

IGNORE TAXATION**1 Background**

Chokaroo (Pty) Ltd ('Chokaroo'), a medium-sized, family-owned business established in 2018, manufactures luxury chocolates.

Chokaroo operates a chocolate-making facility from its premises in Beaufort West and supplies products to retailers and distributors both locally and in Europe. Chokaroo also sells its chocolates from a farm stall located on the same premises. In addition, it sells 'reject' chocolates at discounted prices directly to the public. 'Reject' products have minor defects only, do not differ in taste from the standard products, and are safe for consumption.

The company sells a range of chocolate products, including chocolate bars, succulent-infused chocolates, and chocolate truffles. The company's most popular products are chocolates that are infused with Karoo succulent plants that are indigenously known for their medicinal properties. As a result, Chokaroo specifically markets the health and medicinal benefits of consuming its chocolates, despite not having tested these products for these benefits.

Chokaroo plans to operate as a public company by the end of June 2023 and to list on the Alt-X in the future. For these reasons, the company has launched several initiatives to improve its corporate governance practices.

The Winston family members own 63% of the issued shares in Chokaroo, while the balance is owned by foreign investors.

2 Employees and local footprint

Chokaroo employs many local people from the Beaufort West area, which has a high unemployment rate. Temporary employment increases during holiday periods when travellers passing through the town stop at Chokaroo's farm stall.

Outside holiday periods, Chokaroo employs approximately 200 employees at its chocolate-making facility and farm stall. Employees earn market-related remuneration and are required to belong to the company's retirement fund. Chokaroo contributes 7,5% of the employees' basic salaries to the fund while the employees contribute 2,5%. The remuneration package includes a 13th cheque payable on 31 December every year. The company must be audited in terms of the Companies Act of 2008.

Chokaroo has three executive directors, namely Dave Winston (chief executive officer (CEO)), Sheryl Winston (chief financial officer (CFO)), and Marcia Winston (chief marketing officer (CMO)). Dave and Sheryl are married, and Marcia is their daughter. Directors are also required to belong to the company's retirement fund and Chokaroo contributes 7,5% of the executive directors' basic salaries to the fund while the directors contribute 2,5%.

Chokaroo subscribes to the 'buy local programme' in Beaufort West. The company accordingly provides each of its permanent employees below management level with a shopping voucher of R300 per month to spend at any of the local businesses.

3 Audit considerations

You are a third-year trainee accountant employed at Technica Inc. ('Technica') and were assigned to the audit of Chokaroo for the year ended 30 September 2022 (FY2022). The engagement partner on the audit is Sandy Biyase CA(SA), RA. It is the first time that Technica has audited Chokaroo, after having been appointed in May 2022.

3.1 Engagement partner's visit to Chokaroo

Sandy attended a board meeting of Chokaroo in Beaufort West in April 2022 at which the board discussed, amongst others, the appointment of Technica as the new auditor for the company. Extracts from the minutes of this board meeting are attached as appendix A.

3.2 Matters relating to trainees

In November 2022, you and two junior trainee accountants, Fundiswa Makwe and Alouise Booysen, went to Chokaroo's premises for a week to gather audit evidence. While there, you all had to complete a compulsory online training course about recent updates to International Financial Reporting Standards (IFRS). This forms part of the Technica trainee curriculum. The instructions stated that all audit staff had to complete an online test after completing the course and explicitly stated that no sharing of answers was allowed. Before you completed the training and the online test, Fundiswa and Alouise suggested the following to you:

We were able to obtain the correct answers to the test from a fellow trainee who has already completed the course. It will save us a lot of time if we all simply complete the test using these answers and we won't have to undertake the training course itself. Besides, the audit firm won't know!

You declined to take part in this, but you are aware that Fundiswa and Alouise did follow this suggestion.

While at Chokaroo, Fundiswa came up with the idea of presenting an information session to the accounting staff of Chokaroo based on some of the knowledge he obtained from the above IFRS-related online training course assessment. He realised that Chokaroo's accounting staff were having difficulties with the implementation of some of the IFRS requirements. Fundiswa also designed a few practical examples that the accounting staff could work through. He based the examples on actual financial information of other Technica audit clients to which he had previously been assigned.

Fundiswa asked you for your opinion about his 'course' and examples before presenting it to the client's accounting staff. He planned to end his presentation with a 'questions and answers' session during which he would assist the accounting staff with processing specific general journal entries relating to Chokaroo's 2022 financial year end. He felt this would make the presentation as practical as possible.

3.3 Matters relating to the audit engagement

During the week you spent on the audit at Chokaroo's premises, you made several unsuccessful attempts to contact the audit manager, Jason Lewis CA(SA). Eventually, you emailed the queries you wanted to discuss to him and reminded him of the workpapers he had to review. These all required professional judgement.

On the second-last day of your time at Chokaroo's premises, Jason sent you a WhatsApp message in which he apologised for not having returned your calls or answering the queries raised in your

emails. His message stated that he was extremely busy with other audits due to a shortage of audit managers. He promised that he would review the work papers remotely that evening and have answers for you by the next day. The next day you realised that Jason must have worked well into the night, but barely provided any 'review comments' on the work the audit team had carried out. He also informed you telephonically that he would 'trust you to exercise your own professional judgement' on the queries in the emails you sent him.

3.4 Chokaroo hampers and vouchers delivered to the audit team

While working on the completion phase of the audit from Technica's Cape Town office, the audit team members, and the engagement partner, each received a Chokaroo luxury chocolate hamper and a voucher to spend at its online store. A note from Chokaroo's management read: '*Thank you for the valuable work you are undertaking on the 2022 audit of Chokaroo! It does not go unnoticed.*'

4 Details relating to Chokaroo's chocolate manufacturing operations

4.1 The manufacturing process explained

The manufacture of chocolate takes place by means of several consecutive processes:

The roasting process: This is the first process, in which cocoa beans sourced from a supplier in Tanzania, in standard-sized bags each weighing one tonne (i.e., 1 000 kg), are roasted. The beans are roasted at a high temperature to develop the flavour of the cocoa beans and to 'puff them up' before the next process. Chokaroo roasts one tonne of cocoa beans each time the process is undertaken. Its five roasting machines (each roasts 20 kg of cocoa beans at a time) operate simultaneously with roasting taking 20 minutes to complete. Roasting results in a negligible change in the weight of the cocoa beans.

The separation process: The roasted cocoa beans are transferred to winnowing machines (Chokaroo has eight of them). These machines are used to separate the cocoa bean shells from the cocoa bean nibs and, through a series of sieves, remove the shells. Each machine processes 150 kg of roasted cocoa beans per hour. The weight of the cocoa bean shell is 20% of the weight of the cocoa bean. The cocoa bean shell is a by-product of the separation process. Chokaroo has an off-take agreement with a fertiliser manufacturer who buys the entire quantity of the by-product at a fixed price of R2 966 per tonne.

The refining and grinding process: The cocoa bean nibs are then placed into a refining machine known as a chocolate mill (Chokaroo has ten such mills). These mills make use of grinders to generate heat to melt the cocoa bean nibs. Each mill takes 72 hours to complete this process. Sugar is gradually added to the mixture (two parts of melted cocoa beans to one part of sugar) during the process, which yields a mixture known as cocoa liquor.

The pressing process: The hot cocoa liquor mixture is pumped into Chokaroo's hydraulic press. During this process, high pressure is applied resulting in cocoa butter (a by-product) and a cocoa liquor mass being split off on completion of the process. At that point, the quantity of cocoa butter is 50% of the cocoa liquor mixture (excluding the weight of the sugar that was added). This process takes approximately 90 minutes. The cocoa butter is then stored at room temperature and slowly hardens.

The conching process: At the start of this process, solid cocoa butter is heated until it melts. One part cocoa butter is required for every 5,67 parts of the cocoa liquor mixture. Soy lecithin is stirred into the melted cocoa butter to stabilise the mixture, with 0,1% of the weight of the mixture at that

point being added in the form of soy lecithin. This part of the process takes 45 minutes to complete. Soy lecithin currently costs R195 per litre.

Milk powder can be added at this point should milk chocolate be manufactured and flavourants (such as the succulent infusions) can also be added to the mixture. This part of the conching process takes 48 hours to complete.

Tempering process: During the tempering process, the mixture is first heated and then the temperature is immediately reduced. The tempering machines each have a capacity to temper 5,5 kg of the chocolate mixture input. Tempering takes 15 minutes to complete.

After tempering, the chocolate mixture is ready for moulding into chocolate bars or chocolate truffles.

4.2 Budgeted annual manufacturing overheads

The following spreadsheet reflects the budgeted manufacturing overheads for FY2022 for all the processes and related activities, with the exception of the moulding and wrapping processes:

Process	Annual activity	Total cost (budgeted)
		R
Roasting	800 roasting hours	5 142 363
Separation (winnowing)	320 winnowing hours	8 242 800
Refining and grinding	34 560 grinding hours	29 571 124
Pressing	72 pressing hours	1 998 689
Conching	2 340 conching hours	5 018 028
Tempering	2 064 tempering hours	11 807 704
Total manufacturing overheads (excluding the overheads from the moulding and wrapping processes)		61 780 708

4.3 Details relating to the manufacturing operations for the last production week of FY2022

At the start of this week, the raw materials inventory included 250 kg of cocoa beans valued at R9 622,95. One tonne of cocoa beans at a landed cost of USD2 269 was received from the Tanzanian supplier just before the chocolate manufacturing process commenced.

During the morning of day 1 of this week, one tonne of cocoa beans was introduced into the roasting process. The operations manager decided to manufacture only dark chocolate that week and accordingly did not add milk powder to the mixture.

The operations manager further decided that 20% of the completed chocolate mixture, which had been transferred to the moulding process, was to be allocated to making chocolate truffles. Of this quantity, 40 kg were to be used to make a new chocolate truffle containing a cream liqueur. The liqueur is purchased in 750ml bottles at a discounted price of R119,20 per bottle.

Production process for cream liqueur truffles: Moulding staff members use paintbrushes to coat the sides of a mould with a small amount of the chocolate mixture. Each mould tray contains several round mould forms. The moulds are then allowed to cool. The liqueur is heated at a low heat for 10 minutes to reduce its alcohol content, resulting in the evaporation of 10% of the liqueur. 2,5ml of this heated liqueur is added per 5g (5ml) of the chocolate mixture and stirred to mix, then cooled for two hours before being piped, using a piping bag, into the chocolate-coated mould. Thereafter the individual moulds are covered with a layer of chocolate. The chocolate content, excluding that used to make the filling, is 5g per cream liqueur truffle. During the truffle-making process, there is a spillage of 15% of the chocolate transferred for the truffle-making.

4.4 Further notes relating to inventory and/or production

- 1 Inventory is valued on a first-in-first-out basis.
- 2 Labour costs are considered to be a fixed cost.
- 3 The USD : ZAR exchange rate at the point where the risks and rewards relating to the delivery of the consignment of cocoa beans were transferred, was USD1 : ZAR16,950.
- 4 The cost of sugar is R79 per kg.
- 5 There are 48 production weeks per annum. Each production week equals one full chocolate-making process.
- 6 The conversion cost of the chocolate truffles in the moulding division amounts to R0,57 per individual chocolate truffle.

APPENDIX A

Chokaroo (Pty) Ltd

Extracts from minutes of a board meeting held on 15 April 2022

In attendance

- Dave Winston CEO
- Sheryl Winston CFO
- Marcia Winston CMO
- Godfrey Mabasa Non-executive director and chairman
- Yolanda Dreyer Non-executive director
- Simon Tshivhase Non-executive director

In attendance by invitation

- Herman Strydom Company secretary
- Sandy Biyase Audit engagement partner (Technica)

Apologies

- None

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2 Feedback from board committees

The following feedback was received from Chokaroo's two board committees.

2.1 Audit committee

Yolanda, as chairperson of the audit committee, provided the following feedback regarding the activities of the audit committee:

2.1.1 Activities of the committee

The committee, consisting of Yolanda Dreyer, Simon Tshivhase and an independent member, Alex Mothupi, had a meeting on 15 March 2022. The committee reviewed the audit committee charter and agreed that the committee would continue to meet three times per year, in January, June and October.

2.1.2 Appointment of new auditor

Yolanda informed the board that the previous auditor, RTH Inc. ('RTH'), was dismissed in March 2022 because the executive directors were not satisfied with RTH's work. Dave stated that Chokaroo should sue RTH for having damaged Chokaroo's reputation and for not doing enough to ensure the financial statements were free of material misstatement. This was after RTH expressed a qualified audit opinion on the FY2021 financial statements of Chokaroo because of audit evidence that could not be obtained.

Dave had proposed that Technica be appointed to fill the vacancy and that Sandy be the engagement partner. The audit committee supported Dave's recommendation.

Yolanda noted that if Technica agrees to the appointment, a proposal would have to be submitted to the shareholders for approval. Sandy was excited by the proposal and thanked the board for the opportunity to serve as the company's auditor. She added that she was experiencing significant pressure to bring in more audit clients for her firm. Having Chokaroo would contribute significantly to the quality of her portfolio of audit clients.

Both Dave and Sheryl told Sandy that they looked forward to a prosperous professional relationship. However, the executive directors wanted the audit to take place in November 2022. They requested that all 'complex' audit queries about the financial statements only be addressed to the executive directors and not the accounting staff. Sandy responded that none of these requirements should pose any problems to Technica if it became the auditor of Chokaroo.

2.1.3 Deferred tax calculations

Sheryl would like the audit engagement team to perform the deferred tax calculations for Chokaroo's 2022 financial year during the year-end audit. Sandy replied that this would be a great opportunity for the trainee accountants to apply their technical skills.

RESOLVED: The board approved the appointment of Technica as auditor of Chokaroo.

2.2 Remuneration committee

Simon, who is the chairperson of the remuneration committee, provided the following feedback on the activities of the remuneration committee:

2.2.1 Activities of the committee

The committee, consisting of Simon Tshivhase, Yolanda Dreyer, and Godfrey Mabasa, had a meeting on 28 March 2022. The committee reviewed the remuneration committee charter and decided that the committee would continue to have meetings in January and September of each year.

2.2.2 Salary and fee increases

The committee recommended a salary increase of 5% for all employees, except for executive directors who would receive a 4% increase in their basic salaries, effective on 1 June 2022. An additional increase of 4% was allocated to Marcia, as the company's sales increased by 40% during the first half of the year due to the marketing efforts of Marcia and her team. From 1 June 2022, Dave and Sheryl will each earn a basic salary of R112 320 per month and Marcia will earn R92 232 per month. The executive directors are not entitled to a 13th cheque and there is currently no incentive scheme in place. Such a scheme may be considered in the future.

The annual fees of non-executive directors will remain at R30 000 each.

A new meeting fee of R8 000 per meeting (R16 000 for the chairpersons of the respective committees) for attendance of each of the four board meetings and any board committee

meetings will be paid to all non-executive directors. These additional fees will be back-dated to 1 October 2021.

Executive directors are not paid any fees for attending board committee meetings.

RESOLVED: The proposed salary and fee increases were approved.

3 New Swiss chocolate truffle-making machine

The three executive directors travelled to Switzerland in February 2022. Marcia's husband, who is not involved in Chokaroo's business, accompanied them on the trip. The purpose of the visit was to investigate the possibility of acquiring a chocolate truffle-making machine to replace the manual chocolate truffle-making process currently in place. The total cost of the visit for all four people amounted to R291 552.

Another trip is planned for November 2022, for the CEO and CFO to purchase the new machine. They both indicated that it would not be easy for anyone to reach them while they were away, as they planned to undertake a variety of outdoor leisure activities.

RESOLVED: The cost of R291 552 spent on the February 2022 trip to Switzerland was approved and was to be allocated to travel expenses.

4 Loan guarantee for Marcia Winston

Marcia requested the board to provide a guarantee for a home loan for a holiday home she purchased. The amount of the loan is R2 million and the bank, Better Bank, is willing to grant the loan to Marcia at a discounted rate of 5% if the loan is guaranteed by her employer. Should Chokaroo not provide the guarantee, Marcia will pay an interest rate of 11% on the loan. The guarantee will be effective from 1 May 2022 for a period of 20 years.

RESOLVED: The guarantee to Better Bank was approved.

5 Report of environmental concerns in the Karoo

Herman submitted a government report dealing with the illegal 'poaching' of succulent Karoo plants. Sheryl acknowledged that Chokaroo was paying local unemployed people to find and pick succulents for use in the chocolate-making process. Sheryl believed Chokaroo supports the local community economically in this way.

RESOLVED: The matter is to be discussed at the next meeting.

6 Investigation into false marketing practices

Herman reported that a member of the public submitted a complaint to the relevant ombudsman about Chokaroo's products. The complaint alleges that Chokaroo is making false claims about the health and medicinal benefits of its chocolates. Marcia stated that the marketing of the company's products is similar to how supplements at pharmacies are marketed, despite these supplements having no laboratory-tested benefits.

RESOLVED: The matter is to be ignored.

INITIAL TEST OF COMPETENCE, JUNE 2023

PROFESSIONAL PAPER 3

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

PAPER 3 PART 1 – REQUIRED		Marks	
		Sub-total	Total
(a)	<p>Discuss, based only on the information in the scenario, the matters of concern that Technica should have considered before it accepted the audit engagement with Chokaroo for FY2022.</p> <ul style="list-style-type: none"> Do not address any safeguards or courses of action Technica should have implemented to address the concerns. <p><i>Communication skills – clarity of expression</i></p>	15	
		1	16
(b)	<p>Discuss the professional conduct of Jason, Fundiswa and Alouise in terms of the SAICA Code of Professional Conduct.</p> <ul style="list-style-type: none"> Do not address any safeguards or courses of action. <p><i>Communication skills – clarity of expression</i></p>	14	
		1	15
(c)	<p>Discuss any ethical concerns for Technica arising from the chocolate hampers and vouchers received by its audit team members.</p> <ul style="list-style-type: none"> Do not address any safeguards. 	6	
			6
(d)	<p>Prepare, based on the information in the scenario, the directors' remuneration note that should be included in Chokaroo's financial statements for FY2022 in accordance with the Companies Act of 2008.</p> <ul style="list-style-type: none"> Assume the directors attended all the meetings they were required to attend. Ignore comparative figures. <p><i>Communication skills – presentation</i></p>	18	
		1	19
(e)	<p>Describe the substantive audit procedures you would perform to obtain sufficient appropriate evidence regarding the loan guarantee granted to Marcia.</p> <ul style="list-style-type: none"> Do not include any procedures dealing with the accuracy or valuation of the guarantee. 	12	
			12
Total for part I			68

INITIAL TEST OF COMPETENCE, JUNE 2023

PROFESSIONAL PAPER 3

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

PAPER 3 PART II – REQUIRED		Marks	
		Sub-total	Total
(f)	Calculate the cost of the cream liqueur chocolate truffles manufactured during the last production week of FY2022. <i>Communication skills – layout and structure</i>	20 1	 21
(g)	Discuss the key considerations that should be taken into account when deciding on the purchase of the new Swiss truffle-making machine. <i>Communication skills – clarity of expression</i>	10 1	 11
Total for part II			32
TOTAL FOR PAPER 3			100