Part (e)	Discuss the key business risks faced by AfriViews as a result of the Covid-19 pandemic and the related lockdown regulations.	Marks
1	***Pressure on working capital management (liquidity)***	
1.1	Incomplete projects were susceptible to **theft or damage** as Covid-19 regulations required all construction projects to stop.	1
1.2	Inability to timeously complete projects could lead to **fines**; example the BFN contract was extended by 3 months to avoid a penalty of R5 million.	1
1.3	Extension of projects may result in **increased project costs** and **delays in cash inflows** (especially if cash inflows are receivable at the completion of the project), which could cause further liquidity pressures to AfriViews. This will be problematic for the Park contract agreed at zero margin.	1 + 1
1.4	**Increased credit risk** with AfriViews' customers being unable to meet their payment obligations because of similar pressures on their side. High value of debtors' balances will potentially have to be **written off** because of customers who filed for liquidation and business rescue proceedings OR Government faces a huge budget and fiscal deficit, combined with the credit downgrades which have increased its interest burden, resulting in the **government as a customer of AfriViews being a high credit risk**.	1
1.5	**Inability to source favourable payment terms** from their suppliers due to them also facing liquidity crunch. This could negatively impact AfriViews' **ability to source raw materials** required for fulfilment of orders. OR AfriViews may **not be able to settle its short-term debt** used to finance inventory in the required time, because of the delay in receiving cash.	1
1.6	**Increased finance costs** because of short-term loans to finance operating costs will reduce profitability. This is exacerbated by delays in completion of projects; results in cash being locked in the projects for a longer period.	1
2	***Decrease in profitability***	
2.1	The global shutdown resulted in **suppressed demand** for construction materials, **lower disposable income** and **reduced revenue** for AfriViews.	1
2.2	Covid-19 has led to new and changing **regulations that are costly** to keep up with. **Decontamination** and other costs may not be once-off expenses, leading to less cash flow and lower profitability.	1
2.3	AfriViews has a **high level of fixed costs** from expansions and increased staff compliment, which would make it difficult for the company to restructure its cost in the short term and would result in the company continuing to incur fixed costs while there are no revenues.	1
2.4	As the government is now a client of AfriViews, the risk exists that the **government may shift the spend** prerogative to healthcare rather than construction for the short term during the pandemic.	1
2.5	The decrease in profitability might lead to the company **retrenching staff**, which would lead to **lower staff morale and loss of skilled staff**.	1
3	**Operational risk/supplier chain disruption**	
3.1	Disruption in trade locally and internationally, such as logistics and with certain businesses filing for liquidation and/or business rescue, has led to **low availability of raw materials** likely **to adversely impact prices**.	1
3.2	**Closures of various countries' borders** would have resulted in **delays** in AfriViews' projects for international clients impacting liquidity, especially if they had already invested in inventories required for those projects.	1
3.3	There may be potential **shortages in labour supply** where employees might be reluctant to return to work due to the outbreak incident, chance of being infected, and the 10-day isolation for workers that may be infected.	1
3.4	There is an **increased risk of further lockdowns**, and consequently 'stop-start' operations with heightened uncertainty, which require	1

Part (e)	**Discuss the key business risks faced by AfriViews as a result of the Covid-19 pandemic and the related lockdown regulations.**	**Marks**
	increasing levels of **organisational flexibility**. The board might not have a **crisis management** and recovery plan to deal with the situation.	
3.5	**Poor customer satisfaction because of disruptions** in distributions of finished products, leading to reputational risk.	1
3.6	**Non-compliance with Covid-19 regulations**, such as social distancing and decontaminating premises, may result in **fines and penalties** or even **closure of operations by Government**.	1
3.7	**Non-compliance with Covid-19 regulations** resulting in loss of employee lives may result in **lawsuits, backlash** from employees and their unions and **reputational damage**.	1
3.8	There is a risk of customers **invoking force majeure** or business rescue proceedings to protect themselves from our contracts, resulting in losses due to non-performance and inability to access legal remedies.	1
3.9	**Loss of key personnel**, such as Michelle, Patrick, or any board member, due to Covid-19. The inability to replace the key personnel could result in non-compliance with Principle 7 of King IV and/or AfriViews not being able to immediately continue as a going concern.	1
	Available	**21**
	Maximum	**10**
	Total for part (e)	**10**

Part (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)**					**Marks**
1 Calculation of XYZ long-term loan interest rate						
	Dec. 2021	**Dec. 2022**	**Dec. 2023**	**Dec. 2024**	**Dec. 2025**	
Plus 2%	2%	2%	2%	2%	2%	
Prime interest rate	6,75%	7,25%	7,50%	7,75%	7,75%	
Interest rate	**8,75%**	**9,25%**	**9,50%**	**9,75%**	**9,75%**	1

2 IRR calculation for XYZ long-term loan							
	Jan. 2021	**Dec. 2021**	**Dec. 2022**	**Dec. 2023**	**Dec. 2024**	**Dec. 2025**	
	R'000	**R'000**	**R'000**	**R'000**	**R'000**	**R'000**	
Capital cash flows	20 000					(20 000)	1
Tax saving at 28%		490	518	532	546	546	1C
Interest payments		(1 750)	(1 850)	(1 900)	(1 950)	(1 950)	1C
Total cash flows	20 000	(1 260)	(1 332)	(1 368)	(1 404)	(21 404)	
IRR	**6,74%**						1C
***Note**: IRR may be calculated on a pre-tax basis **(9.355%)** and then multiplied by 72%.*							
3 IRR calculation for preference shares							
	Jan. 2021	**Dec. 2021**	**Dec. 2022**	**Dec. 2023**	**Dec. 2024**	**Dec. 2025**	
	R'000	**R'000**	**R'000**	**R'000**	**R'000**	**R'000**	
Cash inflow	20 000						
Dividend payments		(1 000)	(1 000)	(1 000)	(1 000)	(1 000)	
Cash outflow redemption						(23 000)	
Total cash flows	20 000	(1 000)	(1 000)	(1 000)	(1 000)	(24 000)	1
IRR	**7,58%**						1C
Alternative							
IRR	**7,58%**						1C
FV = R23 million; PV = R20 million; PMT = R1 million; and N = 5							1
***Note**: No credit for IRR mark for preference shares if tax effects are incorporated.*							
Available							**7**
Maximum							**7**
Total for part (f)(i)							**7**

Part (f)	**With reference to the two financing options proposed by Patrick – (ii) recommend with reasons (including an analysis of the characteristics of each option) which financing option AfriViews should select.**	**Marks**
1	**General considerations applicable to both**	
1.1	What **security or collateral** will be required on the loan / preference shares?	1
1.2	**Are any other covenants**, e.g., dividend declarations, restrictions on additional future debt funding, etc. in place and the more favourable to AfriViews?	1
1.3	The differential **cost** of issuing the respective instruments need to be considered as it could impact the attractiveness of the instruments.	1
2	**Long-term loan**	
2.1	The annual interest payments on the loan are variable, which could lead to lower costs if interest rates decline or higher costs if rates increase (**interest rate risk**)	1
2.2	Is there a threat that the company will not be able to meet the requirements of **King IV and the loan becomes immediately repayable**? may cause going concern issues should this materialises as resignations may not be controlled	1
2.3	The benefits of the interest tax shield would be reduced as from 1 April 2022 should the **tax reduce from 28% to 27%.**	1
3	**Preference shares**	
3.1	The preference shares provide **liquidity cushion because of a fixed dividend** commitment of 5% per annum, which appear lower than the loan interest terms. However, the cash flow profile of the preference shares is favourable during the loan term but there is a **large premium at the end which may not be afforded**.	1
3.2	The fixed dividend further **provides cash outflow certainty** relative to the variable interest payments on the loan. The 5% is already low and the **risk that the prime interest rate on the loan could decline to this level is unlikely**.	1
3.3	The question is whether the repayments would be more flexible **(i.e. cumulative)** if cash flow problems are experienced? Although both likely to be classified as debt instruments, this flexibility might provide a lower financial risk to AfriViews.	1
3.4	**CAI, as AfriViews' controlling shareholder, may be accommodating** should AfriViews experiencing financial challenges throughout the term of the funding (subordinations etc.). This flexibility might not be available from XYZ.	1
4	**Recommendation**	
4.1	The long-term loan cost of an effective IRR of 6,74% compared to the preference shares at 7,58% is **advantageous**.	1
4.2	However, the **flexibility that comes with the preference shares** in these uncertain times might be preferable.	1
4.3	Is there an opportunity for an **equity injection from CAI or alternative quasi-equity** funding instrument?	1
	Available	**15**
	Maximum	**8**
	Total for part (f)(ii)	**8**
	Communication skills – logical argument	*1*
	Total for part (f)	**16**

Part (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 VAT period.**	**Marks**
Output tax		
1	This is a **barter transaction** wherein AfriViews transfers a machine to Patrick as **consideration that includes payment made otherwise than in money** as defined in s1 in exchange for the services.	1
2	The transaction is a '**supply**' because it includes performance in terms of a '**sale**' that includes any transaction or act **whereby ownership of a machine** passes from AfriViews to Patrick or it is **'all other forms of supply'**	1
3	AfriViews need to consider the provisions of section 10(4) because the transaction appears not to be at arms' length:	
3.1	AfriViews made a supply for a consideration in money because the R200 000 value for facilitating the risk workshop is a **consideration expressed as an amount of money which**	1
3.2	**is less than the open market value** of the supply of R270 000 (s10(4)(a))	1
3.3	and the AfriViews and Patrick **are connected persons** in relation to each other (s10(4)(b)) because	1P
3.4	Patrick has an **indirect interest in more than 10%** of the equity shares of AfriViews (≥26%) because Patrick holds majority of shares in CAI (> 51%) which in turn owns 51% of the shares in AfriViews (para. (d)(i) of the definition of 'connected person' in s1(1))	1P
3.5	Patrick would **not have been entitled under s16(3) to make an input tax** deduction of the full amount because he is not a VAT vendor (s10(4)(c)).	1P
3.6	For those reasons, the consideration in money for the supply **is deemed to be the open market value of the supply** of R270 000 (s10(4)).	1P
4	This section applies because the transaction was not **entered into by virtue of Patrick's employment** as in accordance with s18(3) and it is a supply of a machine in the course or furtherance of an enterprise.	1
5	Therefore, AfriViews will levy output tax of **R35 217 (R270 000 x 15/115)** because the **open market value of a supply shall include any tax** charged under section 7(1)(a) on that supply as defined in s3(1)(b).	1
6	The time of the supply is **on 25 February 2020,** being the time when the goods were made available to Patrick (as the recipient) (s9(2)(a)(ii)).	1
7	AfriViews **must issue a tax invoice within 21 days** of the date of that supply (i.e. 17 March 2020) in terms of section 20(1).	1
8	There are **no vat consequences** on the services received in exchange of the machine because no output tax would have been charged by Patrick as he is a non-VAT vendor and **there is no notional input tax on services**.	1
	Available	**13**
	Maximum	**8**
	Total for part (g)(i)	**8**

Part (g) With regard to the exchange of the bottle-forming machine by AfriViews in return for a risk identification and assessment workshop by Patrick – (ii) Calculate, with reasons, the normal tax implications for AfriViews for this exchange			Marks
	Amount		
	R	R	
Recoupment on disposal of glass-forming machine			
Selling price: R270 000 market value (s8(4)(k)(iii)) less output tax of R35 217 is not an amount which has been recovered/recouped and not limited to cost of R540 000		234 783	1P
Tax value determined using section 12C		0	
• Acquisition cost excluding input tax	540 000		
• Allowances (40% in 2017 & 20% for 2018 to 2020)	(540 000)		1
Recoupment		234 783	
Capital gains tax			
Proceeds (deemed market value para. 38 of 8th Sch.)	270 000		1
Less: Output tax levied on the supply	(35 217)		1P
Less: Recoupment (para. 35(3)(a) of 8th Sch.)	(234 783)		1P
Proceeds		0	
Less: Base cost		(0)	
Acquisition cost excluding VAT	540 000		
Less: s12C allowances (2017 - 2020)	(540 000)		1P
Capital gain/loss		0	
Alternatively: *no capital gains tax because the selling price (or market value) is less than original cost*			1A
		Available	**6**
		Maximum	**6**
		Total for part (g)(ii)	**6**

Part (g)	With regard to the exchange of the bottle-forming machine by AfriViews in return for a risk identification and assessment workshop by Patrick – (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.	Marks
1.	The **onus of proof** rests upon AfriViews to prove an amount will be deductible for normal tax purposes in terms of s102 of the Tax Administration Act (if any).	1
2.	**An amount of R200 000** agreed between the parties as value of the services to be rendered, would normally qualify to be deducted if it meets the criteria set out in **s11(a) read together with s23(g)**.	1
3.	However, **no deduction must be allowed under s11(a)** in respect of this R200 000 because in this barter transaction, such deduction	1P
4.	**is prohibited by s23B(3)** since the expenditure of R540 000 (in the form of allowances on the machine) has **already been granted in terms of s12C**.	1P
5.	Furthermore, **there is no loss actually incurred** by AfriViews from the barter transaction because a recoupment was realised on disposal; or the machine was voluntarily disposed by AfriViews; **it was not an involuntary deprivation**	1P
6.	The **output tax of R35 217** from the supply of the machine is to be deducted under s11(a) because there is no cash received and paid to SARS (no agency) and it meets the criteria set out in **s11(a) read together with s23(g)**.	1P
Alternative solution		
1.	The **onus of proof** rests upon AfriViews to prove an amount will be deductible for normal tax purposes in terms of s102 of the Tax Administration Act (if any).	1
2.	**Amount of R200 000** agreed between the parties as value of the services, that would have been paid in cash if this was a not a barter transaction,	1
3.	*<u>Alternatively</u>: an **amount of R234 783** being the cash that would have been received from the sale of machine and used fully to procure the services*	1P
4.	would qualify to be deducted because it meets the criteria set out in **s11(a) read together with s23(g) –** if there is expenditure actually incurred	1
5.	The **amount is an expenditure** actually incurred as a **"cost"** to AfriViews as there was a **reduction of its machines** (refer *CSARS v Labat Africa Ltd).*	1
6.	during the 2020 year of assessment, in the production of income because risk workshop is closely connected to income generation and it is not of capital nature because there is no enduring benefit	1
	Available	**6**
	Maximum	**4**
	Total for part (g)(iii)	**4**
	Communication skills – presentation	*1*
	Total for part (g)	**19**