

<b>Part (e) Discuss the pitfalls and merits of each strategic option with regard to DMG entering the Mauritian market, supported with reasons and calculations. State which of the two alternatives you would recommend for DMG</b>	
<b>Merit for both options regarding Mauritius expansion</b>	
1. <b>Emerging low alcohol gin market in Mauritius:</b> Health-conscious individuals who like the flavour of low alcohol gin.	1
2. <b>Tax rates in Mauritius</b> are low, and could result in higher after-tax cash flows to the investors.	1
3. <b>The high GDP per capita of Mauritius</b> means that people might more easily afford the gin than in SA.	1
4. <b>DMG gin of higher quality</b> than current market suppliers in Mauritius resulting in a competitive advantage.	1
5. <b>Hornet/Greys</b> are local alcohol manufacturer and accordingly <b>familiar with local manufacturing/distributing laws</b> and legal requirements in Mauritius.	1
<b>Pitfall for both options regarding Mauritius expansion</b>	
6. <b>Mauritius has a much smaller population than SA</b> and the 25% market share may grow not as much as the South African market would grow in the future – why not expand locally?	1
7. <b>Foreign exchange exposure in terms of Mauritius expansion</b>	1
<b>Merits for Option A (JV with Hornet)</b>	
8. Hornet's premises is <b>easy accessible</b> by road and public transport and provide the venture with access to the <b>labour market</b> .	1
9. Hornet's provides the venture with access to the <b>local labour market</b> .	1
10. No <b>additional production capacity</b> will be required by DMG in SA as Hornet only operates at 40% capacity and the Gin will be manufactured using the spare capacity in Mauritius	1
11. The <b>risk will be shared</b> by both parties with regard to this venture	1
12. Financial considerations:	1
• <b>More profitable:</b> The trading margin of 16% is higher than the current margin of 7.1%	
	<b>7.1% (567 600/7 960 000)</b>
• <b>Higher net cash flows</b> over the long term	1
	<b>(60m*16%) = 9,6m</b>
	<b>9,6m* 60% (DMG share)= 5,76m (P)</b>
	<b>(Y1 - 10%*5,76m - R576 000) (P)</b>
	<b>( Y2 - 20%*5,76m - R1,152m) (P)</b>
	<b>(Y3 - 25%*5,76m- R1,440m onwards) (P)</b>
• <b>DMG investment is 50%</b> of the cost but <b>for a 60% profit</b>	1
	<b>(Hornet is investing R8m, (R6,25m x 60% + R4,25); and DMG is investing R8m )</b>
<b>Pitfalls for Option A (JV with Hornet)</b>	
13. <b>Reliance on a foreign partner for infrastructure and manufacturing</b> and the reliability of Hornet is critical.	1
14. <b>Potential conflicting management</b> styles may jeopardise the joint arrangement, resulting in failure.	1
15. <b>Hornet lacks the expertise in the production of low alcohol gin</b> which may impact the <b>quality of the gin</b> manufactured in Mauritius if supervision will only be from two SA managers.	1
16. <b>No value is</b> placed on DMG <b>distilling expertise</b> .	1
17. <b>Potential loss of expertise and focus in the South African operations</b> as a result of two managers expatriated to Mauritius and Matty needing to visit frequently.	1
18. <b>Labour issues and industrial action</b> may increase the cost of production beyond the current estimates.	1
19. <b>Hornet</b> (potentially a competitor) will now have <b>access to DMG's secret gin recipe</b> . ( <i>Greys does not get access to DMG's secret gin recipe – merit for Option B</i> )	1
20. Hornet currently has sufficient <b>capacity, but what happens if it wants to expand in future?</b>	1
21. Costs and capacity of the <b>free samples</b> not taken into account	1
22. <b>Additional costs for travel and accommodation</b> as a result of <b>two managers expatriated to Mauritius and Matty</b> needing to visit frequently for events.	1
<b>Merits for Option B (Greys)</b>	
23. Greys already has <b>strong existing distribution channels</b> in Mauritius	1
24. DMG will <b>maintain control over the production</b> of gin, therefore ensuring <b>consistent quality</b>	1
25. DMG may benefit from importing Grey's products and <b>diversifying its revenue streams</b>	1
26. Established business and experience in distributing variety of products <b>for over 73 years</b>	1
27. Wide <b>customer base</b> to supply to (small boutiques to hypermarkets).	1

28. <b>Future consideration</b> for DMG to expand to distributing to <b>Europe</b> because of relationship with Greys	1
29. Financial considerations:	1
• <b>Less upfront investment</b> required (R5m versus R8m in option)	
• <b>Shorter payback period</b> to recover capital investment (5.5 years (B) vs 6.3 years (A) – before tax)	1
<b>60m *7.1% = 4,26 m (profit share from the Mauritius marker)</b>	½
(Y1 - 10%*4,26 m = R426 000) (P)	½
(Y2 - 20%*4,26 m = R852 000) (P)	½
(Y3 - 25%*4,26 m = R1,065m onwards) (P)	½
(5m – 426000 (1) – 852000 (2) – 1.065m (3) – 1.065m (4) – 1.065m (5) = 527000 (1/2 of yr 6 cash flow) = 5.5 yrs(P)	1
(8m – 576000 (1) – 1,152m (2) – 1.440m (3) – 1.440m (4) – 1.440m (5) – 1.440m (6) = 512000 (1/3 of yr 7 cash flow) = 6.3 yrs (P)	1
<b>Pitfalls for Option B (Greys)</b>	
30. Reliance on a <b>foreign partner for distribution</b> – thus the reliability of Greys will be critical.	1
31. <b>Demand levels</b> for DMG and Greys gin may <b>not be the same</b>	1
32. The <b>partners are in direct competition</b> ; this may result in Greys not pushing DMG sales as hard as for sales of its own brands. ( <i>Hornet &amp; DMG are not in direct competition (wine vs gin), and the risk of conflict of interest is small – merit under Option A</i> )	1
33. Greys will control Mauritius customer relationships, which means that <b>DMG will be reliant on Greys.</b>	1
34. Greys has a product of lower quality – <b>distributing their gins might harm DMG’s reputation.</b>	1
35. <b>Resistance by Mauritian government and locals</b> to the fact that the <b>gin is not produced locally</b> and not extending work opportunities to the local communities	1
36. <b>Glass</b> bottles could <b>break</b> during <b>transportation.</b>	1
37. <b>Additional distribution costs</b> (and import taxes) for getting the gin to Mauritius	1
38. If the Yuppiedrinks agreement realizes, DGM will only have 10 000 bottles spare capacity and accordingly DMG will need to expand its distillery in SA to increase <b>production capacity to meet the additional sales demand for the Greys venture.</b>	1
<i>DMG capacity - 110 000 bottles of gin (2200/8 hrs * 300 litres, / 750ml)</i>	1
<i>Spare capacity –( 110 000 – 40 000 (2019 budget) – 60 000 (YupD agreement) = 10 000)</i>	½
<b>Recommendation</b>	
<b>Option A:</b> (Hornet): Financial much better/higher profits, also no additional spend on SA plant to increase capacity and partner to share risk <b>OR</b> <b>Option B:</b> (Greys) shorter payback period of investment, DMG’s secret gin recipe safe, quality of product controlled.	1
<b>Available</b>	<b>52</b>
<i>Communication skills – logical argument</i>	1
<b>Maximum for part (e)</b>	<b>21</b>

<b>Part (f) Discuss with regard to to the most recent Board meeting –</b>	
<b>(i) any concerns you have in with reference to the Companies Act, Act 71 of 2008, and the SAICA Code of Professional Conduct.</b>	
1. Harry is <b>conflicted</b> regarding the <b>Board’s decision</b> to award the <b>contract to PackFast</b> as:	
• He ( <b>Harry</b> ) <b>owns 10%</b> of the equity interest in PackFast and is also the CFO and a director of DMG;	1
• His sister ( <b>Sally</b> ) <b>owns 90%</b> and is <b>the CEO</b> of PackFast who would benefit financially from the contract.	1
<b>2. Companies Act:</b>	
2.1 <b>Section 75</b> of the Companies Act as the <b>contract between DMG and PackFast will lead to significant personal financial benefits</b> for him as as shareholder of PackFast.	1
2.2 Accordingly he should have disclosed his <b>personal financial interest</b> in the contract with PackFast:	
• his <b>direct interest of 10%</b> ;	1
• his <b>indirect interest</b> arising from Sally being his sister and <b>related in term of section 2 of the Companies Act</b> (90% ownership and being the CEO).	1
2.3 Following the requirements from section 75 Harry should further have:	
• <b>left the meeting</b> immediately after disclosing his interest in the matter; and	1
• <b>not taken part</b> in the consideration of the matter ( <b>not have voted</b> on the matter).	1

2.4 A further consideration is that Harry also did not acted with the <b>required degree of care, skill and diligence as required by section 76</b>	1
2.5 Harry could be held liable in terms of Section 77 of the companies act	1
<b>3. SAICA CPC:</b>	
3.1 Harry is a <b>CA(SA)</b> and must adhere to the <b>SAICA CPC</b> requirements for Accountants in Business.	1
3.2 Fundamental Principles that could be breached (Section 310)	
<b>Objectivity/Independence:</b>	½
• Self-interet threat exists due to -	½
• The interest in the contract/conflict might <b>compromise his business judgement</b> to act in the best interest of DMG;	1
<b>Integrity:</b>	½
• Not disclosing his interest could lead to him <b>not being honest and straightforward</b> in his dealings with the board of directors / DMG; and	1
<b>Professional behavior:</b>	½
• Not disclosing his interest could lead to non compliance with laws and regulations and accordingly <b>contravening</b> the SAICA CPC and Companies Act.	1
3.3 The threats to these fundamental principles <b>cannot be regarded as being at an acceptably low level (is significant)</b> because not disclosing the interest and voting on the contract with PackFast:	
• Contravene section <b>Companies Act</b> (section 75);	1
3.4 <b>Safeguards need to be applied</b> to eliminate the threats to compliance created by conflict of interest or to reduce to an acceptable level (e.g <b>withdrawing from decision making process</b> related to the matter, <b>consulting with third parties</b> etc.)	1
3.5 Accordingly it is clear that Harry <b>did not follow the safeguards as required by the SAICA</b> Code and could be found guilty of improper conduct (conclusion)	1
<b>Available</b>	<b>18</b>
<b>Maximum for part (f)(i)</b>	<b>9</b>

<b>Part (f) Discuss, with regard to the most recent Board meeting –</b>	
<b>(i) the aspects that should be considered by the audit team with regard to the decisions taken in terms of the Auditing Professions Act, Act 26 of 2005</b>	
1. Katherine Birtwistle, the <b>audit engagement partner</b> , is responsible for <b>direction and review on the audit</b> , and accordingly ultimately responsible for identifying and reporting the aspect as deemed nesessary (ISA 220) in term of the Audit Professions Act and the Companies Act.	1
1.1 Accordingly she should have <b>identified Harry’s interest in the contract with PackFast</b> and followed up whether all <b>statutory requirements were</b> met.	1
1.2 It would be reasonable to expect that Katherine (or at least her audit team) to <b>have read the minutes</b> of the Board meetings of DMG, and hence they would be <b>aware that Harry voted in favour</b> of the PackFast agreement.	1
1.3 It would reasonable be expected by the <b>audit team to perform procedures to identify related party transactions</b> and as such <b>reviewing the register/schedule of directors shareholdings</b> (identified Harry’s shareholding) and accordingly his interest in the contract with PackFast	1
1.4 <b>Sally is a related party to Harry (sister and CEO)</b> and accordingly in terms of the Companies Act, Harry is conflicted and should have <b>declared his interest and not have voted on the matter</b>	1
2. The <b>contract with Packfast is a significant contract</b> for DMG and accordingly the auditors should have <b>inspected the contract and the parties thereto</b> , which would have disclosed Harry’s shareholding and/or relationship to his sister (could possibly be seen as onerous contract in terms of ISA 37).	1
3. Katherine’s considerations to determine <b>whether an RI exists are as follows</b> section 1 of AP Act):	
3.1 Whether an <b>unlawful act or omission</b> has occurred:	
• Harry contravened section 75 of the Companies Act by <b>not declaring his interest in, and voting</b> on the contract with Packfast.	1
3.2 Whether the unlawful act has <b>been committed by someone responsible for management of the entity:</b>	
• The unlawful act was committed by <b>Harry, a director of DMG.</b>	1
3.3 Whether the unlawful act could result in a <b>material financial loss</b> to any partner, member, shareholder, creditor or investor:	
	1

<ul style="list-style-type: none"> <li>The contract is <b>void</b> as Harry did comply with the requirements of section 75 (section 75(7) and unless <b>ratified</b> by the shareholders or the court, and;</li> <li>Could result in <b>penalties to DMG</b> levied by PackFast if the contract is declared void; or</li> <li><b>Financial loss to PackFast</b> in the contract is cancelled.</li> <li>Considerations should be given to the fact that the <b>shareholders of DMG would probly ratify the contract</b> as it appear very <b>beneficial for DMG</b> (e.g. best quality at cheapest price) and accordingly would not result in financial loss to any party.</li> </ul>	1 1 1
<p>3.4 Whether it relates to <b>fraud or theft</b>:</p> <ul style="list-style-type: none"> <li>The unlawful act does not seem to relate to fraud or theft as it may <b>not be intentional</b> and the <b>contract terms are being very beneficial to DMG</b> (contract negotiated at a significant discount to MBG)/ Harry <b>intentionally not disclosing</b> to ensure PackFast is selected.</li> </ul>	1
<p>3.5 Whether the unlawful act constitutes a <b>material breach of fiduciary duty</b>:</p> <ul style="list-style-type: none"> <li>Non-compliance with section 75 is a <b>significant breach</b> of the companies act, which would be considered a material brach of a <b>diretors duty of care, skill and diligence</b> (refer IRBA guide or RI)</li> <li>If the agreement was indeed the <b>best available option for DMG</b> (e.g. best quality at cheapest price), it could be argued that this <b>does not amount to a material breach</b> of his fiduciary duty as Harry acted in the <b>best interest of DMG</b>.</li> </ul>	1 1
<p>4. <b>Conclusion:</b> Based on the above, Katherine will need to report a reportable irregularity to the IRBA.</p>	1
<p>5. In terms of Sec 44 of the APA, If a reportable irregularity exists, it has an impact on the <b>auditor's report</b> which should include a section on '<b>Other Legal and Regulatory Requirements</b>' noting that an RI has been reported and the details thereof.</p>	1
<p>6. In terms of Sec 44 of the APA, the <b>accounting treatment should</b> be considered if the <b>contract is not ratified</b>;and if <b>not correctly accounted</b> for in terms of IFRS, the <b>audit report</b> may need to be qualified.</p>	1 1
<p>7. S52 of the APA states that should an auditor fail to report a RI i.t.o S45, he/she will be guilty of an offense, leading to possible fine (liability) or imprisonment.</p>	1
<b>Available</b>	<b>21</b>
<i>Communication skills – clarity of expression</i>	1
<b>Maximum for part (f)(ii)</b>	<b>11</b>

<b>Part (g) Discuss, with reference to the SAICA Code of Professional Conduct, any concerns you have in relation to the audit team's attendance and conduct at the cocktail evening held by DMG</b>		
1	<b>Trainee accountants</b> are required to <b>adhere to the SAICA CPC</b> due to the requirements of <b>their training contracts</b> and the firm's requirement that it should achieve the 'ethical requirements' objective of ISQC1.	1
2.	<b>Attendance at cocktail evening (Hospitality)</b>	
2.1	Attendance at the event by the auditors may create treats to independence: <ul style="list-style-type: none"> <li><b>Familiarity threat</b> <ul style="list-style-type: none"> <li>due to the team attendance being seen as having a <b>close relationship</b> with DMG management and staff (or the developing of such at these functions), which might have the audit team being too sympathetic to their interests or too accepting of their work;</li> <li>due the the team's attendance can be seen as accepting gifts or preferential treatment from DMG, which might have the audit team being too sympathetic to their interests or too accepting of their work;</li> </ul> </li> <li><b>Intimidation threat</b> <ul style="list-style-type: none"> <li>based on what the <b>intention might be for DMG</b> in inviting the audit team, which could deter the auditors from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over them.</li> </ul> </li> <li><b>Advocacy threat</b> <ul style="list-style-type: none"> <li>due to the team's attendance at the event may be seen to be endorsing the quality of DMG's products</li> </ul> </li> </ul>	½ 1 1 ½ 1 1
2.2	Considerations need to be given whether the hospitality (cocktail event invitation) is <b>significant or trival and inconsequential</b> .	1
2.3	<b>If considered significant</b> , safeguard need to be applied to eliminate or reduce the risk to acceptable level, if cannot be reduced/eliminated then such offer <b>must not be accepted</b>	1
3.	<b>Disclosing client confidential information (Fundamental principles section 110)</b>	
3.1	Diana has not complied with the fundamental principle of <b>Confidentiality</b> : <ul style="list-style-type: none"> <li>She <b>shared private client information obtained during</b> the conduct of the <b>audit</b></li> <li>This she also did <b>without the consent (permission) on the client</b></li> </ul>	1 1

3.2	Diana has not complied with the fundamental principle of <b>Professional Behaviour</b> : <ul style="list-style-type: none"> <li>• <b>Disclosing client information</b> to 3<sup>rd</sup> parties could be seen as conduct that <b>might discredit the profession.</b></li> </ul>	1
3.3	Diana has not complied with the fundamental principle of <b>Objectivity</b> <ul style="list-style-type: none"> <li>• Her '<b>excitement about the potential agreement</b>' and her 'efforts help DMG to secure the agreement' could be seen to <b>advocate the clients business</b> and could create threats to her <b>independence</b></li> </ul>	1
3.4	Accordingly it is clear that Diana <b>did not follow the guidelines as set out by the SAICA Code</b> and could be found guilty of improper conduct (conclusion)	1
<b>Available</b>		<b>13.5</b>
<b>Maximum for part (g)</b>		<b>5</b>