

QUESTION 1**100 marks**

You are a trainee accountant at Auditco Inc. ('Auditco'), a firm of Registered Auditors, and you have been assigned to the audit of Car Leasing SA Ltd ('CLease'). Auditco has been the auditors of CLease since 2010. You are currently busy with the audit for the 30 September 2017 financial year end (FY2017).

Auditco uses the latest available audit software to assist with the performance of its audit procedures. This is to ensure that it makes optimal use of available time and resources to carry out the most effective and efficient audits possible.

Audit workpapers for CLease

The following workpapers have been prepared and are available for your review:

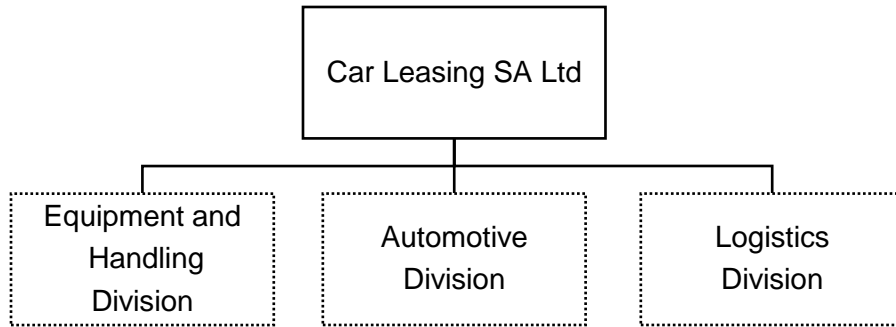
Workpaper	Reference number
Background and understanding of the entity	A100
System description: Fleet Management Solutions System	F400/1-2
System description: Maintenance of vehicles	F410/1-2
Lease contract with AHire	H650

You have also received further information about the audit team and its interactions with the client (see page 8).

Client: CLease	Year end: 30/09/2017	A100
Prepared by: Junior Accountant	Date: 04/11/2017	
Reviewed by:	Date:	
Subject: Background and understanding of the entity		

CLease provides integrated fleet management, product support and logistics solutions. The company was established in 1962 in South Africa and listed on the Johannesburg Stock Exchange in the 1990s.

The following is a diagrammatic representation of the CLease company structure:



CLease is a category C registered value-added tax (VAT) vendor. As a result of interest received by CLease, the Commissioner of the South African Revenue Service has approved a VAT turnover-based method of apportionment to arrive at an acceptable input ratio of 80% for CLease. The divisions are not separately identifiable in the financial records of CLease.

CLease has decided to early adopt IFRS 16 *Leases* and applied it for FY2017. Audit work was performed during February 2017 to assess the impact of the adoption of IFRS 16 and the recognition, initial measurement and classification of the leases were tested and found to be correctly accounted for.

Although CLease has a good IT infrastructure and sound controls in place, the recent ransomware attacks on and hacking of IT systems around the world have caused management great concern with regard to the company's cyber security.

Client: CLease	Year end: 30/09/2017	F400 1 of 2
Prepared by: Junior Accountant	Date: 04/11/2017	
Reviewed by:	Date:	
Subject: System description: Fleet Management Solutions System		

Fleet solutions – part of the Automotive Division

The CLease fleet solutions comprise the following:

- Financing solutions to ensure that clients' businesses obtain the lease option that is best suited to their needs; and
- Fleet management solutions that include a wide range of services to clients, such as vehicle maintenance and vehicle tracking and diagnostics.

The Fleet Management Solutions System

To support the offering of the fleet solutions, CLease operates an integrated IT system called the Fleet Management Solutions System (FMSS) which uses the latest available information technology. The version of the FMSS used is included as part of the logon screen of the system. The FMSS is operated on an Oracle database solution which uses a combination of on-premises and cloud-based applications. The following are some of the features of the database:

- Collecting, processing and storing data on vehicle lease contracts and vehicle maintenance;
- Collecting information for monitoring of vehicle activity (e.g. on the location of vehicles using a global positioning system (GPS));
- Collating and exporting data for analysis;
- Control of the use of computing resources (both hardware and software);
- Automated naming, creation and deletion of data files; and
- Database backup, restoration and recovery.

The FMSS also includes the following standard security features:

- Logon authentication through unique logon IDs linked to passwords for each employee authorised to access the FMSS. The unique logon ID linked to the password also confirms that the sales personnel have authorisation to access the system.
- Access control by means of passwords (using the latest best practice for passwords);
- Assignment of responsibilities and privileges (e.g. limiting or enabling access to certain programs and files) depending on the responsibility level of users;
- The ability to draw reports of persons who accessed the system; and
- Reports that provide an audit trail of daily activities.

The vehicles are tracked using the latest GPS software. Each vehicle is fitted with a tracking device that allows CLease to pinpoint its location accurately, in real-time. All CLease clients also have access to the information from the tracking system, which allows them to track their vehicles at all times. The CLease FMSS also manages the scheduling and tracking of maintenance on the vehicles.

The FMSS is used by the different branches of CLease located across South Africa and are connected via a wide area network (WAN). The FMSS keeps track of all vehicles through a sequential asset number, including vehicles for which a client lease contract has been taken out.

Client: CLease	Year end: 30/09/2017	F400 2 of 2
Prepared by: Junior Accountant	Date: 04/11/2017	
Reviewed by:	Date:	
Subject: System description: Fleet Management Solutions System		

To generate a fleet solutions contract, authorised sales personnel load the client and relevant contract details (e.g. vehicles to be leased, cost of each vehicle, duration of the lease, etc.) onto the FMSS. However, the processing of the loaded information and generation of the sequentially numbered contract, contract cost and the invoice to the client are automated. The information in the system interfaces with the CLease accounting software, and the accounting records (general ledger) are automatically updated from this system. The FMSS creates a hash total of transactions posted to the CLease accounting software each day, which is automatically compared to the hash total generated by the accounting system. Any exceptions are reconciled and reviewed by senior personnel.

The system automatically blocks the generation of the contract if certain checks have not been completed (such as a blank interest rate field or an invalid client identification number). Clients are able to contract CLease for only financing (fleet leasing) solutions or only fleet management solutions, or for both. The cost of each contract is automatically calculated, using standing data for prices, and are individually specified in the contract depending on what the client selects. The standing data for prices can only be updated through approval of the accounting manager and the marketing director.

After the client has signed the contract and once the contract becomes active, clients are able to access the client portal of the FMSS. This provides real-time information on the status of the client's lease contracts, remaining lease periods, payments due, escalations, and information on planned maintenance schedules.

Fleet managers oversee the management of client fleets and all administrative issues. The managers also deal with clients directly to manage their vehicle leasing needs.

Fleet managers also identify clients that have not been settling lease payments due, based on an 'overdue payment' report generated by the FMSS. This report is used by management to determine on which client accounts an allowance for credit losses should be made or which should be handed over for debt collection.

Once a week, the system generates a report with control totals that summarises the total transactions captured or processed on the FMSS system for the week, including new contracts, total interest accrued and total payments received. Every Monday morning the accounting manager reconciles the totals from this report to what has been posted to the general ledger and follows up on any differences.

A section on invalid items, such as no interest charged to a contract for the month or duplicate interest charged, is included in the weekly report. The accounting manager also reviews this section of the report, along with the audit trail of daily activities and processed items, and follows up on any unusual activity or invalid items. The accounting manager also generates a list of the new contracts generated and follows up on any missing numbers within the sequence.

Client: CLease	Year end: 30/09/2017	F410 1 of 2
Prepared by: Junior Accountant	Date: 04/11/2017	
Reviewed by:	Date:	
Subject: System description: Maintenance of vehicles		

Understanding maintenance

Vehicle maintenance and repairs can be either scheduled preventative maintenance or unscheduled breakdown maintenance.

The objective of CLease's maintenance policy is to ensure that the majority of vehicle maintenance and repairs is performed on a scheduled (planned) rather than an unscheduled basis.

- **Preventative maintenance** consists of servicing and repairs to reduce breakdowns and maximise vehicle availability. It is scheduled based on time travelled, mileage, engine hours, and litres of fuel used. Preventative maintenance actions include vehicle inspection, cleaning, testing, and repair and/or replacement of worn parts.
- **Unscheduled breakdown maintenance** is often due to a lack of preventative maintenance, and can be costly. It reduces vehicle life span, and vehicles may become unsafe or prone to excessive breakdowns. If a vehicle becomes unsafe due to a lack of maintenance or repair, the fleet manager could be held liable.

System for preventative maintenance

CLease has service centres situated around the country. Each vehicle leased to clients by CLease has a preventative maintenance schedule, based on specific parameters set as per the preventative maintenance policy.

CLease has developed a checklist of tasks to be performed during routine preventative maintenance services.

When the vehicle is due for scheduled preventative maintenance, the client logs a request for service at the nearest CLease service centre via the CLease website. An administrator accepts the request and schedules a date for the service on the online system. CLease prides itself on scheduling a service date and time within 24 hours of the request, to be performed within a week from the booking request date.

On the day of the service, the client drops the vehicle off at the service centre. The vehicle is then assigned to a team of technicians headed by a senior technician. The team is overseen by a service manager who liaises with the client. This information is recorded electronically on the FMSS.

Before the service commences, the service manager determines whether the vehicle has a maintenance plan (purchased with the leasing of the asset) or not. This will determine the invoicing and accounting for the maintenance costs. These costs are allocated to the relevant vehicle and the cost allocated is recorded on the FMSS.

Client: CLease	Year end: 30/09/2017	F410 2 of 2
Prepared by: Junior Accountant	Date: 04/11/2017	
Reviewed by:	Date:	
Subject: System description: Maintenance of vehicles		

Performing the preventative maintenance service

The team of technicians works through the routine preventative maintenance service checklist. Each item is checked and if repairs are necessary, the senior technician logs both the check and the details of the repair electronically on the FMSS. The system calculates the cost of the repair. If the vehicle is subject to a maintenance contract the repairs are carried out. If not, the service manager and client telephonically agree on repair costs before proceeding. Agreement of repairs to be carried out is confirmed by the client via the FMSS immediately after the telephone call, for authorisation by both parties.

At the conclusion of the service, the senior service technician digitally signs the checklist on the system to verify that the service has been completed. The manager meets with the client to discuss the service and hand over the vehicle. The client digitally confirms receipt of the vehicle and satisfaction with the service and repairs. The service manager also digitally signs via the FMSS to conclude the transaction. Costs of repairs to vehicles not subject to a maintenance plan are charged to the client's fleet account. The clients are invoiced at the end of each month and invoices are payable within 30 days of the invoice date.

Monitoring of costs of preventative maintenance

Since maintenance and repair costs are considered a variable operating expense, CLease fleet managers track parts, labour, fuel and consumables used for each vehicle. These costs are monitored and analysed on a regular basis to determine which vehicles cost the most to run. This provides CLease with information about vehicle efficiency and which vehicles have the lowest operating cost. The fleet managers use this information to advise clients when clients are determining which vehicle will best suit their needs.

Fleet managers compile a detailed report on the FMSS from the data collected from the recorded preventative maintenance activities and costs. The report outlines the total number of completed vehicle jobs, provides detailed information on the type of scheduled and unscheduled work performed as well as on variable operating cost items.

The report is generated on a monthly basis and submitted to senior management for review to ensure that the report is complete. Once the senior manager has reviewed the report, he/she digitally signs the report. The reviewed report is then automatically emailed by the system to the client.

Client: CLease	Year end: 30/09/2017	H650
Prepared by: Junior Accountant	Date: 04/11/2017	
Reviewed by:	Date:	
Subject: Lease contract with AHire		
<p>On 1 July 2016 CLease entered into a contract with AHire (Pty) Ltd ('AHire'), in terms of which AHire received the right to use, at its discretion, a fleet of 100 motor vehicles for a period of three years. These motor vehicles are motor cars as defined in s 1(1) of the <i>Value-Added Tax Act, 1991</i> (Act 89 of 1991), as amended, and are of a similar model and size. CLease has a one-year extension option that will most likely be exercised by AHire. In addition, AHire has the option to purchase of the motor vehicles at the end of the contract term. At inception it was not likely that AHire would exercise the option to purchase the motor vehicles.</p> <p>The contract stipulates that CLease accepts the full risk of destruction or loss of the motor vehicles and assumes all obligations in respect of insurance. AHire accepts the full risk of maintenance and repairs and is required to reimburse CLease for insurance. The 100 motor vehicles are identified by registration number in the contract. Unless requested to do so by AHire, CLease may not substitute a vehicle in the fleet for another one.</p> <p>AHire will pay R410 145 (incl. VAT) at the end of each month as consideration for the use of the motor vehicles. Neither AHire nor CLease incurred any initial direct costs with respect to the lease. The incremental rate of borrowing for AHire is 11,5% per annum and the day 1 cash equivalent for the 100 motor vehicles was R12 694 892 (excl. VAT). The total finance cost of R5 214 784 is stipulated in the contract.</p> <p>The contract was concluded and delivery of the motor vehicles took place on 1 July 2016. The first instalment was paid on 31 July 2016 and all subsequent payments have been made on the respective due dates. AHire estimates the useful life of motor vehicles to be five years. AHire uses all vehicles evenly throughout the year.</p> <p>AHire provides short-term vehicle rental solutions. AHire is a registered category B VAT vendor, makes 100% taxable supplies and has a June year end. In terms of AHire's accounting policy, assets with an individual value of less than R25 000 are regarded as low-value assets.</p>		

Further information about the audit team and its interactions with the client

Fellow trainee and tax advice

Your fellow trainee on the audit of CLease, Prince Charm, is currently auditing the details of the lease agreement with AHire (as set out in workpaper H650). He has realised that there were some tax implications for the 2017 year of assessment regarding the lease that needed to be clarified with the audit manager and Auditco's tax expert. He has not yet met with either of these individuals to discuss the matter.

However, as part of the team assigned to the audit of a competitor of CLease, Prince was involved in auditing a contract with similar taxation issues as those contained in CLease's contract with AHire. He is eager to impress the new tax accountant at CLease, whom he finds very attractive. He accordingly emailed her an extract of the agreement and tax opinion for the other (competitor) client and offered to further advise her on the potential tax implications of the lease agreement. He added that Auditco, using the experience he had gained on the other client, would be able to assist CLease to gain a better understanding of these implications to ensure a positive tax outcome for CLease.

Audit engagement partner and golf event

CLease's CEO recently invited the audit engagement partner to participate in a four-day golf event at a five-star golf resort. The golf event is a prominent annual event to raise money for various charities. CLease paid the full costs for the event of the audit engagement partner. The partner had previously told the audit team that he would never go to an event like that as it was far too extravagant. He has since explained that it was important for him to attend the event as the networking opportunities had been wonderful.

MONETARY CHANGES – ITC 2018

Applicable in respect of years of assessment commencing **on or after 1 March 2016 (i.e. 2017 year of assessment)** – *unless specifically stated otherwise*

REBATES (section 6)

Primary rebate increases from R13 257 to **R13 500**;
(*Secondary and tertiary rebates remained unchanged*)

MEDICAL REBATES (section 6A)

Benefits to the taxpayer: R270 increases to **R286**;
Benefits to the taxpayer and one dependant: R540 increases to **R572**;
Benefits to each additional dependant: R181 increases to **R192**.

SECTION 9D inclusion adjustment if the resident is a natural person (section 9D(2A)(f))

For purposes of paragraph 10 of the Eighth Schedule: 33,3% increases to **40%** of that company's net capital gain for the relevant foreign tax year if the resident is a natural person.

SECTION 10(1)(q)(ii) Scholarship or bursary to relative of employee exemption

(aa) Remuneration proxy: R250 000 increases to **R400 000**
(bb)(A): R10 000 increases to **R15 000**
(bb)(B): R30 000 increases to **R40 000**

RESIDENTIAL ACCOMMODATION (paragraph 9 of the Seventh Schedule)

Symbol B of R73 650 increases to **R75 000**.

CGT ANNUAL EXCLUSION (paragraph 5(1) of the Eighth Schedule)

R30 000 increases to **R40 000**

CGT INCLUSION RATES (paragraph 10 of the Eighth Schedule)

In the case of a natural person or a special trust (as defined in s1): 33,3% increases to **40%**
In the case of a company and a trust (not being a special trust): 66,6% increases to **80%**

RATES OF NORMAL TAX

- In respect of the taxable income (excluding any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit or severance benefit) of natural persons, estates and special trusts

<u>Taxable Income (R)</u>	<u>Rate of Tax</u>
0 – 188 000	18% of taxable income
188 001 – 293 600	R33 840 + 26% of the amount above R188 000
293 601 – 406 400	R61 269 + 31% of the amount above R293 600
406 401 – 550 100	R96 264 + 36% of the amount above R406 400
550 101– 701 300	R147 996 + 39% of the amount above R550 100
701 301 and above	R206 964 + 41% of the amount above R701 300

- **Small Business Corporation (as defined in section 12E)**
(Applicable in respect of years of assessment ending on or after 1 April 2016)

<u>Taxable Income</u>	<u>Rate of Tax</u>
0 – 75 000	0% of taxable income
75 001 – 365 000	7% of the amount above R75 000
365 001 – 550 000	R20 300 + 21% of the amount above R365 000
550 001 and above	R59 150 + 28% of the amount above R550 000

TRAVEL ALLOWANCE

Value of the vehicle (R)	Fixed cost (R p.a.)	Fuel cost (c/km)	Maintenance cost (c/km)
0 – 80 000	26 675	82.4	30.8
80 001 – 160 000	47 644	92.0	38.6
160 001 – 240 000	68 684	100.0	42.5
240 001 – 320 000	87 223	107.5	46.4
320 001 – 400 000	105 822	115.0	54.5
400 001 – 480 000	125 303	132.0	64.0
480 001 – 560 000	144 784	136.5	79.5
Exceeding 560 000	144 784	136.5	79.5

Alternative fixed rate for certain reimbursive travel allowances: **329** cents per kilometer (previously 318 cents)

SUBSISTENCE ALLOWANCE

- Local travel:
 - Allowance for incidental costs only – **R115** (previously R109) for each day.
 - Allowance for meals and incidental costs – **R372** (previously R353) for each day.
- Overseas travel:
 - Actual accommodation plus a prescribed amount based on the relevant country (which amount will be provided in the ITC if it differs from the amount listed in the Regulation in the SAICA Student Handbook).

TRANSFER DUTY (Section 2(1)(b) of the Transfer Duty Act)

In respect of acquisition of property on or after **1 March 2016**:

Value of property (R)	Rate
0 – 750 000	0%
750 001 – 1 250 000	3% of the value above R750 000
1 250 001 – 1 750 000	R15 000 + 6% of the value above R1 250 000
1 750 001 – 2 250 000	R45 000 + 8% of the value above R1 750 000
2 250 001 – 10 000 000	R85 000 + 11% of the value above R2 250 000
10 000 001 and above	R937 500 + 13% of the value above R10 000 000

**INITIAL TEST OF COMPETENCE, JUNE 2018
PROFESSIONAL PAPER 2**

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

QUESTION 1 PART I – REQUIRED		Marks	
		Sub-total	Total
(a)	With reference to the FMSS database – (i) describe the business continuity risks that CLease is exposed to with regard to the integrated nature of the FMSS and because it is partly operated in the cloud; and (ii) identify the application controls that ensure that the processing of information with regard to the client contracts is valid and complete. <i>Communication skills – presentation and layout</i>	6 10 1	 17
(b)	Describe the substantive audit procedures that you would perform to verify the valuation of the ‘net investment in the leases’ balance as at 30 September 2017 in the accounting records of CLease. <ul style="list-style-type: none"> • Exclude substantive audit procedures regarding the recognition, initial measurement or classification of the net investment in the leases. • You can rely on the completeness, validity and accuracy of the lease data initially loaded onto the FMSS (i.e. that used to generate the lease contracts). • Ignore the effects of the lease contract with AHire described in workpaper H650. <i>Communication skills – clarity of expression</i>	15 1	 16
(c)	Describe the tests of controls you would perform on the system of preventative maintenance on the FMSS, as set out in workpaper F410. You can rely on the general computer controls.	14	14
(d)	Discuss, with reference to the SAICA Code of Professional Conduct – (i) the ethical conduct of the trainee accountant, Prince Charm, regarding his interactions with the tax accountant of CLease; and (ii) the ethical implications arising from the partner’s attendance of the golf event. <i>Communication skills – presentation and layout</i>	6 4 1	 11
Total for part I			58

**INITIAL TEST OF COMPETENCE, JUNE 2018
PROFESSIONAL PAPER 2**

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

QUESTION 1 PART II – REQUIRED		Marks	
		Sub-total	Total
(e)	<p>Discuss, supported with calculations where necessary, the following with respect to the contract entered into with CLease:</p> <p>(i) The VAT implications for AHire as a result of the lease agreement for the July and August 2016 VAT periods.</p> <p>(ii) The income tax implications for AHire arising for the 2017 year of assessment.</p> <p>Provide reasons where no tax implications arise.</p> <p><i>Communication skills – presentation and layout</i></p>	<p>14</p> <p>6</p> <p>1</p>	<p>21</p>
(f)	<p>Discuss the accounting treatment of the contract with CLease in the statement of financial position of AHire for the reporting period ended 30 June 2017 in terms of International Financial Reporting Standards.</p> <p>Limit your discussion to –</p> <p>(i) IFRS 16 <i>Leases</i> (assume that AHire has early adopted IFRS 16); and</p> <p>(ii) IAS 12 <i>Income Taxes</i>.</p> <ul style="list-style-type: none"> • Include all relevant calculations. • Round all amounts to the nearest rand. • Assume all amounts are material. • Ignore current tax. • Ignore comparative amounts, presentation and disclosure in your discussion. <p><i>Communication skills – logical argument</i></p>	<p>16</p> <p>4</p> <p>1</p>	<p>21</p>
Total for part II			42
Total for the question			100