SPECIMEN EXAMPLES

ASSESSMENT OF PROFESSIONAL COMPETENCE

DECEMBER 2024

HOW TO USE THE EXAMPLES

This report has been compiled from selection of scripts that demonstrated a competent level of competence for each task, and which the examiners felt fairly represents the expectations per task. Before referring to the specimen examples below, it is important that candidates and prospective candidates refer to the examiners' comments on the December 2024 APC, as this will assist with gaining an understanding of the different tasks.

The examples have been taken directly from candidate scripts, and therefore no changes were made to any aspect, including to the spelling, grammar and errors.

Task (a)
Respond to Cheswill Moos' email regarding the procedures that will provide the required assurance on the revenue component of Café Rapide's EBITDA for its FY2024 by – • identifying and explaining any concerns you have with the procedures proposed by Tom Moos; and • proposing any additional procedures that should be performed to ensure that the revenue component of Café Rapide's EBITDA is not overstated.

Competent
From: Financial Analyst Sent: 4 December 2024 To: Cheswill Moos Cc: Subject: RE: Assurance of EBITDA of Cafe Rapide Good Morning Cheswill, I hope you are well. I have reviewed Tom's suggested audit procedures and have identified some concerns and additional procedures that may need to be performed to provide reasonable assurance that the EBITDA for Cafe Rapide is not overstated. I have included the concerns and additional procedures below for your consideration: Concerns with Tom Moos' audit procedures: General Concerns It appears Tom Moos has not performed a risk assessment of the revenue figures in order to assess the possible risk of material misstatement inherent within each revenue line item. This may have an impact on the nature, timing, and extent of the procedures to be performed for each component of revenue in order to obtain reasonable assurance. For example, the fact that Franchise Fee revenue only increased by 44% compared to an increase in stores of 94%, indicates a higher risk of misstatement that franchisee fees may be understated, or rebate revenue may be overstated. Tom doesn't appear to have thoroughly considered the complex IFRS 15 implications within his audit procedures, as these will have a significant impact on the design of audit procedures. For example, audit procedures should have been designed to test each of the five revenue steps within IFRS 15 due to the nature of the franchisee agreements. Specific Revenue Procedures:

Franchise fees for services upfront

- Tom's request of the new franchise agreements to compute the number of new stores is appropriate, however the procedure should be expanded upon to include that the revenue listing must also include the total revenue earned from each store in order to agree the amount to the revenue recognised for new stores within the trial balance in order to ensure the listing is complete and accurate. Tom's procedure would not be able to be relied upon should it not be linked back to the actual revenue figures recorded.
- Inquiry from the CEO is insufficient audit evidence to ensure that all new franchise agreements have been recorded. The audit procedure relies upon an assertion made by the CEO and should be verified through detailed testing to assert the appropriateness of the assertion.
  This may include an additional audit procedure to obtain a list of bank account transactions and using a filter or through inspection identify all inflows of R1.1 million which occurred during the year and agree the total amount equates to R33m (30 Stores).
- Tom's rough calculation of R500k*30*60% is a good risk assessment procedure to set an expectation of what revenue should be, however Tom doesn't appear to have linked the amount to an actual revenue figure prepared by Cafe Rapide, and has rather included it within his own assessment, therefore not supplying reliable evidence.

- Tom suggests selecting a sample of new contracts and inspecting the contract for the total fee payable for services (R500k), however the procedure should include the sample selection criteria, whether judgemental, statistical, or random sample selection has been used as well as the methodology used to select the sample size, as these are key factors in assessing whether sufficient and appropriate audit evidence was obtained.
- The procedure to inspect the franchise fee of the contracts may not provide sufficient evidence for the transaction price in relation to the recognition of revenue in respect of the initial services rendered as the amount may just indicate the stand-alone selling price for the services - as the steps to allocate transaction price would still need to be performed.
- The procedure to inspect the minutes of meetings to agree the 60% recognised in year one is insufficient in obtaining comfort over the applicability of the measurement made by management. An additional procedure should be performed to test managements assertion.
  This may include for the same sample of contracts selected above, obtain the assessment of expected costs to be incurred in relation to the provision of services over the 5 year span, and obtain the training service logs or invoices, any other service invoices, and applicable extracts of the bank statement for payment made in relation to the services and compare to the total estimated service expenses incurred in order to assess the appropriateness of the % of services transferred to the customer within year 1 of the franchise agreement. This will ensure that revenues for new stores do not result in fictitious revenues within the current year.

Franchisee fees from prior year

- The procedure Tom uses to agree the prior stores is inaccurate as if 30 stores were opened in FY24 to a total of 62 and 14 closures in the same period, the expected opening balance of stores in the prior year would be 46 and not 32 as Tom calculated. This may influence the value of revenue recognised as the closed stores would still have revenue recorded per the amortised revenue stream up to the date of closure. Tom's calculation therefore, negates these revenues.
- For the sample selected, the same sampling methodologies should be applied as above. The procedures performed over the sample should be expanded to similarly include invoices or bank statements relating to additional services rendered within the current year to be compared against the total expected services cost to agree 10% of the expected costs were incurred during the current year. This will ensure that the revenue recorded in the current year reflects actual revenue performed.
- The sample selected should also be tested by inspecting the agreements to ensure the agreement was signed in a prior financial year, and that payment was received on the effective date of the contract. This will ensure that the contracts have occurred.

Closed stores

- Tom's procedure to obtain the listing of closed stores from the CEO is appropriate, however the procedure should include an agreement to the trial balance to ensure that all the revenue included in the listing for closed stores agrees to the revenue recorded.

- Tom's procedure to recompute the revenue from close stores is insufficient, instead a sample of closed stores should be selected to obtain confirmations or support from the franchisees indicating the closure of their stores. This will ensure that fictitious accelerated revenues haven't been recorded in relation to stores which have not in fact been closed.

Rebate revenue
Tom's procedures to test the revenue received from Bazam are insufficient as they do not test the occurrence of the revenue. An additional procedure may be to insect the bank statements for 4 quarterly receipts from Bazam and agree the total figure to the revenue recorded.
Obtain the revenue listing for Bazam revenue and agree there are 4 transactions.

Additional Audit procedures Tom did not Consider
For the contracts selected in each of the above procedures - Inspect the signatures of all participants, promises within the contract align to the revenue streams recorded, the total transaction price and terms of the contract.
Re-perform the assessment of the performance obligations within the franchise agreement, as there is likely to be a separate performance obligation relating to the material right provided to the franchisee in relation to the option to extend the franchise agreement at no additional cost.
This would result in a portion of the transaction price being recorded as revenue received in advance to only be recorded on the exercising of the option to extend and a susbequent overstatement of revenue in the current year if not recorded. This would entail a re-performance/performance of the Management prepared assessment of the likelihood of the option being exercised, as well as the expected cost to provide the extend franchise agreement to the customer, and the subsequent allocated transaction price to the material right.

An assessment of the agency of Cafe Rapide in relation to the equipment sold to franchisees, as should Cafe Rapide be acting as a Principal, revenue would be understated by the value of equipment sold to franchisees.
Please feel free to reach out to me should you have any additional concerns prior to the performance of the audit procedures.

Kind regards,
Financial Analyst.

Examiners' comments

The candidate successfully addresses all aspects of the task, demonstrating a clear and comprehensive understanding of any concerns with the procedures proposed and any additional procedures that should be performed.

Overall, the candidate was able to still provides sufficient valid and well-applied points for each aspect of the task, which demonstrates an appropriate competency level.

Task (b)
Prepare a response to Phumzile Teke-Dlamini to provide her with the following: • Feedback on the journal entries Gill prepared for Leopardis in which you identify and briefly explain any potential errors and omissions; and • The pro-forma consolidation journal entries that Leopardis should prepare in respect of the acquisition of Café Rapide.

Competent

FROM: Financial Analyst
SENT: Wednesday 4 December 2024
TO: Phumzile Teke-Dlamini
CC: Cheswill Moos
SUBJECT: Cafe Rapide Accounting
ATTACHMENT: Workings for pro-forma consolidation entries

Good day,

I hope that you are keeping well! I am glad that I can be of assistance with the accounting for Leopardis' new subsidiary acquisition of Cafe Rapide!

1. Review of Gill's workings

Gill's journal was as follows to bring the investment in Cafe Rapide into the books of Leopardis:

	Dr. **R**	**Cr.** **R**	**Refer to Review Note**
Financial asset at fair value through profit or loss	?		**1**
Creditor payable (current)		26 345 000	**2**
Creditor payable (non-current)		10 615 000	**3**
Gain on bargain purchase		?	**4**
Financial asset at fair value through profit or loss	250 000		**5**
Accruals		250 000	

Review Note 1:

- This journal has been correctly classified as a financial asset at fair value through profit or loss. This is because, and as explained in further detail in point 2 below for the pro-forma consolidation journal entries, an investment entity, as stated in IFRS 10, shall record the investment at fair value through profit or loss in accordance with IFRS 9.
- Leopardis shall recognise this financial asset when and only when they become party to the contractual provisions of the instrument, which is 31 October 2024 in line with the signed share purchase agreement.
- The fair value of the investment, in line with IFRS 13, is the estimated price at which an orderly transaction to sell the shares of Cafe Rapide would take place between market participants on 31 October 2024, under current market condition. The fair value of the investment is therefore the 55 000 ordinary shares acquired, at the determined market value of R672 per share, which gives us a total fair value of R36 960 000.
- Therefore the ? in the journal should be a debited value of R36 960 000.

Review Note 2:

- The initial amount payable of R26 345 000 is a financial liability as it is a contractual obligation to deliver this cash amount to the original shareholders of Cafe Rapide on or before the 31 January 2025, which would make it a current financial liability as it is payable in less than 12 months at Leopardis' 31 October 2024 year-end.

- The initial amount payable is to be finalised on the final EBITDA figure of Cafe Rapide, and as EBITDA is a non-financial variable which is specific to Cafe Rapide, who is a party to the share purchase agreement, this initial amount payable will not meet the definition of a derivative.
- In accordance with IFRS 9, in order to eliminate an accounting mismatch between the investment in Cafe Rapide measured at fair value through profit or loss, the financial liability for the initial amount payable shall also be designated as measured through profit or loss.
- Therefore Leopardis must estimate the fair value of the initial amount payable and this shall be the measurement on 31 October 2024. Given that it is fairly certainable that the EBITDA will remain unchanged, and is payable in less than 12 months so a present value of this amount won't be significantly different, the value can remain as R26 345 000, but must be classified as a financial liability at fair value through profit or loss.

Review Note 3:

- As with the initial payment amount, the contingent consideration will also be a financial liability measured at fair value through profit or loss.
- The valuation expert as provided Leopardis with a fair value of this contingent consideration to be R7 million on acquisition, taking weighted averaged and all probabilities into account. I would need to get a better understanding of his methods myself, but it sounds as if he has applied the present value technique recommended under IFRS 13, which given the circumstances of the contingent consideration, I believe would be the best method to measure the acquisition date fair value of the contingent consideration. This is because the payment will be made far into the future, and this consideration amount should be valued as a present value linked to the future amounts.
- Therefore the contingent consideration should be recognised as a financial liability measured at fair value through profit or loss at R7 000 000.

Review Note 4:

- As explained in further detail in point 2 below for the pro-forma consolidation journal entries, Leopardis, as an investment entity, shall not consolidate Cafe Rapide or apply the acquisition method of consolidation under IFRS 3.
- Thus the "day one profit" made on recognition of the investment as an asset, will not be a "gain on bargain purchase" as used under the IFRS 3 acquisition method, but will be a normal profit made on the acquisition of the investment through profit or loss

Therefore taking all of the above review notes into account, the correct journal to be posted by Gill on 31 October 2024 would be:

	Dr.	**Cr.**
	R	**R**
Financial asset at fair value through profit or loss [SFP]	36 960 000	
Initial Payment - Financial Liability at fair value through profit or loss [SFP - Current]		26 345 000
Contingent Consideration - Financial Liability at fair value through profit or loss [SFP - Non-Current]		7 000 000
Gain made on acquisition of Cafe Rapide [P/L]		3 615 000

Review Note 5:

- The legal and due diligence fees incurred of R250 000 do not change the fair value of the investment in Cafe Rapide, as this is merely a transaction cost to obtain the investment, and does not change the fair value of the equity in Cafe Rapide obtained which has been valued as R672 per share.
- In accordance with IFRS 9, when a financial asset is measured through profit or loss, transaction costs shall be expensed.

Therefore the correct journal to account for these legal and due diligence fees payable as at 31 October 2024 is:

	Dr.	Cr.
	R	R
Legal and due diligence costs [P/L]	250 000	
Trade and other payables [SFP - Current]		250 000

Considerations for future accounting:

- If there is a change for the initial payment made to the shareholders on or before 31 January 2025, let's say only R26m is then paid, the journal would be:

	Dr.	Cr.
	R	R
Fair Value Adjustment to Financial Liability [P/L]		345 000
Bank [SFP]		26 000 000
Initial Payment - Financial Liability at fair value through profit or loss [SFP - Current]	26 345 000	

- Leopardis must recognise the change in the fair value of the contingent consideration at least annually, and before payment therefore. For example, if by the end of 31 October 2024 the contingent consideration's fair value is R8m, the journal would be:

	Dr.	Cr.
	R	R
Fair Value Adjustment to Financial Liability [P/L]	1 000 000	
Contingent Consideration - Financial Liability at fair value through profit or loss [SFP - Non-Current]		1 000 000

2. Pro-forma consolidation journal entries for Leopardis in respect of the acquisition of Cafe Rapide

IFRS 10 states that an investment entity shall not consolidate it's subsidiaries or apply IFRS 3 when it obtains control of another entity. In accordance with the definition of an investment entity in IFRS 10, Leopardis is an investment entity as they obtain funds from shareholders for the purpose of investing in South African medium-sized companies that meet their investment criteria, for the purpose of providing the shareholders with returns from capital appreciation on these investments.

I understand that you are eager to record the investment in Cafe Rapide in the FY2024 AFS to demonstrate the progress Leopardis has made in delivering value to the shareholders. In line with IFRS 10, the investment in Cafe Rapide will be recorded as follows:

- As Leopardis is an investment entity, they shall not consolidate the investment into their financial statements, but will record the investment at fair value through profit or loss in accordance with IFRS 9, just like how Leopardis records their other investments in entities.
- Further, as Cafe Rapide's main purpose is being a franchisor of coffee shops, their purpose is not to provide services to Leopardis which relate to it's investment activities, so Leopardis cannot use this exception in IFRS 10 to consolidate them into their financial statements.
- The ultimate parent of Leopardis, being the Moos Family trust, shall consolidate all entities that it controls, which would include Cafe Rapide, unless the parent itself is an investment entity.
- Therefore the Moos Family Trust will consolidate Leopardis as well as Cafe Rapide in it's annual financial statements, following the IFRS 3 acquisition method.

I have done the necessary calculations to measure the net asset value of Cafe Rapide to be R62m, and goodwill acquired to be R755 000. Please see the excel attachments for the calculations performed for these figures and the accompanying notes to explain how these figures were arrived at.

Therefore, the following pro-forma consolidation journals to be prepared by the Moos Family Trust for the group financial statements will need to recognise the necessary adjustments to net asset value, non-controlling interest and goodwill, while eliminating the investment recognised in Leopardis' books and Cafe Rapide's equity in their books.

	Dr.	**Cr.**	**Note**
	R	**R**	
Cafe Rapide Brand	45 000 000		
Fair Value Adjustment – Land	1 500 000		
Equity of Cafe Rapide	15 500 000		**1**
Financial asset at fair value through profit or loss		36 960 000	**2**
Gain made on acquisition of Cafe Rapide [P/L]	3 615 000		
Non-controlling interest		27 900 000	
Gain on bargain purchase		755 000	

Note 1
This should be split between share capital and retained earnings of Cafe Rapide, which I do not have the figures for, so I have put their net asset value together here to illustrate the journal.
Note 2
The financial asset at fair value through profit or loss in Leopardis' books, as well as the gain made by them for this investment, must be eliminated.
Please let me know should you have any further questions!
Kind regards,
Financial Analyst

Task B - Attachment to e-mail

Calculation of Goodwill/Gain on Bargain Purchase

Acquisition date fair-value of consideration:	**Amount**	**Note**
Initial Payment	R 26 345 000	*1*
Contingent Consideration	R 7 000 000	*2*
Non-Controlling Interest	R 27 900 000	*3*
Net Asset Value	-R 62 000 000	*From below*
Goodwill/Gain on Bargain Purchase	-R 755 000	*Gain on bargain purchase*

Note 1
The initial payment amount of R26,345,000 is assumed to be the acquisition date fair value,
as EBITDA is certainably not going to change as communicated from the shareholders,
and it is payable on 31 January 2025, so the present value is assumed not be significantly different.
If the EBITDA changes within the measurement period under IFRS 3, then this may be revalued to goodwill.
Please note that the legal and due diligence costs are not considered consideration under IFRS 3,
and are therefore not included in the calculation of goodwill.

Examiners' comments

This candidate covers both parts of this task very well.

The first part of the response is well presented, linking back to the given journal entry. The candidate uses a line-by-line approach to review the journal, making sure all significant issues were addressed. The corrected journal entry was also not required either, although its provision does not influence assessment of the competence of this response.

For the second part of the task, the candidate presents a pro forma journal entry as required. However, the extensive discussion of the investment entity exemption was not required. The candidate prepared workings in Excel with explanatory notes.

Overall, the candidate achieves good coverage of both parts of the task and does not demonstrate material errors in their response.

Task (c)
Respond to Phumzile Teke-Dlamini's email regarding the sustainability of Café Rapide's business model and its future revenue streams, and the communication by Leopardis regarding its investment in Café Rapide to Weetland.

Competent

From: Financial Analyst
To: Phumzile Teke-Dlamini
Sent: Wednesday 4 December 2024, 12:41PM
Subject: RE: Cafe Rapide Investment

Hi Phumzile

Thank you for your email. Please find my response below with regards to your email
1.Please find my concerns noted on the email with regards to sustainability of the business model and its future revenue streams.

Pricing of goods

- Cafe Rapide sets a blanket of R20 selling price for all items sold. Individual franchises therefore have no control over the price in which they could sell goods and would look to increase their margins by finding cheaper produce.
- Uniform pricing can negatively impact profit margins from franchises in areas with higher operating costs (i.e urban centres with expensive rent) creating dissatisfaction and financial difficulties for some franchises as evidence by the closure of 14 stores in the current year.
- It is up to the head Cafe Rapide franchiser to find optimal prices from products which maximises immediate profitability and sustainability while creating lasting impression of being consumer conscious and fair in the way the price their products.

Resourcing of goods

- Maintaining consistent product quality across multiple franchise locating can be difficult while Cafe Rapide mandate the purchase of coffee beans from Bazam Coffee roasters, franchises have the flexibility in sourcing other beans items like food and beverages. This can lead to inconsistencies in product quality which may impact customer experience and the brand loyalty ,which in terms affects whether investors are willing to purchase the franchise.
- With rapid growth in the number of franchises opened, there is further possibility of Bazam not being able sustain the needs of the franchises and that would cause supply issues as the sourcing of all beans is relying on our supplier.

Upfront franchisee fee and Future revenue

- Revenue Concentration risk. Cafe Rapide relies heavily on its initial upfront fee as its primary source of income once there fee is collected and recognised over five years, there is no ongoing revenue from franchises(such as royalties or marketing fees).which limits the company's ability to generate recurring income from each store. Cafe Rapide is dependent on continuously opening new stores to sustain the income, which is not a viable sustainable solution for long run prosperity.
- The receipt of large upfront fee makes short term profitability, this does bring into question how profitability will diminish once the Opening of franchises slows down.
- No subsequent revenue is received from the franchisee agreement except the intial fee meaning that there is no benefits for Cafe Rapide to engage with the franchises outside of maintaining brand reputation as there is no future revenue to be received based on franchise performance.

This significantly impacts the long term sustainability of Cafe Rapide as once the opening of franchises slows down, so will to the inflows of revenue for the franchisor.

With the prospective growth of the number of franchises to reach over 200 entities, there is the

heightened potential of cannibalisation of the market. This being that as Cafe Rapide expands and opens more stores, there is a risk of market saturation and cannibalisation of sales. while under the current agreement the cannibalisation of sales does not impact Cafe Rapide, however as sales decline the incentive of opening further franchises diminishes and thus impacts the future revenue to be generated by Cafe Rapide. Given the volatility of the south african economy,the rapid growth may be stunted by limited funds being available to afford the upfront fee, leading to less franchises being opened which affects the sustainability of their revenue. There is no renewal fee at 5 years ,so in essence the agreement between the franchiser and franchisee continues into perpetuity once the initial fee has been paid,Further enhancing the question of sustainabilty as no further revenue is generated by a franchisor once the initial fee has been paid Based on the discussion above I do not think the business model is sustainable **2.Communciation by Leopradis to Wheetland.** The investment in Cafe Rapide must be communicated to Wheetland as they are in the same industry to ensure transparency between leopardis and its investees9Wheetland. Leopardis needs to assure wheetland that they will still gate the support from the investor as before . Since wheetland and Cafe Rapide have the same supplier of coffee beans ,this could enable collaboration between two companies. Leopardis needs to consider the conlifict of interest in case where the same board members serving in wheetland will serve on Cafe Rapide. They need to also assure wheetland that independence will be maintained and no information about each other will be used against each other. Kind regards
Examiners' comments
The candidate effectively addresses all aspects of the task, incorporating sufficient valid considerations. . • Competent candidate grasps some of the key issues around sustainability and revenue (e.g., the issue around the once-off fee and the lack of the renewal fee) and identify some of the other key aspects (e.g., the undisclosed rebate arrangement). • Overall, the candidates were able to still provides sufficient valid and well-applied points for each aspect of the task, which demonstrates an appropriate competency level.

Task (d)
Respond to Cheswill Moos' email regarding the proposed capital raising initiative and Belinda's email to him (containing proposed details of REIFSA's potential investment in Leopardis). In particular – • briefly comment on any income tax implications for Leopardis, should it issue the convertible debentures (comment on the implications from when they are issued until they are converted); • briefly comment on the income tax implications for Leopardis with regard to the proposed preference shares. Also, whether Leopardis would have to withhold dividends tax on the preference share dividends paid given that REIFSA is a business trust; and • critically analyse and compare the funding proposals and indicate, with reasons, which alternative is more attractive for Leopardis at this stage.

Competent

From: Financial Analyst Sent: 04 December 2024

To: Cheswill Moss
Subject: Leopardis Capital raising

Hi Cheswill

I trust you are well.

Please see some of my comments or discussions in relation to the available capital

Income Tax implications on convertible debentures

Date of issue

- The proceeds received will not be included in gross income when Leopard receives the proceeds as the proceeds are capital in nature.

Interest payment or incurred

- s24O will not apply as leopard is not acquiring at least 70% of the shares in operating company (only 55% is being purchased)
- Shall consider whether s8F is applicable on convertible debentures:
- The arrangement is an instrument that bears interest 12% and is issued by Leopardis as a resident (Leopardis is a resident as it is incorporated in South Africa).
- Per the agreement obliged to convert the debentures into 333 333 shares.
- The market value of the shares (R50 million) is equal to the debt owed at the time of conversion (R50 million).
- The arrangement does not constitute a hybrid debt instrument as defined
- Therefore, S8F does not apply to these convertible debentures – shall need to consider general provisions:
- Leopardis' intention is to generate profits through dividend income.
- Debt is used to acquire shares.
- The interest is incurred is not in the production of income.
- Interest expense will not be deductible in terms of s24J (2).

Conversion date

- As debt is being converted into shares, this constitute a debt benefit as defined in s19 of the Income tax act.
- The debt was not used to fund expenditure that is deductible. The debt was used to fund the

shares, which are capital nature.

- The shares are not trading stock as Leopardis is not in the business of selling the share, they hold shares for long-term purpose for capital appreciation.
- As a result, no recoupments in terms of s19 of the Income Tax Act.

Issue of shares

- At the conversion date, Leopardis will have to issue the 333 333 ordinary shares.
- Issue of shares is not an expenditure as it does not change the assets or liabilities of Leorpardis. As result no s11(a) deduction.
- The R50 million will be treated as the contributed tax capital.

Income tax implications for preference shares

Issue date

- The issue is not an expenditure as there's no movement in the assets of Leopardis. As a result, no s11(a) deduction of the issue date.
- The R30 Million is the contributed tax capital as per s1 of Income tax act Dividends paid
- The arrangement is not a Hybrid equity instrument as defined in 8E as it is not redeemed within 3 years from issue date (4 years) hence s8E does not apply.
- No s11(a) on the dividends paid as they are incurred for purposes of trade - s23g prohibits expenditure incurred for purposes other than trade.

Dividends tax

- The payments constitute dividends in terms of s1 as they are transferred on behalf of a person due to shares as distribution and they are not contributed tax capital
- The payments meet the dividends definition in terms of s64D as they are paid by South African resident (Leopardis)
- As they are cash, REIFSA is liable for dividends tax at 20%
- Dividends are deemed to paid on the date of payment.
- REIFSA is not a trust per s37A hence exemptions are not applicable.
- Leopardis will have to withhold dividends tax.

Redemption date

- The redemption price is the reduction in contributed tax capital.
- No Income tax implications other than CTC adjustment.

Critically analyse the funding options

Redeemable preference shares

- Redeemable preference shares only provides Leopardis with R30 million while they need R50 million. Hence there will be a funding shortfall of R20 million. Leopardis will have to consider other options which can be costly.
- The shares do not provide any voting rights hence will not have impact on the shareholders control of the company.
- The cost of the redeemable preference shares is 10% per annum.
- No tax shield or tax benefits on dividends as discussed above. Leopardis will have to administer the withholding tax and the payment thereof to SARS.
- Leopardis still has an obligation to redeem the prefs in the future. Leopardis will either have to sell off part of its investments or raise sufficient capital to redeem the prefs.
- Preference shares are more flexible as Leopardis will in effect be raising debt without increasing debts levels which will have a positive impact on the debt to equity ratio, thus reduce financial risk and improve covenant compliance.
- If Leopardis does not have sufficient capital can defer the dividends to a later period hence avoiding being in default

Convertible debentures

- Although does not provide immediate control at the date of conversion shareholders might be unhappy with dilution of control. The fact that the Moos family is willing to provide funding indicates that they are no willing to lose their control.
- The arrangement offers interest at coupon of 12% which is higher than the prime lending rate. Hence the debentures does not look attractive as leopard will pay higher amounts.
- As Leopardis will not be entitled to a s24J deduction, the cost of the convertible debentures is 12% per annum.
- Given the fact that Leopardis has been in loss making position in the prior year and profits in the current year are due to fair value adjustment, Leopardis may not have sufficient capital to pay the coupon when they are due.
- Leopardis is heavily financed by equity, additional R50 million will not result in Leopard being insolvent or unable to pay long term debts.
- Debentures are more long term as after five years, the Funders will get the shares and continue being part of company

Based on above and the current conditions of the company, the company may be unable to pay the interest on convertible debentures and their rates are quite high, hence it is best to choose preference shares.

Examiners' comments

This response indicates the required level of competence. The candidate addresses all aspects of the task – income tax, dividend withholding tax, critical analysis of the funding options and concluding on which instrument is more attractive at this stage.

The candidate correctly identifies, with reference to the percentage equity being acquired, that section 24O will not apply. Based on the assumption that the market value of the shares is equal to the outstanding debt at the date of conversion, the candidate correctly concludes that section 8F is not applicable. The candidate then correctly concludes that section 24J will not be applicable due to the interest not being incurred in the production of income.

In view of the fact that the preference shares are redeemed in four years' time, the candidate correctly concludes that the preference shares are not a hybrid equity instrument in terms of section 8E. The dividend withholding tax is correctly addressed for the preference shares.

In critically analysing the two funding options, the candidate correctly identifies the R20 million funding shortfall should the preference shares be chosen. The candidate correctly identifies the potential liquidity risk that Leopardis could face when having to redeem the preference shares in four years' time. Furthermore, the candidate correctly identifies dilution in control and after-tax cost of the instruments.

The candidate provides a conclusion supported by a reasoned argument.

Task (e)
Respond to Phumzile Teke-Dlamini's email regarding the VAT implications of the SaaS agreements and Lerato Molote's email to her. Review and provide feedback to Lerato Molote on whether – • she has correctly accounted for the VAT on each of the items / components outlined in her email; and • it would be possible to submit corrections to the filed VAT returns in the event that there were errors based on Lerato Molote's calculations. Keep your feedback brief.

Competent

From: Financial Analyst
Date: 04 December 2024
To: lmolote@renovare.co.za
cc: Phumzile Teke-Dlamini
Subject: SaaS tax implications

Morning Lerato, I hope you are well. Thank you for giving me the opportunity to assist with the Vat implications on the SaaS agreements, I believe my input will assist with resolving the issue.

Please see the below as my assessment:

Monthly rental charged to customers Unfortunately the VAT has been incorrectly accounted for, due to the following reasons:

- The SaaS agreements do represent the supply of goods, which is the solar system supplied to customers and services which represents the installation and the maintenance and repairs, by a vendor as Renovare is a registered Vat vendor, for the making of taxable supplies, which is represented by the solar solution services, thus Renovare is required to levy VAT out put at a standard tax rate of 15%.
- The SaaS agreements does not represent a instalment credit agreement, but rather a normal rental agreement due to the fact that Renovare retains ownership of the assets, as no risk and rewards transfer to the customer after the lease and that Renovare remains responsible for the maintenance and repairs.
- As a rs ult of the SaaS agreements being a rental agreement for Vat purposes, its a deemed supply in terms of S8(11), hence VAT output should be levied, on the monthly payments on the earlier of the last day of the month or when the customer pays.

Maintenance and repairs
This has been correctly accounted for only of the supplier of the services supplied to Renovare is from a VAT vendor, and they have charged Renovare output VAT. Furthermore, they are used to supply solar solution services to the customer, which is in the making of a taxable supply.

Purchase of Solar Equipment All Vat input should be claimed on the earlier of payment or invoice. Vat input is correctly claimed as the equipment will be used in making taxable supplies, if the local supplier is a Vat vendor.

Assuming the equipment purchased is new, VAT input is incorrectly claimed when the equipment was purchased by a local non-vendor, as this notional input is only available if second hand equipment was purchased from a local non-vendor and used to supply solar services.

Its incorrect to claim no Vat input on the importation of goods from China, as this is permitted by SARS, if the goods are used in the production of supplying solar services (taxable supply), the Import VaT will be payable when the equipment enters SA for home consumption purposes. The Import VAT will amount to 15% of the 10% added to the customs duty value plus the import duties. (15% x (1.1 x customs duty value + import duties)

Insurance premiums on Solar
Vat input is incorrectly not claimed. The insurance premiums is incurred in order to supply Solar service solutions a taxable supply, thus VAT input should be claimed on the earlier of invoice or payment.

Furthermore, VAT output should be levied on insurance payouts on the day the payments is received, as its a deemed supply, the value of this will be the value of the amount received multiplied by the standard rate.

In respect of the correction of the VAT returns:
Renovare will be able to correct their VAT 201 by requesting for corrections to account for VAT output in the period it was liable to charge VAT output. Furthermore, Renovare will not be able to change the monthly rental price already paid by customers to recoup the VAT not levied, thus the VAT will eat into the prices already set by Renovare.
These corrections to the VAT 201 will also need to be accompanied with supporting documents, upon the submission made to SARS.

Renovare will be held liable for an understatement penalty based on a penalty % and the shortfall amount which is the difference between the VAT paid to SARS and the Correct amount that should have been paid to SARS, including the difference in the amounts owing to Renovare.

The penalty % will range from 0%-200% depending on the severity of the situation.

Since the issue of the retrospective correction on the VAT could lead to penalties, I believe we should engage with a TAX specialist to assist to ensure we avoid any further non-compliance and penalties.

I hope the above assist you with the current matter at hand. Please feel free to reach out if you require further assistance or anything is unclear.

Kind regards

Financial Analyst

Examiners' comments

Overall, this response indicates the required level of competence for this task based on the following:

- The key issue of how the financial manager interpreted the SaaS agreements for VAT purposes is addressed in arriving at the conclusion that they were treated incorrectly.
- For maintenance and repairs, the discussion includes the requirement that the services must have been rendered by VAT vendors, which is something the financial manager failed to mention.
- The requirements for claiming notional input VAT are addressed while concluding that the treatment adopted by the financial manager might be incorrect.
- The discussion of VAT on imports makes the link to what the equipment will be used for, that is, to provide taxable supplies – which is the key requirement for Renovare to be able to claim input VAT on imports.
- The discussion on the insurance payouts is sufficient as it indicates that output VAT will be levied on this supply as it is a deemed supply.
- For the question on corrections, the candidate indicates that Renovare can request that corrections to be made on previously submitted VAT returns.

Task (f)
Respond to Phumzile Teke-Dlamini's email regarding the key risks facing Renovare, by – • documenting the risk-mitigating techniques that Renovare should employ for each of the four key risks identified by Phumzile; and • describing four key risks that Renovare faces in addition to those listed by Phumzile.

Competent

From: Financial Analyst
To: Phumzile Teke-Dlamini
Sent: 4 December 2024: 17h00
Subject: Risk Management - Renovare

Good day Phumzile

Please see below on the risks of Renovare, as requested.

Key Techniques to Mitigate Identified Risks

Customers unable to settle amounts due

- • Renovare can avoid this risk by carrying out a credit vetting exercise to ensure that the customers can afford to take on the additional obligation of paying the rent amounts for the solar systems that they choose.
- • Renovare can transfer this risk when it occurs, by getting insurance for possible future bad debts, which is often provided to businesses.

Sub-optimal installation

•Renovare can avoid this risk by ensuring that when a technical team is sent out to install a solar solution, there is an independent supervisor that is sent out with the technicians who would inspect that the installation was done correctly

•Renovare can avoid this risk by ensuring that all installers are qualified technicians that are qualified in installing the solar solutions that they provide to customers

•Renovare can send out an installation technician periodically (say once a year) to ensure that the completed installation is still optimal and functioning as it should

High levels of competition

•They currently only supply households and SME's, they should look to diversify their customer base and also offer their solar solutions to bigger corporate and other establishments

•If it would be cost effective to do so, they can also facilitate selling solar solutions straight to other businesses. They would enjoy the advantage of lower prices from bulk purchases (economies of scale), which would allow them to remain competitive with their renting out of solar systems but also enjoy additional income streams from selling to other businesses

Imposition of Tariffs

•Renovare can avoid this risk by locating a suitable supplier that is located in South Africa, as they will not incur any tariffs

•Renovare could also even locate suppliers from any of the BLNS countries (Botswana, Lesotho, Namibia, eSwatini) as there are favourable trading laws that are in place with these countries and this would lead to lower tariffs

Additional Risks facing Renovare

1. The country has seen a very interesting turn of events where the loadshedding crisis has partly decreased, where areas that have lower electricity demand do not go through load-

shedding, and there is instead load-reduction in high electricity demand areas, this would lead to a lower demand of solar solutions as there is a smaller market that needs them
2. Renewable energy investments are exposed to rapid technological advancements, as well as policy shifts. This means that inventory could go obsolete a lot quicker than expected and they would not be able to cover the costs in purchasing those items. Policy shifts relate to, for example, tax savings available to such companies, these laws have been updated a few times and this has an impact on profitability.
3. South Africa has the most unequal society in the world. One of the results of this is that the crime rates are high. We have seen an increase number of theft of solar systems being reported throughout, this will lead to increased insurance costs for Renovare.
4. There may be serious legal and compliance risks resulting from the sub-optimal installation of solar solutions i.e. it could cause fires which can damage the properties of customer, can lead to bodily harm of customers etc.

Kind regards
Financial Analyst

Examiners' comments

The candidate effectively addresses both aspects of the task, mitigating the risks and identifying valid additional risks.

- The competent candidate was able to sufficiently provide mitigating factors that are valid and provide relevant examples for some of the key risks that Renovare faces in addition to those that were listed.

Task (g)
Respond to Jandri's email, by – • advising on the possible implications that the information discovered by Jandri may have on Zlisk and Leopardis; • suggesting what actions Leopardis could take now that it is aware of Seal's disclosures and the news article; and • explaining two things that Leopardis got right and two things the company needs to work on in terms of creating sustainable wealth and making a meaningful difference in the South African society.

Competent

From: Financial Analyst
Sent: Wednesday 4 December 2024
To: Jandri Volmink
Subject: Re: Recent Discovery

Hi Jandri

Thank you for your email.

It is difficult to correctly provide implications as we do not have the reports to verify the allegations at hand. However, there may be possible implications directly impacting Zlisk which may also impact Leopardis indirectly. It seems like due to the fact Seal has withheld some information that was contained in the article, they may be more severe discoveries which may result in serious implications.

- As Seal is the CEO, the company (Zlisk) will face direct implications.
The discoveries may result in financial implications wherein in material customers may cancel contracts with Zlisk which will impact the revenues and income of the company. As Zlisk's customer are companies, most companies do not want to be associated with bad governance and reputation. This is because Zlisk would suffer reputational damage due to the CEO being implicated in the scandals.
- Leopardis' returns on investment will be negatively impacted as there will be less or no dividends due to liquidity and cash flow issues experienced by Zlisk.

- Other investees of Leopardis may question Leopardis' vision statement (creating sustainable wealth and making meaningful difference in society), due to this discovery – which raises questions on whether the investment criteria of Leopardis includes ethical and good governance practices within an investee.

- I do not believe the impact of the reputational damage will directly impact Leopardis as we are shareholders
Actions that Leopardis can take
- With the above implications, I believe we can take actions to protect the interest of Leopardis by engaging with the board of Zlisk as their stakeholders on the possible actions that Zlisk is planning to take on the discoveries.
- It is important to note that we do not have control therefore, we are unable to influence the decisions made but this does not mean we should not act to protect our interest.
- Leopardis should enquire with Zlisk and present the finding, request a report of next steps, what has been done regarding the article, obtain MI report in order to assist with investigations and suggest to the board of Zlisk that Sean steps down pending investigations.
- Leopardis could conduct its own investigations on the allegations

The two things Leopardis got right:
- Leopardis has experienced leadership with sufficient knowledge of different industries and expertise

which promotes a successful business wherein they have built a strong relationship with investees, through the support that they give to their investees - Investment in renewable energy through purchase of Renovare to support sustainable and environmentally friendly energy solutions. - Adhering to King IV: even though Leopardis is not a public company, it is compliant with majority of the principles of king which is good. Shows the commitment towards good governance with improvement here and there they can be well on their way of ethically sustainable wealth generation. ***The two things Leopardis needs to work on:*** - Leopardis needs to work on improvement of governance and risk mitigation as there is weak governance at investee companies and late implementation of governance processes after purchase which may result in serious non-compliance risks and severe relationships with stakeholders - Lack of alignment between short-term and long-term investment decisions and goals which is due lack of sustainability reporting metrics and tracking (ESGs) I would also advise that you obtain assistance from a legal expert on possible actions and limitation relating to the discovery. Let me know should you have need further information. Regards, Financial Analyst
Examiners' comments
The candidate successfully addresses all aspects of the task, demonstrating a clear and comprehensive understanding of each component. They effectively identify and articulate all key issues, providing well-explained insights and thorough justifications: • Implications affecting both entities are provided and clearly explained. It is apparent that the candidate adequately applies themselves to the matter. • The candidate's understanding of the information presented on the day and its implications became evident as they outline possible actions for Leopardis. The proposed actions are not only practical, considering the stage of discovery, but also pragmatic in their approach. • The candidate demonstrates a deep understanding of the structural aspects (Leopardis being a shareholder/investor) and provided actions that take these aspects into consideration. • The candidate demonstrates competence across all three aspects of the task, with sufficient valid and clearly articulated points on each aspect.