Part (a)	Discuss the appropriateness of the provision raised in respect of contract A23 in the separate financial statements of AfriViews for FY2020 • Provide calculations where necessary.	Marks
1.	The R4 million recognised as a provision is from a contract with the municipality and it could only be a valid provision if it is **onerous**. That is when the **unavoidable costs** of meeting the obligations under the contract **exceed the economic benefits** expected to be received under it.	1
2.	In accordance with IAS 37.68 unavoidable costs under a contract reflect the **least net cost** of exiting from the contract, which in this instance is the **lower** of a) **completing** the contract by 30 April 2021 under the new cost estimates or b) **cancelling** the contract and paying the local municipality the cancellation penalty.	1
3.	As at 31 December 2020 the contract was 25% **complete** therefore – - AfriViews is entitled to receive a further **R7,5 million in revenue** from the contract, and - the total estimated costs to complete the contract amount to R7,5 million, consisting of **R4 million** for **plant hire** and - **R3,5 million** for **labour and other** costs.	1 1 1
4.	The unavoidable penalty for **cancelling** the contract is stated as amounting to **R6 million**.	1
5.	**Conclusion:** The **least net cost** in relation to the contract is therefore **R0** (R7,5 million – R7,5 million), representing the net cost of fulfilling the contract.	1P
6.	**Conclusion:** The contract is therefore **not onerous** as at 31 December 2020, and the provision recognised by AfriViews in respect of this contract, should be reversed.	1P
7.	***(Alt)*** *The loss of R4 million (R2.5 m – R6.5 m) would have been recognised by 31 December 2021 and should not be viewed as a future loss under the contract.*	1
8.	In terms of IFRS 15.95 the plant hire **costs paid** to Hire-4-All **during the period** when the contract was halted should **already have been expensed in FY2020** when it was incurred. This is **because** the costs (even though directly related to the contract) did **not generate or enhance resources** for the entity that was used by AfriViews in continuing to satisfy the performance obligations of the installation contract to the local municipality.	1 1
9.	In terms of IAS 37. 69, before a separate provision for an onerous contract is established, an entity **recognises** any **impairment loss** that has occurred on **assets** dedicated to that contract. This would be applicable for any contract assets that may have been recognised.	1
	Available	**12**
	Maximum	**7**
	Communication skills – appropriate style	*1*
	Total for part (a)	**8**

Part (b)	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.	Marks
1.	The loan amendment will be considered **a modification** of the financial liability. As a result, it is necessary to determine whether or not the modifications constitute substantially different terms or would be considered a **substantial modification**, in which case the modification is accounted for as an **extinguishment** of the **original** liability and **recognition** of a **new** financial liability. (IFRS 9.3.3.2) Where the modification does **not result in an extinguishment**, the **gross carrying value** of the financial liability is **recalculated** at the original effective interest rate with the **adjustment** recognised in **profit and loss**.	1 1 1
2.	The **current (present) value** of the liability on 1 July 2020 is **R5 million**.	1
3.	The present value of the amended liability at the same effective interest rate is R4 608 701.	(CF)
4.	As the **difference (R391 299)** between the discounted present value of the cash flows under the new terms and the old terms, at the original effective interest rate, **is below 10%** (7,83% = 391 299 / 5 million) the change does not meet the definition of a substantial modification. **Conclusion:** Thus, the modification will **not** be treated as an **extinguishment** (IFRS 9.B3.3.6).	1C 1
5.	Consequently, the above amendments will **not** result in AfriViews having to **de-recognise** the financial **liability** and **recognise a new one** (IFRS 9.3.3.2).	1
6.	Instead, the difference of R391 299 should be **recorded** as a modification **gain in the statement of profit and loss** (IFRS 9.B5.4.6) and a corresponding decrease to the financial liability.	1
7.	The **tax** effect of the modification gain will have to considered.	1
8.	The **interest expense** on the loan of R190 109 (4 608 701 x 8.25% x 6/12) until 31 December 2020 will be recognised	1

Calculations

		Notes	
Rates			
Market (EIR)	8,25%	*Given*	
New rate	6,5%	*Given*	
	Amended calc		
PMT	0		
PV	**5 000 000**		½
I	**6,5%**	*Given*	½
N	**5**	Given	½
Calculate FV	**6 850 433 C**	*Calculated*	½C
Present value of amended loan at EIR			
FV	**6 850 433 C**	*Carried forward*	½C
Calculate PV	**4 608 701**	*Calculated*	½C
I	**8,25%**	*Given*	½
N	**5**	*Given*	½
PMT	0	*Given*	
		Available	**14**
		Maximum	**10**
		Total for part (b)	**10**

Part (c)With reference to email 1 and email 2 – (i) discuss any ethical considerations regarding the audit fee arrangement		**Marks**
1.	The audit partner, Ms Timika Prang, is considered a professional accountant in public practice and are required to adhere to the SAICA CPC.	1
2.	The discount of 40% in the AfriViews audit fee, in exchange for the supply of renovation service and supplies, creates a **self-interest threat** to the compliance with the principle of **professional competence and due care**, if the fee quoted is so low that it might be difficult to perform the engagement in accordance with applicable technical professional standards.	½ ½ 1
3.	This threat could be considered **not at an acceptable level**, if the reduction of 40% does not allow for the necessary resources, skills, hours, technology etc. to conduct the external audit in relations tot ISQC 1 (lack of quality in the work done).	1
4.	A further factor to consider in evaluating this level of threat is, whether the client is aware of the terms of the engagement and the basis on which the new fees are charged and which professional services the new quoted fee covers. While the audit partner and the CEO discussed the arrangement on which the fee will be discounted, it is not evident that has been **considered and approved by the Audit Committee of Afriviews**	1
4.	A professional accountant quoting a reduction in fee or a lower fee, due to this arrangement, **in itself is not unethica**l, unless the threat cannot be reduced/eliminated	1
5	If it is determined that the threat is not at an acceptable level, **safeguards,** such having an **appropriate reviewer** review the work performed or/and TJM would need to ensure that **additional resources are contracted/allocated** for this audit, in addition to ensuring that sufficient hours and resources are provided to maintain the quality, regardless of the lower fee, or not entering into the reduced fee arrangement.	1 1 1
6	The reduced fee arrangement (bartering transaction), could create a **self-interest threat** to the principle of **Professional Behaviour and integrity,** should TJM **not recognise this as revenue**, for it is not reflected as cash in the bank, and therefore not straightforward or honest, as well as non-compliance with financial reporting framework and potentially other laws and regulations	½ ½ ½ 1
7.	If it is determined that the transaction is not recognised as revenue, the threat is **not an acceptable level** (especially depending on the materiality of the transaction) and as such the only **safeguard** would be to correctly account for the transaction.	1 1
8.	The purchase of products from AfriViews in exchange for 40% reduction in the audit fee could also give rise to **familiarity threat** to fundamental principle of **objectivity** (independence), due to already being 'old friends' and now entering into a business relationship between auditor and audit client, which could lead to the audit partner and audit team being sympathetic to their interests or too accepting of their work.	½ ½ 1
9.	This threat can be considered **not at an acceptable level** due to the audit partner already showing sympathy to the audit client experiencing cash flow constraints due to the Covid-19 outbreak and lockdowns.	1

10.	The threat can be reduced by implementing safeguards such as appointing **another audit partner** for the AfriViews audit and/or appointing an **external quality control reviewer**	1 1
	Available	**18 ½**
	Maximum	**5**
	Total for part (c)(i)	**5**

Part (c)	With reference to email 1 and email 2 – (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.	Marks
1 1.1	Concerns relating to client **acceptance:** **No audit engagement letter** appears to have been signed as required by ISA210 – given that the 'formal appointment' was only communicated by Patrick.	1
1.2	The **auditors' fees** are being **determined by the audit partner and Patrick**, but these should have been determined by the Audit Committee.	1
1.3	TJM Inc's **independence is being compromised** by having accepted the appointment as auditors where they might **not get adequately paid** for the work performed and they are facilitating/ rationalizing it by entering into this arrangement.	1
2. 2.1	Concerns relating to the engagement **partner:** The audit partner and CEO are **close friends**, it will result in a **familiarity/self-interest** threat to objectivity as the audit partner **will overlook issues** to maintain her friendship or have **clouded judgement** over the audit of Afriviews. The factors to consider in evaluating the **level of the threat** is that Patrick is in the position **to influence** the financial statements (as **CEO**), and that the T. Prang is the **audit partner** as such the threat is not acceptable. It is not evident that this threat has been adequately evaluated and/or that actions were taken to reduce this threat to an acceptable level. An appropriate **safeguard** would have been to **allocate a different audit partner** to this audit.	½ ½ 1 1 1
2.2	In terms of ISA220.15, the engagement partner is **responsible** for the **direction of the audit** engagement in compliance with the professional standards. However, the nature of the direction provided by Timika is very **poor** – as the audit planning documentation for the audit of a **bank** is likely to **differ** significantly from that of a **manufacturing** company, such as Afriviews.	1
2.3	The engagement partner's **involvement in the planning** of the audit is very **limited** – and not consistent with the requirement in ISA300.5 that the **engagement partner shall be involved in the planning** of the audit.	1
2.4	The engagement partner is also **responsible** for the **supervision and review** of the audit work performed (in terms of ISA 220.15 and .16). The review of the audit work conducted (at least that performed by the audit manager) is not considered	1

2.5	The audit partner is **willing to sign** the auditor's **report** when the work is completed. As Timika is only going to sign-off on the audit report, it is **not** possible that she would be able to **identify if appropriate consultation** has taken place where there are difficult matters on the audit of Afriviews and if the conclusions from consultations have been implemented (ISA 220, para 18).	1
2.6	The **partners overall behaviour** could be said to be a breach to the fundamental principle of **professional competence and due care**.	1
3 3.1	**Concerns relating to the engagement <u>team</u> collectively:** The team does not collectively appear to have the appropriate competence and capabilities to perform the engagement in accordance with the Standards. There is **insufficient staff with appropriate levels of skills** to perform the audit as there is only one second-year trainee to assist on the fairly sizeable audit engagement, indicating that the audit is understaffed.	1
3.2	Two completely **inexperienced graduates** are being used on the audit on a part-time basis, which does not aid the audit team in having appropriate competence and capabilities.	1
3.3	The two graduates are **not trained** in the **firm's methodology** and testing methods and may not have sufficient knowledge or experience to deal with the audit.	1
4. 4.1	Concerns relating to the **<u>quality of work</u>**: Timika does **not** appear to have adequately **considered the firm's ability** to comply with the sufficiency of staff **to perform the engagement** in accordance with the required standards.	1
4.2	As the second-year trainee will be the only other person, apart from the manager, who will be active on the audit, and the graduates are inexperienced, **more oversight will be required to coach the graduate students,** placing pressure on the trainee and the manager, lowering audit quality.	1
4.3	Further, given that the audit partner of the firm allows such breaches to occur, this indicates that **the leadership** of the firm does **not promote an internal culture of quality within the firm**	1
4.4	The firm's ***promotion policies*** *are also* ***not suitable/****incentivises the audit manager inappropriately* as it does not promote quality but rather **puts pressure on individuals** to produce work even if it's not of quality just to get promoted.	1
5. 5.1	Concerns relating to the **<u>audit manager:</u>** The audit partner stating that the **manager will be considered for promotion** is not appropriate and results in undue pressure. This creates a **self-interest threat to professional competence and due care.** It also creates an **<u>intimidation</u> threat** as the manager cannot act independently/objectively in this regard. This might result in the audit manager compromising quality & standards just to get promoted. It is **not** evident that this threat has been **adequately evaluated** and/or that **actions were taken to reduce this threat** to an acceptable level	½ ½ ½ 1 1
	Available	**22,5**
	Maximum	**10**
	Total for part (c)(ii)	**10**
	Communication skills – logical argument	*1*
	Total for part (c)	**16**

Part (d)	Evaluate the audit work performed by the second-year audit trainee in working paper 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.	Marks
1	**Overall**	
1.1	There is **no indication** that **a** **risk assessment process** has been undertaken – as required by ISA570.10 – to determine the nature and extent of audit work required on the appropriateness of the going concern basis of accounting. Or The auditor did **not obtain full** **understanding** of the process and individuals involved in the preparation and approval of the forecasts.	1
1.2	In addition, the trainee has **failed to perform the audit work with** **professional scepticism** – as required by the ISAs.	1
1.3	In general, there is **excessive reliance** **on Michelle's representations** regarding the **assumptions** used in the preparation of the cash flow forecast – even though these are not reasonable in a number of instances.	1
1.4	**FY 2020** **is not a stable year to use as a measure of continued growth** for the business and was **correctly not used** in the future cash-flow projection	1
1.5	**Reliance was placed on the work of the** **previous auditor** **without** any apparent **consideration** being given to the professional **competence and independence** of the previous auditor (ISA510.A4).	1
1.6	Overall the **trainee** has at least **considered** **casting** and **agreeing** the **interest** to the work done on file.	1
2.	**Gross Profit**	
2.1	**(P)** The trainee did **not assess the reasonableness** of the gross profit percentage as it was not compared to prior year actuals. **(A)** The **GP% has been on the** **decline** for the past three years and as a result the **increase** **in GP%** in the cash flow forecast is **unsubstantiated.** **(Ad)** The trainee **should have performed a** **trend analysis** of the **GP% over the past three years** which would have identified the following: 2020 – 42% 2019 – 49% 2018 – 54% 2017 – 56%	1 1 1
	Revenue:	
2.2	**(P)** The annual equivalent **revenue** **projection** for FY2021 (that was calculated by using a stable FY2019 as a base year) is **unreasonable**. **(A)** The revenue **projection** **is at 92% growth** which seems to be significantly **overstated**.	1 1 1

	(Ad) Compare the expected increase to the performance of the **competitors in the same industry** to confirm the reasonableness of the forward-looking assumptions.	
2.3	**(P)** The auditor did **not assess the reasonableness of the percentage increase (10%) rate in revenue** used by Michelle for the **five-year projection** as it is not necessarily based on the historic percentage increase rate. **(A)** Revenue has only been **growing at an average of 2%** for the past three years. **(A)** The **assumption** that the company will be **more familiar with larger contracts** from 2022 is **unfounded**, because Afriviews is **still growing** exponentially and this process would reasonably take more than a year considering that the world is slowing during the recovery from the Covid-19 pandemic. **(Ad)** The auditor should **inspect any recent larger contracts** entered into that could **substantiate** some of the **increases in revenue.**	1 1 1 1
3.	**Cost of sales**	
3.1	**(P)** The **reasonability of cost of sales was not challenged** as the trainee accepted that it is more reliable without questioning further.	1
3.2	**(A) Using FY2019** for the cost of sales value figure would have **understated cost of sales** and thus **overstated the future cash flows.** This was not detected by the auditor as the reasonableness of the cost of sales calculation was not challenged by the auditor.	1
3.3	**(Ad)** The **cost of sales** values should have been **calculated on the average gross profit percentage** over the past three years (excluding FY2020, which is an outlier).	1
4.	**Other costs**	
4.1	**(P)** It is **not reasonable** of Michelle to **use a rate (4%) that is lower than CPI,** but the auditor did not challenge this. The auditor only inquired from the CFO if it is correct.	1
4.2	**(A)** The auditor should also be cognisant of the fact that **due to a pandemic** such as Covid-19, the **CPI is predicted to increase** and a rate of **4% is unrealistically low,** leading to a **very conservative cost projection** for the next five years. This could ultimately lead to a false going concern assessment being made.	1
4.3	**(Ad)** Sufficient and appropriate audit evidence was not obtained by the auditor to substantiate the lower CPI; **experts should have been consulted** about this.	1
5	**Overall omissions:** Based on the **omission of the various costs**, the **cash flow forecast is overstated** and inaccurate as a result of the omission of this key information.	1
5.1	The effects of **taxation** were **not taken into account** by the CFO.	1
5.2	The cash flow forecast **does not take into consideration working capital** movements. It cannot be simply based on profit or loss as this does not reflect cash flow.	1
5.3	The CFO did **not take the timing of cash flows into account,** which means that the cash flow forecast cannot actually be considered to be a cash flow forecast.	1
5.4	Based on the above, these are **fundamental mistakes** and so the **integrity and accuracy** of the entire cash flow forecast is **questionable.**	1

5.5	As a result, the auditor was incorrect to rely on this forecast for making an informed decision. Moreover the **conclusion about the going concern** of AfriViews appears to be **incorrect.**	1
6.	**Further audit procedures:**	
6.1	**Ask** the CFO to **amend the cash flow for the errors** in respect of the inflation of revenue, costs of sales, the omission of taxation and the timing of cash flows.	1
6.2	**After** the cash flows have been **amended**, **obtain a management representation letter** relating to the **accuracy, completeness and reasonability** of the forecast.	1
6.4	Enquire from management **which** of the **two financing arrangements Afriviews opted for in January 2021** and consider any related cash flows as part of the cash flow forecast.	1
6.5	Inspect the **bank confirmations, minutes of board meetings and financing agreements** and **establish whether AfriViews is subject to any covenants** in respect of this financing and whether the covenants will be met because an inability to meet covenants would cast doubt on the ability of Afriviews to continue as a going concern.	1
6.6	Enquire from management what the **impact of the discontinuation of the bottling plant/capital expenditure forecasts** will have on the cash flow forecast, including any additional costs related to this. **Review any additional workings** that might have been done **relating to the discontinuation decision of the bottling plant**.	1 1
6.7	Request that the client's management **include reference to the future plans** / actions **to ensure the going concern** ability of the company, **and the feasibility of these plans.**	1
6.8	With permission from management, send a **lawyer's confirmation** to confirm whether there are any **additional potential litigations** which may need to be **included** in the forecast.	1
6.9	**Recalculate** the **solvency, liquidity** and debt/equity **ratio analysis** based on the current and forecasted statement of financial position figures to confirm whether the entity is projected to be solvent and liquid to support the underlying capital value.	1
6.10	The trainee should have also **enquired** from management as to **events that occurred after year-end** that may **impact the forecast** and if these events have been considered in the forecast.	1
	Available	**39**
	Maximum	**20**
	Communication skills – clarity of expression	*1*
	Total for part (d)	**21**