

Ignore taxation

You are an audit trainee at EZEE Auditors Inc. ('EZEE'), a large, national firm of registered auditors. You have been assigned to the audit of MasterBus (Pty) Ltd ('MasterBus') for the financial year ended 30 September 2019.

MasterBus is a rapidly growing technology company founded in 2013 by three friends, Mr Duduzani Moyo, Mr Sizwe Mhlambi and Mr George Hendricks. The idea for MasterBus originated from the frustration that the friends experienced with having to use public transport as students to travel around Johannesburg for job interviews, entertainment and sport commitments. They identified a need for an app that would assist users with finding the most efficient and cost-effective mode of public transport. The result was the MasterBus app.

MasterBus does not provide the transport itself but relies on transport providers, ranging from municipal bus companies, minibus taxis and train operators (Gautrain and Metrorail) to e-hailing operators such as Uber and Bolt.

MasterBus facilitates a cashless environment for commuters and transport operators. The MasterBus app allows commuters to load funds onto the app, which they can then use to pay fares.

One commuter said in a radio interview that she is a devoted user of the MasterBus app because it saves her money and time. In the past she used minibus taxis, which entailed taking two taxis and a change-over at a major taxi rank, despite living close to a bus terminus. With the MasterBus app she found that she could take the bus home at a cheaper price and arrive closer to her home. She had known about the bus, but could never figure out the bus schedules until she started using the MasterBus app.

Another commuter, a wealthy venture capitalist, found herself stranded in Johannesburg after losing her purse while in transit to an investor conference in Sandton. She saw a poster advertising the MasterBus app and decided to try it. She described the app at the conference in glowing terms, dubbing it 'the MasterCard of public transport'.

MasterBus has rapidly expanded since 2016, and now operates in all major cities in South Africa. The company employs 32 staff, and all operations are run from the company's Johannesburg office.

Corporate governance structure

The Board of MasterBus currently consists of the following persons:

Mr Duduzani Moyo	Chairman and Chief Executive Officer
Mr Sizwe Mhlambi	Innovations Director
Mr George Hendricks	Chief Information Officer
Ms Nosisa Mantashe CA(SA)	Chief Financial Officer (CFO)
Ms Josephine Josephs	Human Resources Director

Nosisa and George have been friends since childhood. George recruited Nosisa for the CFO position at inception of the company because of her audit experience with technology start-up companies.

Because MasterBus was a tech start-up company, Nosisa wanted to ensure that the company would be able to attract investors. For that reason she has from the start prepared integrated reports, which she continues to do every year. The integrated report states that MasterBus voluntarily subscribes to all the recommended practices and principles of King IV. The company also undergoes an annual audit; thus, audited financial statements are readily available to potential investors and banking institutions.

Because the directors are tech-savvy, they have a particular interest in the Fourth Industrial Revolution (4IR) and the impact it could have on the business, the South African economy and society at large. The directors are accordingly planning to have a strategic breakaway weekend during which they will discuss their response to the risks and opportunities facing the business as a whole, with special attention to those presented by the 4IR.

Duduzani and Nosisa selected EZEE as the company's Registered Auditor because the firm is at the forefront of the technology revolution and 4IR. Nosisa was also very impressed with EZEE's use of data analytics to enhance the quality and efficiency of audit work performed and to add value to its clients. EZEE makes use of specialised audit software to perform its audit procedures.

Additional information

- MasterBus prepares its financial statements in terms of International Financial Reporting Standards.
- A pre-tax discount rate of 15% per annum is applicable to MasterBus.

Documentation

You have been presented with the following documents:

Document	Description
WP 03	Description of the mobile app and revenue
Memorandum A	Notes from on a discussion with Nosisa Mantashe on a new MasterBus loyalty programme,
Email	Email from M Anager
Attachment to email from M Anager	Press article on MasterBus
Extract from EZEE's audit manual	General audit procedures

Client	MasterBus Pty Ltd	Year end	30 Sept. 2019	WP 03																											
Prepared by:	A Clerk	Reviewed by:	M Anager																												
Date prepared:	1 Sept. 2019	Date reviewed:	15 Sept. 2019																												
Subject: Description of the mobile app and revenue																															
<p>The following information regarding the mobile app and revenue was updated in the current year:</p> <ul style="list-style-type: none"> • Commuters download the mobile app that interfaces directly with the MasterBus application using their smart devices. • They register all their details, including their names, surnames, identity numbers, cell phone numbers and email addresses, on the app. • These data are recorded on the 'registered commuter database' and a unique user identification (ID) and personal identification number (PIN) are generated. • Users load funds onto the app by either linking their details to their bank card or depositing money in the app at an ATM or any supporting retailer using their unique ID and PIN. • Users may use these funds for any transport service that supports MasterBus. • When a registered user opens the app, the app identifies the user's location. The user inserts his/her travel destination and the app displays the various trip options, based on travel time and cost. • The app is connected to the real-time departure and arrival information of the different transport operators. (Service providers that register with MasterBus install tracking devices at their own expense.) • The user selects a trip option and a unique code is generated which is used when boarding the selected transport service. • The scan of the unique code on the transport service confirms that the commuter has made use of the transport service. • The app is integrated directly with the company's financial accounting software. • MasterBus uses an integrated operating system with cloud storage capabilities provided by a third-party service provider to manage the company's data. <p>Income</p> <p>Subscription to the MasterBus app is free.</p> <p>MasterBus mainly earns its income from a percentage of transit fares, which is negotiated with the different transport operators. Commuters using the app pay the transit fare to MasterBus and MasterBus in turn pays the transport provider, after deducting its agreed-upon percentage. Transit fares are the official fares of the transport providers and these fares are observable and determined by the transport providers. Amounts due to transport providers are paid at the end of each month.</p> <p>As the app is integrated directly with the company's financial accounting software, the app records the total fare paid by the commuter in the general ledger by means of the following journal entries:</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 80%;"></th> <th style="width: 10%; text-align: center;">Dr</th> <th style="width: 10%; text-align: center;">Cr</th> </tr> </thead> <tbody> <tr> <td>Journal 1</td> <td></td> <td></td> </tr> <tr> <td>Bank/Revenue received in advance</td> <td style="text-align: center;">XXX</td> <td></td> </tr> <tr> <td style="padding-left: 20px;">Revenue</td> <td></td> <td style="text-align: center;">XXX</td> </tr> <tr> <td colspan="3"><i>Recording of the total fare paid by the commuter</i></td> </tr> <tr> <td>Journal 2</td> <td></td> <td></td> </tr> <tr> <td>Cost of sales</td> <td style="text-align: center;">XXX</td> <td></td> </tr> <tr> <td style="padding-left: 20px;">Bank</td> <td></td> <td style="text-align: center;">XXX</td> </tr> <tr> <td colspan="3"><i>Recording of the amount paid to the transport provider, after deduction of the agreed-upon percentage</i></td> </tr> </tbody> </table> <p>MasterBus presents revenue and cost of sales as separate line items in its statement of profit or loss.</p>						Dr	Cr	Journal 1			Bank/Revenue received in advance	XXX		Revenue		XXX	<i>Recording of the total fare paid by the commuter</i>			Journal 2			Cost of sales	XXX		Bank		XXX	<i>Recording of the amount paid to the transport provider, after deduction of the agreed-upon percentage</i>		
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Memorandum A
Notes from a discussion with Nosisa Mantashe
on a new MasterBus loyalty programme

MasterBus identified that some commuters who initially used their app to find the best transport option did not subsequently return to book trips through the app. MasterBus found that often the commuters use the real-time departure and arrival information of the app, but then prefer to pay the transport costs directly to the transport provider.

MasterBus accordingly launched a customer loyalty programme on 1 November 2019, which rewards app users with loyalty points for trips booked through the app.

The terms and conditions of the loyalty programme are as follows:

- All app users are automatically enrolled in the customer loyalty programme.
- App users receive 1 point for every R8 spent.
- Fractional points are possible, which means that if, for example, R12 is spent, 1,5 points are awarded.
- Ten loyalty points are equivalent to a value of R1, which the app user can use towards paying for subsequent trips.
- An app user cannot earn loyalty points on trips that are paid for with loyalty points.
- Loyalty points are awarded on the first day of the month following the month in which transit fares are sold via the app. This means that, for example, loyalty points in relation to transit fares sold in November, will be awarded on 1 December.
- Unused loyalty points expire six months after being allocated.
- The amounts due to the transport providers are unaffected by the loyalty programme. Thus, they receive their share of the total value of the transit fares sold in a particular month, after the MasterBus agreed-upon percentage on transit fares has been deducted, irrespective of the loyalty points earned or used by the app user.

The following is an extract of the transaction reports for November and December 2019 that was obtained directly from the financial manager of MasterBus:

	November 2019	December 2019
Loyalty points used by app users	–	57 500 points
Total value of transit fares sold in the month	R1 200 000	R1 309 750
MasterBus's agreed-upon percentage of transit fares	7,5%	7,5%

Based on industry statistics, MasterBus estimates that 85% of loyalty points will be used before they expire.

Email from M Anager

To: atrainee@ezeeauditors.co.za
From: manager@ezeeauditors.co.za
Date: 27 November 2019
Subject: Press article on MasterBus

Attached:  Press article on MasterBus.docx
11 KB

Dear A Trainee

I hope you are well and still learning a lot from your audits. While working through news articles relating to MasterBus from the past six months in preparation for the 2019 audit, I came across the attached article which appeared on www.Zin24.com on 26 August 2019.

I determined that MasterBus's internal legal team researched the matter when the Zin24 article was published. They provided me with the following information:

- According to the user agreement, MasterBus owns a perpetual, irrevocable licence to do anything it wishes with the user information.
- Users have to agree to the terms and conditions when they sign up for the app.
- The *Protection of Personal Information Act, 2013* (Act 4 of 2013) provides for the protection of information by public and private bodies. The legal team has determined that due to the media attention relating to the case, there is a 60% chance that MasterBus will be required to settle, even though it is difficult to determine at this point if MasterBus did actually contravene the Act.
- The legal team has determined that the case will likely be settled at 25% of the amount claimed.
- It is probable that the case will be settled by 30 September 2022, at which stage any compensation due would need to be paid.

I found it quite interesting and it will most definitely be something that we should consider in our audit. Let's get together to chat about its impact on our audit.

Kind regards

M Anager
EZEE Auditors Inc.

Attachment to email from M Anager Press article on MasterBus

Johannesburg - A South African attorney said on Monday, 26 August 2019, that he was preparing a class action lawsuit against MasterBus on behalf of hundreds of MasterBus app users who have become aware, through media exposure, that their personal information has been sold to an external party. Each user is claiming an amount of R10 000.

Attorney Solomon Dlamini, who formed part of the legal team that launched a legal battle against a European website development company that led to a €100 million settlement in 2017, said he would file class action papers with the South Gauteng High Court in Johannesburg 'within the next few months'.

'We are meeting with our advocates next week to thrash out the final form of the application,' Dlamini told Zin24. He said he had so far signed up 150 plaintiffs who are users

of the app and have been disturbed by the fact that their information was sold to a third party without their consent.

The planned lawsuit, of which there are limited previous legal rulings of a similar nature in South African law, has its roots in a landmark ruling by the European court that ruled in favour of the plaintiffs regarding the misuse of clients' information without their express consent. Dlamini would not comment on the size of a settlement, but industry research suggests that the company would have to pay millions of rand to settle the case.

When approached for comment, Ms Nosisa Mantashe, the Chief Financial Officer of MasterBus, stated that disclosure is provided to users when they sign up for the app and the terms and conditions state that when users sign up, MasterBus has the right to sell their data.

However, an inside source revealed that the MasterBus legal advisors do not believe this argument will hold up in a court of law, as the terms and conditions are not clear or easily understandable by everyday users. Ms Mantashe herself is responsible for the wording, implementation and monitoring of the company's terms and conditions. The source further revealed details of a MasterBus Board meeting at which Ms Mantashe had allegedly raised concerns about 'hiding' the sale of data in the terms and conditions. However, after having considered the lucrative additional income from these sales, the company's Board resolved that this practice be continued. Ms Mantashe apparently now believes that this practice is in the best interest of the company as a whole.

Source: <http://www.Zin24.com/Companies/Digital/MasterBus-users-to-initiate-lawsuit-20190826>

Extract from EZEE's audit manual

EZEE's audit manual, developed to form part of the firm's quality control system, contains the following 'general audit procedures' that have to be performed by an audit team for all material classes of transactions and account balances in a client's annual financial statements:

- 1 Obtain client schedules supporting the classes of transactions and account balances.
- 2 Re-perform the casts and cross-casts on these schedules.
- 3 Agree the closing balance of these schedules to the amounts in the general ledger, trial balance and annual financial statements.
- 4 If applicable, agree the opening balance of these schedules to the prior-year working papers/audited financial statements.
- 5 Inspect the schedules and general ledger accounts for any unusual entries (e.g. negative, zero, large and round numbers, and back-dated journals) and follow up with management.
- 6 Perform overall analytical review procedures (e.g. by comparing current to prior year, budget, similar industries, etc.) and follow up on discrepancies by enquiry from management and inspecting supporting documentation.
- 7 Inspect the financial statements for adequate financial disclosures in relation to the International Financial Reporting Standards or the relevant accounting framework.
- 8 Obtain a signed management representation letter relating to all assertions regarding the classes of transactions and account balances being audited.
- 9 Consider the effectiveness of internal controls regarding classes of transactions or account balances and its impact on the nature, timing and extent of the substantive procedures.

INITIAL TEST OF COMPETENCE, JANUARY 2020

PROFESSIONAL PAPER 4

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

PART I – REQUIRED		Marks	
		Sub-total	Total
(a)	Discuss the appropriateness of the accounting treatment followed by MasterBus to account for its percentage of the transit fares for the financial year ended 30 September 2019. <i>Communication skills – logical argument</i>	10 1	 11
(b)	Calculate the amounts that should be recognised as revenue for November and December 2019 in the accounting records of MasterBus. <ul style="list-style-type: none"> • Show revenue for each month separately. • Round all amounts to the nearest rand. <i>Communication skills – presentation</i>	18 1	 19
(c)	Discuss the accounting recognition and measurement of the class action lawsuit in the financial statements of MasterBus for the financial year ended 30 September 2019. <ul style="list-style-type: none"> • Do not discuss the Conceptual Framework. • Round all amounts to the nearest rand. • Ignore the statement of cash flows and the statement of changes in equity in your discussion. 	10	 10
Total for part I			40

