigation would have to be undertaken to confirm management's view on such a transition. Management has noted that FY2020 cannot be used as the starting point for estimating profits from online courses, because of FY2020's 'abnormal' circumstances. Rather, FY2019 should be used as the base year for the analysis.

The following financial information is available for the analysis:

<b>Extract from the management accounts for the year ended 31 December</b>			
	<b>Notes</b>	<b>2019</b>	<b>2020</b>
		<b>R'000</b>	<b>R'000</b>
Course fees	1	24 000	1 600
Subsidies and grants	2	10 000	667
Interest and dividends		600	500
Rental income	3	550	350
		35 150	3 117
Invigilation costs	4	(150)	(50)
Employee costs – facilitators	5	(6 750)	(6 750)
Employee costs – administration	6	(4 800)	(4 800)
Finance costs – including Covid-19 loan guarantee scheme		(100)	(350)
Head office building costs	7	(500)	(500)
Lecture venue building costs	7	(1 000)	(1 000)
Software – amortisation		(50)	(50)
Other costs	8	(100)	(30)
Net profit/(loss)		21 700	(10 413)

### Notes

- 1 The following course fees were received from candidates who had registered for Imfundo's courses:

	<b>2019</b>	<b>2020</b>
Average course fee	R8 000	R8 000
Number of candidates	3 000	200

It is estimated that, if Imfundo moves to the delivery of online courses, it could offer a discount of 30% of the average course fee to candidates, as a result of cost savings. The number of candidates is forecast to increase to 2 000 in FY2021. Although the online environment would also provide opportunities for candidates outside South Africa to register for Imfundo's courses, this possibility has not been incorporated in the forecasts.

Imfundo currently offers courses that conclude with a final written assessment as proof of successful completion of a course. There is only one assessment per course. The duration of all assessments is two hours.

The company is considering two other offerings for its courses:

- A fee that excludes the cost associated with writing a final assessment, to provide flexibility for candidates who want to complete the course and not necessarily write the assessment immediately; or
- A fee for a final assessment as a stand-alone component for candidates who are not successful in their first attempt of the assessment.

If a multiple pricing model is followed, the following number of enrolments are anticipated for FY2021, together with the proposed course fees:

<b>Pricing model</b>	<b>Price</b>	<b>Number of enrolments</b>
Course and assessment	R5 500	1 500
Course only	R5 000	900
Assessment only	R800	500

- 2 Subsidy funding from the Department of Higher Education and Training is based on the number of candidates who has not only enrolled but also passed an assessment on their first attempt (throughput percentage). The throughput percentage is expected to remain the same despite the decreasing enrolments of candidates. The subsidy funding would consequently reduce in the same proportion as the anticipated decline in the candidate numbers.
- 3 An insignificant portion of the lecture venue building is let to various small vendors. The vendors sell a range of products to employees and candidates that visit the premises, including stationery, textbooks and snacks.
- 4 In order to obtain a course certificate each candidate is required to complete and pass an assessment at the end of each course. At present, candidates write assessments in a venue in which invigilators are present to physically monitor candidate behaviour. The invigilation costs in FY2020 and FY2019 relate to the fees paid to these invigilators.

If Imfundo decides to switch to online courses, it will no longer require invigilators. However, it will have to invest in proctoring/invigilating software in addition to the existing software that is used for other functions. The proctoring software is needed to manage the risk of dishonesty when candidates write the assessments online, as there are no invigilators to monitor behaviour online. Proctoring software confirms a candidate's identity and identifies any suspicious behaviour of candidates during the assessment. It locks the computer and web browser of the candidate so that the candidate cannot open new tabs, applications (apps), Windows programs, etc., while the assessment is being written. The software provides a detailed candidate behaviour report after each assessment.

A third-party proctoring provider has provided the following quote:

<b>Number of candidates for proctoring</b>	<b>Charge per hour</b>
	<b>R</b>
The first 1 000 candidates	68
For candidate 1 001 to candidate 2 500	50
For candidate 2 501 and above	45

- 5 Imfundo's team consists of 15 well-trained facilitators. These facilitators provide resources, monitor progress and support students in the acquisition, retention and application of knowledge and skills. All 15 facilitators will be retained if Imfundo switches to the online delivery of courses.
- 6 The company has 50 permanent employees based at its head office. These include a marketing team, administration (admin) team (applications and registrations), material

development team, assessment team (administering and marking of assessments and capturing of marks), an operations and finance team, and an information technology team. Imfundo management has been considering whether a reduction in the number of employees would result in cost savings given the change in business model to the delivery of online courses. The employees have been engaged at length on the proposal to retrench some admin staff. The majority agreed that all staff would take a salary cut of 20% rather than some of the staff being retrenched. The board approved the salary cut and views this as an interim solution to assist in returning Imfundo to profitability.

- 7 The costs for the buildings include depreciation, maintenance, cleaning and security costs.
- 8 Variable printing costs of course content is included in other costs. Imfundo will not incur these printing costs if it moves to online course delivery as candidates would receive digital copies of the material. The remaining costs are fixed and expected to remain the same.
- 9 All costs that are not specifically referred to in the notes will remain consistent with FY2019 levels.
- 10 Material prepared for the venue-based delivery method cannot be directly converted to a digital format, as the material may be summarised and require additional explanation. An online education specialist would need to be contracted to re-design the material content to suit the online environment. The specialist will charge R1 800 per hour and will need 40 hours to review the material.
- 11 Imfundo is considering the development of an app that could be downloaded by a user to a mobile device, as part of its online offering. This would make it easier for candidates to access the material and to interact with their peers and facilitators. Imfundo has not yet determined what such an app would cost.

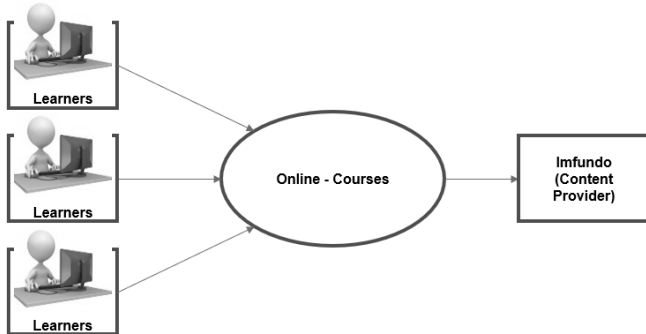
### **Alternative 2: Starting a platform business**

The board of directors would like to explore one of the platform business models followed by companies such as Airbnb, Uber and Taxify. The company would then create a platform that connects candidates with a wider range of digital content providers. They are unsure how this would compare to the online course delivery strategy and whether this would bring about more risks than opportunities for Imfundo.

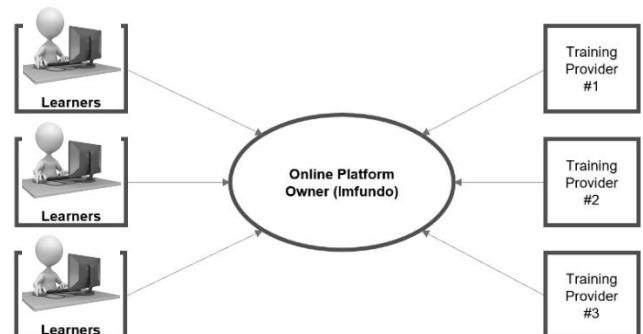
The chief financial officer (CFO) of Imfundo, Lili Meinhart CA(SA), agreed to undertake research on this type of business model and provide some more insight to the board.

Lili has prepared the following diagram on differences between the online model and platform business model:

Online model\*



Platform business\*\*



- \* For the online model, Imfundo would have to move its current business model from a venue-based person-to-person course delivery system to an online delivery system of courses.
- \*\* For the platform business model, Imfundo will own and administer the platform and connect candidates with multiple content providers and will earn a fee for providing this service.

Lili found the following information excerpts on the internet after doing some research on platform businesses:

*'So, what is a platform business?*

*What we mean with a platform business is a business model (not a technology infrastructure) that focuses on helping to facilitate interactions across a large number of participants.*

*The role of the platform business is to provide a governance structure and a set of standards that facilitate interactions on a much larger scale.*

*Traditional training businesses own and deliver the content to learners. The platform training business model does not own the content, but rather creates and facilitates the connection between the learners and content providers/owners.'*

Lili has also come across research that shows the complexity of the platform business and warns against the current hype. She read this in a media report:

It's really easy to look at companies like Uber and say, 'Look at these wildly successful businesses!' but forget all the people who tried to do similar things and failed. New rules and legislation are increasing as platform companies are using anti-competitive tactics to maintain and extend monopolies. Few platform businesses have fully considered how the growing regulatory risks could impact their business models and potentially derail their businesses.

## 2 Sale of lecture venue building

Given the impact of Covid-19 and the need for the company to redefine its business model and strategy, and based on the low level of utilisation of the building during FY2020, Lili proposed that the lecture venue building be sold as soon as possible. Part of the head office building could be converted to lecture venues if Imfundo decides not to offer online courses.

On 30 November 2021, the board of directors approved the proposal and started the advertising process immediately. All criteria for classification as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* were met on 30 November 2021.

The building was acquired on 30 November 2018 at a cost of R7,5 million. The value of the land is insignificant. The building was available for use as intended by management immediately and is accounted for in accordance with the cost model of IAS 16 *Property, Plant and Equipment*. The building is depreciated on a straight-line basis over an estimated useful life of 20 years and has an insignificant residual value.

On 31 December 2020, an impairment loss of R1,5 million was recognised in respect of the building in accordance with IAS 36 *Impairment of Assets*. The loss was ascribed to the substantial reduction in course revenues due to Covid-19 as well as the general move in the market to online course offerings.

The details of the fair value and costs to sell are as follows:

	Fair value	Costs to sell
	R'000	R'000
30 November 2021	4 750	500
31 December 2021*	5 000	525

\* The fair value has subsequently increased because residential property is in high demand and property developers are converting office space into residential units. Imfundo's property is in a prime location for residential use.

## 3 Investment in Senza

Imfundo had done some research and found that companies that supplied do-it-yourself (DIY) equipment reported an increase in profits during FY2020. This was attributed to the increase in home renovations that took place during the lockdown periods, with people converting areas in their homes into dedicated office spaces. As a result, Imfundo decided to invest in Senza Konke (Pty) Ltd ('Senza'), a manufacturer and supplier of DIY equipment, to diversify its revenue streams.

On 30 September 2021, Imfundo obtained control over Senza by acquiring 80% of Senza's issued ordinary share capital. The purchase price for the 80% controlling interest consisted of the following:

- A cash payment of R3,5 million. The cash payment was payable in two equal instalments, with the first instalment payable immediately and the second instalment payable on 30 September 2022. Costs relating to the acquisition of R20 000 were incurred.

- The issue of ordinary shares in Imfundo with a fair value of R500 000 on the date of acquisition.
- An additional contingent payment of R550 000 if Senza's profits are 5% higher than the forecast in the valuation model. The fair value of the contingent consideration was estimated to be R495 000 on 30 September 2021 and R270 000 on 31 December 2021.

Senza's CFO provided the following information relating to the assets and liabilities of Senza on the date of acquisition:

<b>Statement of financial position of Senza at 30 September 2021</b>		
	<b>Notes</b>	<b>R'000</b>
<b>Assets</b>		
<b>Non-current assets</b>		
Land	a	900
Factory building	a	4 500
Plant and equipment		300
<b>Current assets</b>		
Inventories	a	750
Cash and cash equivalents		300
Trade and other receivables		350
<b>Total assets</b>		<b>7 100</b>
<b>Equity and liabilities</b>		
<b>Total equity</b>		
Ordinary share capital		350
Retained earnings		4 805
<b>Non-current liabilities</b>		
Long-term borrowings		1 200
Deferred tax		50
<b>Current liabilities</b>		
Trade payables		445
Provisions		250
<b>Total equity and liabilities</b>		<b>7 100</b>

## Notes

- (a) The fair value of assets in the statement of financial position is equal to their carrying amounts, except for the following:
- Land = R1,25 million
  - Factory buildings = R4,6 million
  - Inventories = R760 000.
- (b) Senza continuously looks for ways to improve its business and the products being offered to the public. The company invested in internal research and innovation in the DIY space to assist clients with DIY ideas for their projects. The objective had been to publish the ideas as part of strategic marketing for the company. The expenditure to date was expensed by the company. At 30 September 2021, the research output could be sold for R45 000 or transferred to an interested party. The amount of R45 000 is not deductible for tax purposes.

- (c) During October 2021, Senza was in the process of entering into a contract to deliver DIY equipment to an overseas buyer. It was highly probable that the contract would have been signed during October 2021. The fair value of this contract was R800 000 as at 30 September 2021.
- (d) Senza owns a database, used in managing its loyalty scheme, which captures information on customer demographics, preferences, relationship histories and past buying patterns. The database cannot be sold or licensed due to regulatory laws. The fair value of the database was R500 000 as at 30 September 2021.
- (e) Senza is involved in a legal dispute with a customer who complained that a series of carports they built, based on a DIY idea obtained from Senza's website, collapsed. The customer sued Senza to recover the costs incurred in building the carports. Senza did not include a note on the company's website stating that it will not be held liable for any of its ideas, suggestions or advice that do not work as indicated. However, Senza's legal team has indicated that it is highly unlikely (constituting a 10% probability) that a court of law would uphold the customer's claim. The fair value of Senza's obligation was estimated to be R150 000 as at 30 September 2021.

Senza measured the non-controlling interest at its proportionate share of the identifiable net assets.

An appropriate pre-tax discount rate is 15% per annum, compounded annually.

The tax rate is 28% and the inclusion rate for capital gains is 80%.

#### **4 Development of a new course**

Imfundo was approached by the Law Society of South Africa to develop a machine-learning course for its members. Imfundo is not familiar with this specific area. The material development team, in collaboration with the facilitators of the course, were tasked with determining whether this project should be pursued. Lili reminded the team that Imfundo was under significant financial pressure and they should endeavour to 'make this happen by any means necessary'.

The Material Development (MD) Team then presented the following to the board for consideration:

*The Law Society request can be met at minimal cost based on the research the MD Team has undertaken. The MD Team was able to identify two providers that offer similar courses. A cousin of one of the team members has registered for one of the courses and we can download the content and use it as our own course. We could simply add our logo to the material and remove the other provider's logo. This would entail minimal costs for material development.*

*This would save time and money for the company!*



**INITIAL TEST OF COMPETENCE, JUNE 2022  
PROFESSIONAL PAPER 4**

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

<b>PAPER 4 PART I – REQUIRED</b>		<b>Mark</b>	
		<b>Sub-total</b>	<b>Total</b>
(a)	Prepare a report to the Imfundo board of directors in which you provide the following (ignore the effects of inflation and all forms of taxation):		
	(i) A projected annual profit and loss statement related to offering the online courses (alternative 1). <ul style="list-style-type: none"> <li>• Use FY2019 as the base year for your calculations.</li> <li>• Briefly motivate any amounts omitted from your calculations.</li> <li>• With respect to the potential sale of the lecture venue building, ignore any profit or loss that may arise.</li> </ul>	18	
	(ii) Any other eight key factors the board should consider prior to embarking on this new business model.  <i>Communication skills – layout and structure</i>	16  1	35
(b)	Describe the key business risks and potential opportunities that arise from the initiative to start a platform business (alternative 2) that the Imfundo board of directors should consider in evaluating this potential business strategy.  <i>Communication skills – logical argument</i>	8  1	9
(c)	Discuss, with regard to Imfundo’s decision to pursue the development of the machine-learning course for the Law Society:		
	(i) Two ethical concerns and two business risks; and	4	
	(ii) Any actions Imfundo should take to mitigate any such concerns and risks.  <i>Communication skills – clarity of expression</i>	4  1	9
<b>Total for part I</b>			<b>53</b>

**INITIAL TEST OF COMPETENCE, JUNE 2022  
PROFESSIONAL PAPER 4**

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

<b>PAPER 4 PART II – REQUIRED</b>		<b>Mark</b>	
		<b>Sub-total</b>	<b>Total</b>
(d)	Prepare the journal entries to account for the lecture venue building in the financial statements of Imfundo for FY2021. <ul style="list-style-type: none"> <li>• Provide dates for journal entries.</li> <li>• Exclude journal narrations.</li> <li>• Ignore current and deferred taxation, and capital gains tax.</li> </ul>	12	12
(e)	Prepare the note for the acquisition of Senza in the consolidated financial statements of Imfundo for FY2021 in terms of IFRS 3 <i>Business Combinations</i> and indicate, as part of the note disclosure, any missing information required for complete disclosure. <ul style="list-style-type: none"> <li>• Assume all missing information is material.</li> </ul> <p><i>Communication skills – presentation; layout and structure</i></p>	33	35
<b>Total for part II</b>			<b>47</b>
<b>Total for the question</b>			<b>100</b>