QUESTION 1 **100 marks**

All amounts exclude value-added tax (VAT) unless stated otherwise.

AfriViews Pty (Ltd) (‘AfriViews’) is a family-owned company specialising in the manufacturing and installation of aluminium and glass. The company has operations in South Africa and Canada. The business was founded in 1967 by Mr Piet Oxmaul and has been in the Oxmaul family for three generations. For a number of years prior to 31 December 2019, all the shares in the company were owned by Ms Michelle Oxmaul. She was also the chief executive officer (CEO).

The sturdy design and patented toughened glass of the AfriViews products have resulted in a broad customer base both locally and internationally. Many private homeowners, property developers, designers and architects consider AfriViews’ products to be the ‘gold standard’ of quality.

The company had experienced significant revenue growth over the three years prior to the 2020 financial year (FY2020). To keep up with customer demand, AfriViews has aggressively expanded the business by purchasing more assets and increasing the number of employees from 46 to 153. The capital expansion was financed by utilising debt, and AfriViews’ debt to equity ratio was 22% at the end of FY2020.

Key information pertaining to AfriViews:

- The company prepares its financial statements in accordance with International Financial Reporting Standards (IFRSs).
- AfriViews has a 31 December year end and is a registered category B VAT vendor.
- Income Tax Practice Note 42 of 1995 is applicable to AfriViews’ processes of manufacture.

The financial year ended 31 December 2020 (FY2020) has been a challenging year for AfriViews, with the company being plagued by order delays and poor customer satisfaction because of the Covid-19 pandemic. The pandemic caused reduced global demand, the forced closure of South African manufacturing facilities for certain periods of time and a reduced ability to transport finished products between locations. This led to a decline in revenue, and increased costs to adhere to new health and safety regulations in manufacturing processes. In addition, many of AfriViews’ customers have initiated business rescue proceedings, and some have been liquidated, resulting in major impairments and write-offs of debtors.

1 Capital Atlas Investments (Pty) Ltd

To realise the growth aspirations of AfriViews, Michelle approached Capital Atlas Investments (Pty) Ltd (‘CAI’) during 2019 to become a strategic business partner. CAI is an investment management firm, majority owned by a well-known investor, Mr Patrick Sabelo. CAI focuses on investing capital and skills in small businesses it believes have long-term growth potential.

This led to CAI acquiring a majority equity interest in AfriViews on 31 December 2019, subject to the following contractual terms:

- Patrick will be appointed as the CEO of AfriViews with immediate effect.
- Michelle will be appointed as the chief financial officer (CFO) of AfriViews with immediate effect.
- AfriViews will appoint TJM Inc. ('TJM') as its new external auditor with effect from FY2020.
- CAI will subscribe for new shares in AfriViews by injecting R32 million in cash. After this subscription it will hold 51% of the shares in issue. The fair value of the shares issued to CAI on this date amounted to R30 million.

After his appointment as CEO, Patrick restructured AfriViews to improve governance and oversight, extract embedded value and realise growth aspirations.

Step 1: Governance improvements

The first step towards restructuring AfriViews was to establish several committees and appoint board members to meet the requirements of principle 7 of the King IV Report on corporate governance. The new governance structures were implemented on 15 January 2020.

Step 2: Asset verification

The second step consisted of an asset verification exercise that was conducted to improve efficiencies and generate cash flows through the disposal of unused or fully depreciated non-core assets. During this exercise, a bottle-forming machine that was fully impaired at the end of FY2018 was identified. AfriViews decided in FY2020 to discontinue the manufacture of glass bottles due to intense market competition. One of CAI's other businesses was a new start-up company in the craft beer market at the time and Patrick realised that this company would be able to use the bottle-forming machine. He accordingly entered into a separate contract with the board of directors of AfriViews. This transaction was not entered into by virtue of his employment. In terms of this contract Patrick acquired the machine in exchange for facilitating a risk identification and assessment workshop for AfriViews. Patrick is not a registered VAT vendor with the South African Revenue Service.

The bottle-forming machine had a market value (and open market value) of R270 000 on 25 February 2020, being the date on which the machine was made available to Patrick. The agreed value for facilitating the risk workshop was R200 000, based on quotes received from independent service providers. The accounting records reflected the following information relating to the bottle-forming machine as at 25 February 2020:

Asset number: A09786 **Asset description:** Bottle-forming machine			**Asset category:** Plant and machinery		
Acquisition date	**Historical cost**	**Useful life**	**Accumulated depreciation**	**Accumulated impairment**	**Carrying amount**
1 June 2017	R540 000	6 years	R142 500	R397 500	–

AfriViews originally acquired the bottle-forming machine new and unused from an unconnected entity.

Step 3: New sales strategy

The third step entailed a sales strategy to refocus the company on larger, more lucrative corporate and government contracts. As a result, AfriViews concluded several new contracts. The details of two significant contracts (contract A23 and contract A34) are discussed in section 2 below.

2 Significant developments during FY2020

Manufacturing shutdown

The lockdown resulted in AfriViews having to cease operations in South Africa from 27 March 2020. Operations resumed on 1 May 2020, but only at 33% of available capacity. Unfortunately, the business experienced a Covid-19 outbreak four days later, during which 5% of the workforce was infected. The Board therefore decided to halt all operations until circumstances changed to avoid a loss of human life. After the outbreak, AfriViews had to decontaminate all its operational sites, at a cost of R400 000. Normal operations at 100% of capacity, with improved safety protocols, only resumed on 1 July 2020.

Contract A23: Fumuleni Community Park

AfriViews entered into this contract with its local municipality in January 2020. It entailed the installation of guardrails at the Fumuleni Community Park in Khayelitsha and was aimed at improving the corporate social responsibility profile of AfriViews. Patrick had discovered that a large shopping complex was to be built in Khayelitsha in the coming months and therefore the contract could also be of strategic importance. The guardrails contract was a fixed-price contract for R10 million, and the initial project budget is summarised below:

Initial contract budget	
Period (1 February 2020 to 30 June 2020)	5 months
	R'million
Contract revenue	10
Labour and other costs	(5)
Plant hire from Hire-4-All (Pty) Ltd (R1 million per month)	(5)
Project profit as stipulated by Patrick	**–**

Because of the pandemic, work on the contract was halted on 27 March 2020 after only 25% of the contract work had been completed and paid for by the local municipality. In addition to the plant hire cost, costs of R1,5 million had been incurred in respect of labour and other costs on the project by this date.

By 31 December 2020, no further progress had been made on the project despite the plant hire costs being paid to Hire-4-All for the duration of the lease (i.e. until 30 June 2020). The expected completion date for the project was revised to 30 April 2021. However, because of the delays, the plant would have to be rehired for those additional four months, at the same rate. The estimates regarding total labour and other costs for the project have remained unchanged. Accordingly, Michelle raised a provision of R4 million in the statement of financial position of AfriViews at 31 December 2020, as she regarded the contract as onerous.

Should AfriViews elect to cancel the contract, a cancellation penalty of R6 million would become due and payable to the local municipality.

Contract A34: BFN Stadium

On 15 January 2020, AfriViews was awarded a contract of R40 million to supply all the aluminium work for BFN sports stadium. Because of the size and requirements of the contract, AfriViews had to employ an additional 22 staff members. AfriViews received half the contract fee on 10 February 2020 and the remainder of the fee would be paid based on an external assessment of the stage of completion on 30 June 2020 and 30 November 2020 respectively. AfriViews expected the contract to be 50% complete by 30 June 2020 and 100% complete by 30 November 2020.

However, as a result of production delays caused by Covid-19, AfriViews invoked the *force majeure* clause of the contract to avoid a R5 million penalty becoming due and payable for late completion. *Force majeure* relates to unforeseeable circumstances that prevent someone from fulfilling a contract. This clause gave AfriViews a three-month extension for reaching the agreed milestone completion percentages. On 30 June 2020 the project was assessed to be only 23% complete. By 30 November 2020 the project was assessed as 76% complete. At year end the contract was assessed internally to be 80% complete.

Loan from Michelle

Michelle extended a loan of R5 million to AfriViews on 1 July 2017 at a market-related interest rate of 8,25% per annum. Interest is payable annually in arrears with the loan capital being repayable on 30 June 2022.

However, AfriViews started to experience liquidity constraints because of all the events that occurred during FY2020. The two parties therefore reached an agreement on 1 July 2020 to amend the existing loan agreement. In terms of the amendment, the repayment of the loan capital was extended by a further three years to 30 June 2025 and the interest rate was reduced to 6,5% per annum. In addition, interest payments were no longer to be paid annually, but would instead be added to the outstanding loan capital, compounded annually and settled together with the capital amount on 30 June 2025.

Additional financing

Patrick proposed the following two additional financing options to assist AfriViews with meeting its strategic objectives and maintaining long-term viability.

Option 1: Long-term loan

XYZ Financiers (Pty) Ltd (‘XYZ’), a registered financial service provider specialising in finance for small and medium enterprises, was prepared to grant AfriViews a R20 million loan on 1 January 2021. XYZ is. The loan would become payable on demand at any time during the duration of the loan agreement if AfriViews did not comply with principle 7 of King IV. The loan would bear interest at the prime lending rate plus 2%, payable on 31 December each year. Interest would be compounded annually. The loan would be payable after five years.

Option 2: Preference shares

CAI was willing to subscribe for preference shares to the value of R20 million. AfriViews would issue the shares on 1 January 2021. The preference shares would carry no voting rights. The preference shareholders would be entitled to a fixed dividend payment payable annually in arrears and calculated at 5% of the nominal value. The preference shares would be redeemable at a premium of 15% after five years.

3 Extracts from TJM's audit file

TJM was appointed as the external auditor of AfriViews for FY2020. AfriViews' Memorandum of Incorporation requires the appointment of an external auditor and audit committee. The correct due process was followed in terms of the Companies Act in appointing TJM. TJM is a medium-sized audit firm that acts as the external auditor to many of the companies in which CAI invests.

The audit partner is Ms Timika Prang, who predominantly deals with clients in the insurance and mining industries.

The 2020 audit file of AfriViews contains amongst others the following documents:

Reference	Details
E-mail 1	New audit client: AfriViews
E-mail 2	AfriViews' audit fee for FY2020
Workpaper: RP 300	Going concern assessment

E-mail 1

From t.prang@tjm.co.za
To a.manager@tjm.co.za
Date 9 November 2020 09:40
Subject New audit client: AfriViews

Hi

My good friend, Mr Patrick Sabelo (the CEO of AfriViews), informed me that we have been formally appointed as the auditors of AfriViews.

I want you to prepare an audit planning document and have it ready for discussion at AfriViews' Audit Committee meeting, which is scheduled for 25 November 2020. Start with the standard audit planning template used for TimidBank – as I know that it works.

In terms of the staffing for this audit, you will only have one second-year trainee to assist you. In addition, I have recruited two post-graduate students to assist on a part-time basis. Unfortunately, there will be no other trainees available in the firm at the time this engagement will be performed.

From previous audits on which we have worked together, I know you are capable of running the engagement on your own. Just let me know when I can come for the sign-off of the auditor's report. In my opinion this exercise will help you in furthering your career. Remember, you will be considered for promotion to partner level during 2021 and your experience in running audits will stand you in good stead during the evaluations.

Regards

Timika Prang
Audit partner: TJM Inc.

E-mail 2	
From	t.prang@tjm.co.za
To	p.sabelo@afriviews.co.za
Date	11 November 2020 10:00
Subject	AfriViews' audit fee for FY2020

Hello old friend!

As we can both agree, 2020 has been quite a year. We completely understand that AfriViews is experiencing some cash flow constraints due to the Covid-19 outbreak and the intermittent lockdowns.

As our firm is expanding and constantly trying to attract new clients, we are looking to renovate our current office space. As per our discussion yesterday, my proposal is that AfriViews supplies, for purposes of the renovation, new handrails for the staircases (currently wood, that we would like to replace with aluminium) as well as new glass for our entrance (as the 'tinted' glass is outdated). I accept your estimate that the value of this service will amount to 60% of the audit fee.

In exchange for the supply of this material, we will discount the AfriViews audit fee by 40%. This will assist AfriViews with its cash flow constraints.

Regards

Timika Prang
Audit partner: TJM Inc.

Client: AfriViews (Pty) Ltd	**Year end:** 31/12/2020	**RP 300**
Prepared by: Second-year trainee	**Date:** 24/01/2021	
Reviewed by:	**Date:**	
Subject: Going concern assessment		

Background and work performed

- Obtained the client's cash flow forecast for the next five years and re-performed all calculations to confirm its accuracy.

- Cast the cash flow forecast and all amounts are accurate.

- The sales generated by AfriViews are earned evenly throughout the year. This was confirmed by means of a review of the previous auditor's workpapers. They performed analytical procedures month on month for revenues, cost of sales and all other expenses.

- Revenue for the past few years were as follows:

FY2017	R69 million
FY2018	R70 million
FY2019	R75 million
FY2020	R53 million

Client: AfriViews (Pty) Ltd	**Year end:** 31/12/2020	**RP 300**
Prepared by: Second-year trainee	**Date:** 24/01/2021	
Reviewed by:	**Date:**	
Subject: Going concern assessment		

- Cost of sales for the past few years was as follows:

FY2017	R30 million
FY2018	R32 million
FY2019	R38 million
FY2020	R31 million

- The decrease in sales and cost of sales for FY2020 are reasonable given the closure of operations for three months. As a result, this does not indicate any going concern issues.

- Below are the forecast cash flows which were received directly from Michelle:

Details	Notes	2021	2022	2023	2024	2025
		R'million	R'million	R'million	R'million	R'million
Sales	1	141	155	170	187	206
Costs of sales	2	(70)	(77)	(85)	(93)	(103)
Gross profit		71	78	85	94	103
Admin costs	3	(13)	(14)	(14)	(15)	(16)
Distribution costs	3	(3)	(3)	(3)	(3)	(3)
Other costs	3	(2)	(2)	(2)	(2)	(2)
Interest payments	4	(6)	(5)	(4)	(4)	(3)
Cash inflow	5,6,7	47	54	62	70	79

Notes

1 Revenue for FY2021 was calculated using the annual equivalent revenue from FY2019 (as FY2020 was not a stable year to use for forecast purposes). This amount was confirmed by means of a discussion with management as they expect a growth spurt in the market in FY2021. The revenue growth rate from FY2021 to FY2022 and onwards is approximately 10% year on year. Per discussion with Michelle, this is the expected percentage based on the fact that, by FY2022, the company will be more familiar with larger contracts and revenue is therefore expected to grow consistently.

2 Cost of sales was calculated based on the gross profit percentage for FY2019. Per discussion with Michelle, this was because the FY2019 percentage is more reliable than the FY2020 actuals.

3 The costs were inflated by 4%, which is below the estimated inflation rate of 6%. All costs were agreed to the statement of profit or loss for FY2020. The reason for the 4% increase is that Michelle is of the opinion that inflation will not rise by 6% because of Covid-19.

4 The interest payments were agreed to the amortisation schedule per the interest testing section of the audit file. They are complete and accurate.

5 The effects of the timing of cash flows (the time value of money) were ignored as Michelle believes this is far too complex.

6 The recovery of debtors and payments to creditors have been ignored.

7 No further queries were raised on the cash flow forecast; it seems reasonable and accurate, per the preparation and discussions with Michelle.

Conclusion: AfriViews is a going concern.

Client: AfriViews (Pty) Ltd	**Year end:** 31/12/2020	**RP 300**
Prepared by: Second-year trainee	**Date:** 24/01/2021	
Reviewed by:	**Date:**	
Subject: Going concern assessment		

4 Projected annual average prime interest rates

For the period ended	Rate
31 December 2020	7,25%
31 December 2021	6,75%
31 December 2022	7,25%
31 December 2023	7,50%
31 December 2024	7,75%
31 December 2025	7,75%

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INITIAL TEST OF COMPETENCE, SEPTEMBER 2021

PROFESSIONAL PAPER 3

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

<table>
<tr><td colspan="2" rowspan="2">PAPER 3 PART I – REQUIRED</td><td colspan="2">Marks</td></tr>
<tr><td>Sub-total</td><td>Total</td></tr>
<tr><td>(a)</td><td>Discuss the appropriateness of the provision in respect of contract A23 in the separate financial statements of AfriViews for FY2020.

• Provide calculations where necessary.

Communication skills – appropriate style</td><td>7

1</td><td>

8</td></tr>
<tr><td>(b)</td><td>Discuss how the amendment of the existing loan agreement with Michelle should be accounted for in the separate financial statements of AfriViews for FY2020.

• Provide calculations where necessary.
• Do not discuss any presentation or disclosure requirements.</td><td>10</td><td>10</td></tr>
<tr><td>(c)</td><td>With reference to email 1 and email 2 –
(i) discuss any ethical considerations regarding the audit fee arrangement; and
(ii) discuss any other concerns that arise based on the content of these emails with reference to TJM’s adherence to the SAICA Code of Professional Conduct and the International Standards on Auditing.

Communication skills – logical argument</td><td>5

10

1</td><td>

16</td></tr>
<tr><td>(d)</td><td>Evaluate the audit work performed by the second-year audit trainee, as documented in workpaper RP 300, on the cash flow forecast and thus the going concern assessment of AfriViews, incorporating considerations of the information in the scenario.

• Where necessary, provide additional procedures to obtain sufficient and appropriate audit evidence in relation to the going concern ability of AfriViews.
• Do not discuss the documentation requirements of ISA 230.

Communication skills – clarity of expression</td><td>20

1</td><td>

21</td></tr>
<tr><td colspan="2">Total for part I</td><td></td><td>55</td></tr>
</table>

INITIAL TEST OF COMPETENCE, SEPTEMBER 2021

PROFESSIONAL PAPER 3

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

PAPER 3 PART II – REQUIRED		**Marks**	
		Sub-total	**Total**
(e)	Discuss the key business risks faced by AfriViews as a result of the Covid-19 pandemic and the related lockdown regulations.	10	10
(f)	With reference to the two financing options proposed by Patrick – (i) calculate the most cost-effective financing option of the two (use the internal rate of return method); and (ii) recommend with reasons (including an analysis of the characteristics of each option) which financing option AfriViews should select. *Communication skills – logical argument*	7 8 *1*	16
(g)	With regard to the exchange of the bottle-forming machine by AfriViews in return for a risk identification and assessment workshop by Patrick – (i) discuss, supported by calculations, any VAT implications for AfriViews for the February 2020 tax period; (ii) calculate, with reasons, the normal tax implications for AfriViews for this exchange; and (iii) discuss the amount, if any, that AfriViews can deduct for normal income tax purposes for the 31 December 2020 year of assessment, in respect of the service rendered by Patrick in exchange for the bottle-forming machine. *Communication skills – presentation*	8 6 4 *1*	19
Total for part II			**45**
TOTAL FOR PAPER 3			**100**