Part (c) Identify and discuss the key factors that the management of AppliCo should consider in evaluating to which African markets (South Africa, Kenya, Zambia) it should sell its iDish product.		
1	Management of AppliCo need to **consider both financial and non-financial factors** in deciding whether to invest in accessing the greater Africa market, such as:	1
2	**Management's risk appetite**: relates to balancing the trade-off between risk and return, e.g. does the estimated initial excess profitability in the Zambian warrants taking the additional risks such as poor infrastructure, reliability of delivery, etc	1
3	**Profitability for each alternative** is critical in the decision-making process.	1
3.1	**Zambia** is the **most profitable** per product per unit R4900, Kenya R4100 whereas **South Africa** R3400 is the **least profitabl**e per unit **(profit per unit).** As production capacity is limited to 9000 units, profit should be maximized if **sale preference** is given to Zambia 2 000 units, Kenya 6000 and SA 1000 - resulting in a maximum available profit of **R37,8million.**	1 1 1
3.2	**Insurance cost for each alternative should be considered in relation to profitability, as these costs are not established by the research team (unknown).:** Should insurance and other related cost be marginal for South Africa, and more than R1 500pu for Zambia and R200 for Kenya, South Africa would be the better option. **(SA cost marginal vs other countries)**	1 1
4	**Logistical (transport) considerations and implications by country,** considering the information provided by the research team	1
4.1	***Zambia:*** The transport options available to deliver to Zambia are limited as it has **no access to sea transport** or **low cost air carrier numbers**. - The most viable options would be via **road and/or rail** which are expected to be **higher risk and lead to higher insurance costs**, operating losses and damaged goods costs	1 1
4.2	***Kenya:*** Transport to Kenya **has a sea transport option**, which appears to be relatively better developed than its road and rail networks, - Sea carriage poses **risks of pirates** along the East African coastline and could result in high maritime insurance costs. - **Air transport appears a viable option** with a comparatively high number of registered carrier departures.	1 1 1
4.3	***South Africa:*** Have **well-developed road, rail, sea** and air network - Access and **transport related** cost such as insurance and other costs **are expected to be low** and **delivery more reliable**.	1 1
5	**Consumer market and sustainability of demand** product's affordability and its ability to meet consumer needs in each of the assessed markets (small markets fade quickly & product perception):	1
5.1	***South Africa***. Consumer **market demand** in South Africa is **more than five times** that of the other markets. Consumers have on average more than **three times the GDP per capita**, access to finance/credit making them more likely to invest in convenience items (consumer spending/income category). This is further supported by the **product's focus on energy efficiency and after-sales support**, which should result in a stable ongoing market across the country.	1 1 1
	This is **however offset by strong and active competitive forces** in the market, the increased consumer activism and apparent rise in warranty claims. These factors could result in increased compliance, legal and **warranty costs**.	1 1
5.2	***Kenya*** Kenyan customers **prefer buying cash rather than credit**, aligned to their culture of savings and limited access to formal credit markets. This may indicate a **need for a different marketing approach** to target cash consumers opposed to using credit as a lure.	1 1
	The **growing middle income bracket** aligns with AppliCo's need to find new growth markets and Kenya could open opportunities for other AppliCo products as its brand becomes more recognised.	1

	The **consumers' price sensitivity** could result in lower than expected sales depending on alternatives and local competitor actions in the market. Consumer and government **desire for sustainable and efficient energy** support the iDish which meets these demands and could support the initial product launch.	1 1
	Kenyans 'appetite for **global brands'**, works in AppliCo's favour.	1
5.3	***Zambia*** Consumers are comprised largely of persons in **the lower income bracket** and the product might appear expensive. The appetite for the product is likely to be subdued with an expected demand of only 2 000 units.	1 1
	The products status as a leading brand is missed on the Zambian consumer, **who demands low-cost, durable products**.	1
	The lack of formal credit markets and high interest rates make cash sales critical and at current levels it is hard to see the iDish achieving even its low demand expectation. The **currency volatility** could erode any profits made in Zambia due to the depreciation in the currency, resulting in reduced profitability or potentially losses being incurred.	1 1
6	**Energy and water supply as** the product requires a stable supply of water and electricity, which is a scare resource. The risk of unstable **supply could damage the iDish**, it also affects the usability of the product.	1 1
6.1	**South Africa and Kenya** both have extensive water supplies to homes and stable electricity supplies, which means that the consumers would benefit from use of the product.	1
6.2	**Zambia's have inconsistent power supply**, resulting in consumers having less desire for the product as they might not continuously benefit from its use.	1
7.	**Market focus:** AppliCo is able to deliver 9 000 units to the market. It should consider whether it wants to pursue **a single market or a mix of markets**	1
7.1	***Zambia:*** **Small market, high margins**: If it wants to pursue a single market, Zambia, which only has a potential demand of 2 000 units, may not be best alternative. However, the potential excess profit per product could justify the immediate investment.	1 1
7.2	***Kenya and South Africa:*** appear to have a **strong demand** for the product, but demand is **offset by lower margins.**	1
7	**General**	
7.1	AppliCo is not known in the Kenyan and Zambian markets, and might have to spend considerable amounts of **money on marketing** to create awareness of the company and its products.	1
7.2	AppliCo has not traded in the Kenyan and Zambian markets and does not know the markets **– it might get its strategy very wrong if it do not understand its customers' needs.**	1
7.3	Kenya and Zambia might not have the **same electric current** as South Africa, which might mean that additional costs need to be incurred for conversion plugs.	1
7.4	R&M **is suffering from liquidity issues** which begs the question of where AppliCo will get **the funding for its growth strategy**.	1
7.5	**Political environment** and business stability in Kenya and Zambia which could affect exports and demand.	1
7.6	**Local laws and regulations** affecting imports and sale of foreign goods in Kenya and Zambia regulations (credit, consumer protection laws).	1
7.7	**Cost of providing after sale support:** will be much higher for Kenya and Zambia than SA.	1
7.8	**Border control issues (bribes/costs): will be higher for Zambia, as road freight only option**	1
	Available	**49**
	Communication skills – clarity of expression	**1**
	Maximum part (c)	**15**

Part (d)	**Prepare a memorandum addressed to the Risk Committee of the R&M group setting out the key business risks for the group arising from its strategy to operate in greater Africa.**	
1	**Political risk**	

1.1	Operating in a **volatile and politically unstable economy** holds the risk for the group of the recoverability of investment/profits derived from African countries due to repatriation restrictions.	1
1.2	The long-term sustainability of the business can be compromised as a result of **government policy changes**, **protectionism and populist politics**.	1
1.3	Resource dependent economies, such as Zambia and most other African states, are vulnerable to commodity price movements**,** making **market demand less predictable** and increasing earnings volatility.	1
1.4	There is an **increased exposure to bribery and corruption** given that the group is considering entering new countries where corrupt officials may target new entrants to the market. Increased legal, and reputational risk resulting from **the risk of bribery and** the risk of employees succumbing to the pressure to give bribes to achieve profitability and sales targets.	1 1
2	**Forex risk**	
2.1	**Currency volatility** is a constant concern. The group is exposed to **foreign currency** risk (USD vs ZAR) which could lead to foreign exchange gains and losses distorting performance.	1
3	**Forecast/model risk**	
3.1	Estimating consumer demand in foreign markets requires significant **assumptions and estimations**	1
3.2	Due to the **limited knowledge of the different consumer needs** it is likely that under/over estimation could arise, resulting in realised margins differing significantly from the forecasts.	1
4	**Regulatory risk**	
4.1	Cross border regulatory risk such as **taxation, VAT, transfer pricing and double taxation agreement issues**. This could include **exchange control** issues.	1 1
4.2	These issues can exercise a **material drag on realised margins/payments delayed**. **Non-compliance with laws and regulations** could result in **fines and penalties** (**legal risks**).	1 1
5	**Control risk**	
5.1	There is a business risk that the entity is **expanding rapidly beyond SA borders** and **the internal controls may not be adequate**, resulting in operational failures and ultimately losses being realised.	1
6	**Skills risk**	
6.1	There may be **a lack of skills** for the integration and daily operations of the new businesses in Africa, resulting in slow market penetration, poor customer service and product delivery.	1
7	**Quality risk**	
7.1	The iDish is known for its **high-quality after-sales support**. This may be difficult to achieve **in foreign countries**.	1
8	**Logistical risk**	
8.1	There is a business risk that deliveries are not scheduled correctly or that **deliveries are incorrect** (both quantity and type).	1
9	**Opportunity cost**	
9.1	The risk is that expansion will not be profitable and **other more profitable investments may be overlooked** or cannot be taken up because the group's capital is tied up in this iDish venture.	1
10	**Hedging risk**	
10.1	The **cost of hedging** certain illiquid currencies may also reduce expected profit margins, making risk management less economical.	1
10.2	**Hedging costs** may also be uneconomical, resulting in the business not managing risk appropriately.	1
11	**Credit risk**	
11.1	The debt recovery is at risk within these African countries, as a result of unstable economic environments.	1
12	**Other risks**	
12.1	There is a risk of **operational failure** as AppliCo neither **knows the African market, nor is known in the African market (possible culture differences** as well**).**	1
12.2	**Water supply issues and different electric currents** in the other African countries may damage the product, with a resultant high repair costs as the company is not based in those countries.	1
12.3	Currently the **company have liquidity problems**, and expanding into Africa will require significant cash flows increasing the risk of business failure.	1

12. 4	AppliCo should consider its **competition** within each of the markets against other global and local brands (e.g. Samsung, LG, Bosch) and consider its offering and support services relative to its competitors.	1
	Available	**24**
	Communication skills – presentation (memo)	**1**
	Maximum for part (d)	**14**

Part (e)	**Discuss the alternative courses of action that could be taken by the Board of Directors to address the liquidity issues that the R&M group is facing**	
1	***Funding sources***	
1.1	Consider the possibility of a **new substantial share issue.** The Debt: Equity ratio is very high and issuing shares will restore some balance (rights issue). The question is, however, whether **shareholders would be willing to take up shares in a struggling company?**	1 1
1.2	Is there any possibility **of loans from shareholders (debentures)/guarantees** by interested parties?	1
1.3	Consider a possible **subordination agreement** with present shareholders in respect of long-term loans.	1
1.4	The company may be able to **negotiate overdraft facilities**	1
1.5	It may be able **to convert some long-term loans to equity** if a viable recovery plan can be put to the bank. However, the **limited security that is available** may be an obstacle.	1 1
1.6	**Possible discounting / factoring of debtors**	1
1.7	Possible **compromise with creditors** may be attractive given that underlying assets are unlikely to realise values reflected in the draft annual financial statements if the African operations are not a success in the future.	1
1.8	**Sale and leaseback** of any viable assets could be considered.	1
1.9	**Improve working capital management**, to improve cash flow. (collection on debtors, inventory management – produce on demand)	1
2	***New business***	
2.1	Given market information, the chances in this regard seem slim, but it may be worth exploring the possibility of **negotiating with other agencies / joint ventures to gain access to overseas markets**.	1
3	***Contain / reduce costs***	
3.1	An **analysis of operational areas making losses** should be undertaken to consider the possibility of closure or automation. (synergies)	1
3.2	**Staff could be retrenched** to reduce costs over the long term. However, **severance payments** may reduce the immediate cost saving benefits.	1 1
3.5	The company should consider **additional closure costs** that may arise and determine how to provide for these.	1
3.3	**Assets could be sold off (non-core)**, although this may also be difficult in the present economic climate.	1
3.4	Could other **cost areas be limited/reduced** by for example investigating / preventing frauds/improving infrastructure resource usage?	1
3.6	**Long term product change**: change focus from 'luxury' furniture to easy-to-put-together, inexpensive products (perhaps more viable in SA market?)	1
3.7	The company should **consider halting the expansion into Africa** and rather **concentrate on its South African business** until liquidity issues have been addressed.	1
3.8	Consider **selling household appliances on assignment**, rather than producing the products (e.g. the iDish).	1
	Available	**21**
	Communication skills – logical argument	**1**
	Maximum for part (e)	**7**
Part (f)	**Discuss the advantages to the quality of the external audit that should be considered if it is decided to change auditors as requested by the non-executive directors of the R&M group**	

1	New team on the audit: • It could result in the **introduction of new expertise available** in the new auditing firm to which R&M have not previously been exposed (efficiencies); • It could **better service the client's needs** and unique risks faced by the client; and • It could provide an opportunity **to strengthen the exercise of professional scepticism.** • Better/new look and understanding **of the clients business risks** • Better/new look and understanding **of the audit risks** • Better / fresh look and understanding of the **control environment** • Understanding and **documenting the clients systems** and **controls** will result in a fresh look and reduce the possibility of fraud, error and misstatement • New firm might follow **different audit approaches (unpredictability)** which are more risk effective given a fresh look. • New methods **of sampling and substantive testing** could reduce risk of material misstatement	1 1 1 1 1 1 1 1 1
2	It will **reduce** familiarity and self-interest **threats to auditor independence** that could lead to auditor bias or complacency. (independence in mind)	1
7	It will have a **positive impact on the appearance of auditor independence** from the perspective of the user of the financial statements (independence in appearance)	1
3	The **existing auditors** are likely to perform their **audit testing and documentation more thoroughl**y as the new audit firm will be assessing the present firm's work.	1
4	Long-term auditors have the risk that quality is compromised, due to **doing less because of higher comfort levels**, this risk is mitigated by appointment of new auditors.	1
5	As tendering audit firms will need to submit tenders and proposal documents to secure new audits, it will **allow audit committees to ensure that firms selected have the risk level of skill and expertise** to perform the audit.	1
8	Could improve the **clients governance** as those charged with governance do not become over familiar with the audit firm and partners	1
	Available	**15**
	Maximum for part (f)	**7**

Part (g) List the substantive audit procedures that AIP Auditors should perform to address the following key audit matters for the deferred tax asset and the two properties		
(i) List of substantive audit procedures to address the accuracy, valuation and allocation of the deferred tax asset on the tax loss of S&T		
Accuracy, valuation and allocation		
1.	Request a **schedule reflecting the computation of the deferred tax** asset as at 31 December 2017	1
2.	**For the deferred tax schedule:** • agree the schedule amount to the total of the deferred tax balance in the general ledger, trial balance and AFS • agree the tax loss per schedule to that of the tax loss as per the clients tax workings • inspect the schedule to **ensure** that the deferred tax amount was computed by applying the **tax rate of 28%** to the total estimated tax loss.	1 1 1 1
3.	Audit the **assessed tax loss for 2017** by:**:** • agreeing the amounts as per the **client t ax computation** • inspect their workings for **any errors** with the **client's tax computation**. • agree to the tax loss to **the audit work performed** on the income tax computations • discuss the tax work and assess loss with the **audit firm's tax specialists**	 1 1 1 1
4.	Inspect S&T's latest **SARS income tax assessment** to assure that the **tax loss brought forward from FY2016** and used in the computation of deferred tax asset, **is accurate**.	1
5.	Inspect S&T's **budget for 31 December 2018** and future years to determine the **estimated taxable income to be generated** against which the accumulated tax losses could be utilised.	1
6.	By enquiry and discussion with management obtain an **understanding of management's budgetary process** to ensure the process results in a robust and realistic budget. Consider the **qualification and competence** of persons **preparing the budget**	1 1

7.	To **establish management's budgetary ability**, compare management's **budgeted profits for prior years** and 2017 to the **actual** historical performance to audit the reasonability thereof.	1
8.	Perform **analytical procedures on the amounts in the budgets**, as follows: • Compare the figures in the **budget from 2017 to that of 2018** and 2019 (month to month / year to year , actuals etc.). • Obtain an **understanding of any unusual changes** by enquiry from management, and inspection of supporting documentation.	1 1
9.	Evaluate the **assumptions made by management** in preparing the budgets by **enquiry from management** and **inspection of supporting documentation**. (viability, CPI, economic outlook)	1
10.	**Re-perform calculations** to verify the clerical **accuracy of the budgets**.	1
11.	Inspect **the minutes of the meeting of the Board of Directors**, where the budget was approved as being reasonable.	1
12.	Inspected the **notes to the annual financial statements** for the **disclosure** made by the directors regarding their **expectation of the recoverability of the deferred tax** asset to ensure adequate disclosure of the level of uncertainty was provided.	1
13.	Request that management include reference in their **written management representation letter** to the ability of S&T to generate future taxable income.	1
	Available	**21**
	Maximum for part (g) (i)	**9**

(ii) List of substantive audit procedures to address the fair value of Mxolisi's two properties included in assets held for sale		
1	Request the **reports** prepared by Prop Guru, and **re-perform all calculations** in the reports (and supporting workings) – Clerical Accuracy.	1
2	Agree the figures used in Prop Guru's **valuation reports** to the relevant account balances in the **general ledger, trial balance and annual financial statements**.	1
3.	Evaluate **whether reliance can be placed on management's expert (Prop Guru**) through enquiry of Prop Guru, R&M staff, inspection of relevant documents, etc and assess • His **membership (qualification)** of accredited professional bodies • His **experience** in doing fair value work on these kind of properties • Their **independence / objectivity** from the R&M group from Mxolisi,	1 1 1
2	Obtain an understanding of the **process followed by Prop Guru** in computing the fair values by: • **inspecting the engagement letter** setting out the nature, scope and objectives of Guru's work (scope) ; • **assessing their understanding of the requirements of the accounting reporting frameworks (**IAS 40/ IAS 16)	1 1
3	Agree the **property details** (such as erf numbers and locations) in the property **valuation reports** to the **title deeds of the properties to ensure the correct properties were valued**.	1
4	Perform procedures to assess the reasonableness of the expert (Prop Guru) by: • Comparing the **fair value to other recent disposals** of similiar properties in the market. • Assessing the **reasonability of the discounted cash flows** and **discount rates** used in **the fair value determination**. • Agreeing the **discounted cash flows to budgets, contracts/market rates.**	1 1 1
5	Should there be a significant **disagreement** between the auditors fair value findings and that of Prop Guru's, obtain **permission from management** to **appoint an "auditors own expert"**.	1 1
6	Request that management include reference in their **written management representation** letter to the appropriateness of the fair values attributed to these properties in the annual financial statements.	1
	Available	**14**
	Maximum for part (g)(ii)	**9**
	Communication skills – layout and structure; presentation	**2**
	Total for part (g)	**20**