Part (d)	**Discuss the key considerations that the directors of Eurofix should take into account when deciding whether to replace 200 employees with robots in 2024**	**Marks**
1	The Board should consider the impact not only on the 200 employees, but also their **extended family members** (6 to 10 people per worker) – who will be losing an average income per employee of +/-R100 000 per annum.	1
2	Due to the large number of people affected by this proposal, the Board should consider the **negative impact** the decision would have on the socio-economic state of the **community** in which the workers live.	1
3	Since 200 of the 300 workers will be replaced, it will most probably adversely affect the **morale of the remaining 100 staff**, leading to poor job performance and/or loss of competent staff who may fear losing their jobs in the future.	1
4	The board should consider potential **reputational damage** to the company from public outcry when retrenching staff – customers may decide to boycott the company and rather support competitors.	1
5	The **trade unions** representing workers would most probably object to the replacement and institutes strikes / protest action.	1
6	The possible **strikes / protest action** may lead to production downtime and/or property damage, increasing Eurofix's going concern problems.	1
7	The board should consider the legal implications of retrenching employees – there could be disgruntled employees who will take Eurofix to **CCMA**.	1
8	At present the board is considering 2 options – replacing 200 employees with robots or liquidating the company. By replacing the 200 employees with robots, **100 jobs can still be saved**.	1
9	By not retrenching staff in favour of robots, the **saving of more than R4 million per annum in expenses will not be realised** and the company may find it even more difficult to survive.	1
10	The potential **cost of retrenchment packages** also needs to be taken into account in the decision. Can the company afford such a once-of cash outflow, considering it already has cashflow problems?	1
11	The wage cost saving does not consider the time taken to set up robots / customization to Eurofix's manufacturing / **cost of installation** / **training** of employees to operate robots / appointment of **new employees** to operate robots.	1
12	What are the **maintenance** / **insurance** costs of robots? Is this part of lease contract?	1
13	Consider that robots are subject to increased risks of manipulation / algorithim bias, theft and cyber-attacks, thus an increase in costs to **secure** the robots and to ensure the adequate functioning of the robots.	1
14	The board should consider the possibility of **breakdowns / malfunction** which can result in production downtime. On the other hand, **humans become tired and need holidays**, robots do not.	1 1
15	The robots will need to keep up with technology, therefore the costs of replacing or upgrading robots when **technology changes** should be considered, which may be more expensive annually than any training that was offered to staff.	1
16	The robots will most likely work with electricity – would the **cost of electricity** not wipe out the cost saving?	1
17	What happens during **load shedding –** necessary to invest in generators / electricity back-up devices in order to continue during load shedding / effect on production?	1
18	Robots are not owned, and the **lease may be cancelled** in future, leaving Eurofix unable to operate as normal / **reliance on third parties**.	1

19	The directors should also consider the **positive effect** the implementation of the robots would have on the **CO_2 emissions** of the group.	1
20	The reduction in CO_2 emissions would lead to – • improvement in the environment – **cleaner air and healthier community** • improvement in the **reputation** of the company as being concerned about the environment.	 1 1
21	This decision will also result in the **reduction of wastage** – which will reduce costs and losses of the company.	1
	Available	**23**
	Maximum	**8**
	Communication skills – appropriate style	*1*
	Total for part (d)	**9**

Part (e)	**Describe the substantive procedures that you expect Audibi Inc. to perform on the 2022 forecast information and relevant applicable notes, to obtain audit evidence about Eurofix's ability to continue as a going concern for the 12 months after the end of FY2021.** • **Include information relating to the subordination agreements in your answer.** • **Assume that all amounts are material.** • **Do not provide substantive procedures to audit the FY2021 actual results.**	**Marks**
1	Inspect the minutes of the board / audit committee / management meeting where the forecast (including action plans like the subordination agreement) was presented to ensure that is was **approved** and accepted.	1
2	By enquiry from the accountant / management, obtain an **understanding of the process** followed to prepare the forecast as well as the process to approve it.	1
3	Evaluate the competence and integrity of the **accountant** who prepared the forecast by: • inspecting his/her **CV**; confirming his/her **qualification(s)**; and considering his/her relevant **experience** in preparing such information; • comparing the forecasts prepared by the accountant in **prior years to the actual results** for those years to evaluate the effectiveness / reliability of the forecast prepared by the accountant.	1 1
4	**Recalculate the calculations** in the forecast OR confirm that all Excel calculations/formulae in the spreadsheet are indeed correct (electronically through CAATs).	1
5	Compare the line items of the previous forecast to the current year forecast / on a month-to-month basis to determine whether there are any material omissions / duplications / inconsistencies of items from the forecast (**analytical procedures**).	1
6	Compare the **FY2021 results** in the management report that were used in the preparation of the forecast with the actual audited figures to confirm that amounts used for the basis of the assumptions were accurate.	1
7	Compare the forecast (8% increase in sales and other items) for the period **July to (at least) October 2021 with the actual income and expenditures** for the same period to determine the reliability of estimates made in the forecast.	1
8	Perform the following on the **8% expected sales increase** assumption for FY2021: • Consult a **reliable outside source**, e.g. an economic expert, to determine whether the 8% is reliable / inspect the **international trend information** used by management. • Compare the 8% assumption with the **growth rate of the previous two years** to confirm reasonability of the estimated growth in sales. • Through discussion with management, question the reason why they believe **Covid-19** did not adversely affect operations and inspect supporting corroborative information to verify.	1 1 1
9	Perform the following in respect of the **other items** included in the forecast: • Perform a month-to-month analysis of **cost of sales** to sales (gross profit percentage) and follow up on any variances. • Recalculate **depreciation** and **finance charges** (confirm that the finance cost for the subordination agreement has been excluded).	1 1

	• Inspect the **rental contract** between Eurofix and Europrop to determine if the costs are accurate and that the relevant inflation has been included. • Review the AFS or financial results of the financial asset for accuracy and probability of the dividend (**investment income**); • Enquire of management as to the plausibility of not having **asset disposals** taking place during the forecast period and agree with the capital expenditure forecast / Obtain the **capital expenditure forecast** (including retail stores to be opened/closed/improvements) and confirm that this ties into the overall forecast budget and that the relevant assumptions have been included.).	1 1 1
10	Perform the following in respect of the **subordination agreements**: • Obtain the subordination agreements for each of the shareholders who have subordinated their loans and do the following: o Inspect that it is a valid binding legal document which has been **signed** by the applicable shareholder; o Inspect the **date** to confirm that the subordination agreements are already in place for FY2022; o If necessary, consult a **legal expert** to determine the validity of the subordination agreements; o Recalculate the **solvency and liquidity** of Eurofix to determine if the subordination agreement will improve the solvency and liquidity of the company; o Consider whether the backranking creditor is financially of **sufficient substance** to be in a position / has the **intention** to subordinate the debt (i.e. that that creditor is not itself not facing liquidation), by inspecting its latest annual financial statements / management reports (if available); o Confirm details of the subordination agreements directly with the respective of shareholders (**direct confirmation**).	1 1 1 1 1 1
11	Obtain the **cash flow forecast from management** indicating the expected cash flows, supporting calculations and assumptions used in the forecast. Inspect for the following: • All **revenue and expenses are translated into cash flows** (movement in debtors, creditors and inventory) taking assumptions into account and the relevant time in the year these are receivable / payable); • **Non-cash flow items** like depreciation have been excluded; • Inspect the cash flow budget month-on-month (if available) / for the year to ensure that the **net cash flow is more than the R15 million** (overdraft facility available for the next 2 years).	1 1 1 1
12	Enquire from the directors and inspect board minutes **after the financial reporting date**, to determine whether any additional information that should be taken into consideration has become available since the forecast was prepared / support the going concern forecast.	1
13	Obtain a signed **management representation letter** regarding the validity and completeness of the assumptions and estimates used in the forecast / management's plans for future actions, the feasibility thereof and the ability to continue as a going concern.	1
14	With permission of Eurofix, contact their **lawyers / legal counsel** and enquire of any possible litigation and claims that should be included in the forecast.	1
15	With permission from the client, **enquire from bankers and financiers** regarding terms, conditions and credit facilities available / Request a formal **written confirmation** of this from the bank and financiers.	1

16	For any **unusual fluctuations** in any procedure enquire to the relevant parties responsible / inspect corroborative supporting information to verify.	1
	Available	**31**
	Maximum	**14**
	Communication skill – clarity of expression	*1*
	Total for part (e)	**15**

Part (f) **Prepare the additional journal entries to account for the investment property and the lease with Eurotile in the separate accounting records of Europrop for FY2021.** • **Assume that the appropriate pre-tax discount rate is 15%.** • **Include journal entries relating to deferred taxation.** • **Ignore journal entries relating to current taxation.** • **Round all amounts to the nearest rand.** • **Do not provide journal narrations**	**Marks**
Crux: As the factory building (and the related land) meet the definition of an 'investment property' in terms of IAS 40 *Investment Property*, being land and a building held to earn rental income, and it is the accounting policy of the Eurotile group of companies to subsequently measure investment property at its fair value, **Europrop will have to determine the most appropriate fair value for the investment property in line with the guidance provided in IFRS 13 *Fair Value Measurement.***	

Calculation of fair value of investment property (as at 30 June 2021):

	FY2022	FY2023	FY2024	FY2025	FY2026	Marks
Lease income [(2 760 000 x 100/115) (½) x 1,04 (½)]	2 496 000	2 595 840	2 699 674	2 807 661	2 919 967	1
Operating costs [(1 104 000 x 100/115) (½) x 1,04 (½)]	(998 400)	(1 038 336)	(1 079 869)	(1 123 064)	(1 167 987)	1
Net lease income	1 497 600	1 557 504	1 619 805	1 684 597	1 751 980	
Applying inflation rate of 4% FY2023 – FY2026						1P
Proceeds on sale [5 750 000 (½) x 100/115 (½)					5 000 000	1
Net cash inflow					6 751 980	
Discount rate: 15%						1
NPV at 15%					7 865 107	1P

Calculation of fair value adjustment for FY2021:	**R**	
Fair value at 30 June 2021 (calculated above)	7 865 107	
Accrued lease income (R1 140 607 (½) + R63 089 (½))	(1 203 696)	1
Adjusted fair value	6 661 411	
Fair value at 30 June 2020 (given)	6 059 393	½
Fair value adjustment	602 018	

Journal entries

		Dr R	Cr R	
30/06/2021	Investment property (SoFP)	602 018		1P
	Fair value adjustment (P/L)		602 018	
	Recognition of fair value adjustment on factory building			
30/06/2021	Income tax expense (P/L)	278 517		1P
	Deferred tax (SoFP)		278 517	
	Recognition of deferred tax			

Deferred tax FY2021					
	Carrying amount	**Tax base**	**Temporary difference**	**Deferred tax**	
	R	**R**	**R**	**R**	
Building					
- Cost @ 28%	(½) 4 500 000	W1 2 250 000	2 250 000	(½) 630 000	1
- Fair value @ 22,4%*	W2 1 495 270	(½) -	1 495 270	(½) 334 940	1
Land @ 22,4%	W3 666 141	(½) 500 000	166 141	(½) 37 216	1
Lease accrual @ 28%	(½C) 1 203 696	(½) -	1 203 696	(½) 337 035	1½
Total liability				**1 339 191**	
Workings:					
W1: R4 500 000 – (R4 500 000 x 5% x 10 years) = R2 250 000					1
W2: (R6 661 411 (C) x 90%) – R4 500 000 = R1 495 270					1C
W3: R6 661 411 (C) x 10% = R666 141					1C
Movement in deferred tax FY2021				**R**	
Balance at 30 June 2021 (calculated above)				1 339 191	
Balance at 30 June 2020 (given)				1 060 674	½
Movement for FY2021				**278 517**	
				Available	**17½**
				Maximum	**15**
				Total for part (f)	**15**

Part (g)	Disclose all relevant information relating to the fair value of the investment property leased to Eurotile as it would appear in the notes to the annual financial statements of Europrop for FY2021, to comply with the requirements of IFRS 13 *Fair Value Measurement* in respect of non-financial assets. • Comparative information and accounting policy notes are not required. • Where the available information is insufficient, provide examples and/or details of information that you would include to complete the required disclosure in terms of IFRS 13.	Marks

Notes to the annual financial statements of Europrop (Pty) Ltd for the financial reporting period ended 30 June 2021		
22. Fair value measurement		
Fair value measurements at the end of the reporting period using significant unobservable inputs (level 3) *Par93(a, b)*		1
Description: *Recurring fair value measurements*		
Investment properties: Commercial – South Africa	R6 661 411	1P
	R6 661 411	
Fair value measurements using significant unobservable inputs (level 3) – reconciliation *Par93(e, f)*		
Investment properties	**South Africa**	
Opening balance	R6 059 393	1P
Total gains or losses for the period Included in profit or loss (other income) (1)	R602 018	1P
Closing balance	R6 661 411	
Change in unrealised gains or losses for the period included in profit or loss for assets held at the end of the reporting period	R602 018	1P

Quantitative information about fair value measurements using significant unobservable inputs (level 3) *Par93(d)*

Description	Fair value at 30/06/2021	Valuation technique (1)	Unobserv-able input (1)	Range (weighted average)	2
Investment properties: Commercial: South Africa	R6 661 411	**Discounted cash flow**	**Discount rate**	15%	

1	*Information about the <u>nature of the item being measured at fair value, including the characteristics of the item being measured,</u> that are taken into account in the determination of relevant inputs (IFRS 13.92), could be as follows:*	
1.1	The investment property being measured at fair value is a factory building that is located in Vereeniging, Gauteng.	1
1.2	The relevant inputs into the measurement of the fair value of the factory building are highly susceptible to qualitative factors such as violent protests in the area, environmental impact of production processes, etc. (Any other characteristic(s) of the factory building being measured, that will help users of the financial statements evaluate the quantitative information disclosed.)	1
2	*A <u>description of the valuation processes used</u> (par. 93(g)) by Europrop, for example:*	
2.1	The entity's valuation policies and procedures are determined by the senior financial valuations committee, which is a sub-committee of the Board of Directors reporting directly to the Chief Financial Officer.	1

2.2	The entity obtains evidence from third parties on a semi-annual basis to support the reasonability of the fair value estimate.	1
2.3	The fair value of the factory building is assessed on a quarterly basis for material increases or decreases based on significant events occurring in the Vereeniging area that may impact the fair value of the building, such as strikes and protests.	1
2.4	The entity carefully monitors the discount rate, which is an unobservable input, by recalculating it on a quarterly basis, based on the most recent information available to the entity.	1
3	*A narrative description of the sensitivity of the fair value measurement to changes in significant unobservable inputs, for example (par. 93(h))*	
3.1	The most significant unobservable input used in the fair value measurement of the entity's investment property is the discount rate. Significant increases (decreases) in the discount rate, in isolation, would result in a significantly lower (higher) fair value measurement of investment property.	1
	Available	**14**
	Maximum	**8**
	Communication skill – presentation	*1*
	Total for part (g)	**9**
TOTAL FOR PART II		**48**