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DEPARTMENT OF ACCOUNTANCY

2014

B.COM HONOURS (ACCOUNTING WITH SPECIALISATION IN CHARTERED ACCOUNTANCY)

SESSION 2

LAST ASSESSMENT OPPORTUNITY
20 October 2014

This document consists of 7 pages including the cover page

MARKS: 100

TIME: 3 HOURS

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INFORMATION DOCUMENT

SESSION 2 QUESTION 1

(100 MARKS)

You are a trainee accountant currently busy with the audit of the C-track Group. C-track Ltd ("C-track"), the holding company, is a South African company listed on the Johannesburg Stock Exchange Ltd. C-track specialises in the research, design, development, manufacture, sales and support of technologically advanced GPS/GPRS Vehicle Tracking and Fleet Management Solutions. Their range of products are based on the latest technology using GPS/GPRS location methods which means they can locate your vehicle typically to within 4 metres of its position.

Sale of Vehicle Tracking Solutions

Since incorporation of the business, C-track has been providing its vehicle tracking services under 36 month contracts. C-track enters into 36 month contracts with its customers after performing the necessary credit and background checks on the customer to establish creditworthiness. C-track installs the vehicle tracking unit (including panic button and anti-hijack device) into the customer's vehicle, and charges an installation fee of R700, which is paid up front by the customer. The cost of the tracking unit to C-track amounts to R2 000 per unit and fair value of the tracking unit amounts to R2 500 per unit. The tracking unit provides the platform through which C-track can monitor and track vehicles through the use of its sophisticated vehicle tracking software. The vehicle tracking unit is specifically designed that it can only work with the C-track software. In other words, the customer will not be able to use the vehicle tracking unit without the software and support provided by C-track.

After installation of the unit, C-track offers various support services over the 36 month contract, as follows:

- Ongoing stolen vehicle recovery over the 36 month contract. The customer pays a fee of R180/month for this service, which is processed as an authorised debit order directly from the customer's bank account. This fee includes internet vehicle tracking, a feature whereby the customer can log onto C-track's website and track the location of his/her vehicle. This fee also includes the customer support call centre, whereby customers can phone in to report stolen vehicles, or for general administration queries.
- C-track offers a warranty over the vehicle tracking unit installed in the customer's vehicle. If the unit fails or is damaged during the 36 month contract, C-track will either repair or replace the damaged unit free of charge. The warranty also covers the negligent or accidental damage caused to the device due to the fault of the customer.
- A free SARS compliant travel logbook can be downloaded once a year for the purposes of customer's travel claims. The customer submits a request through his/her online profile and the free logbook is emailed to the customer within seconds.
- If customers experience an accident or breakdown, C-track provides free roadside and towing assistance, and also includes free hotel accommodation and car hire. In addition, free roadside medical response is available for customers who are injured in an accident.
- C-track introduced a trademark service named Home Drive™, whereby customers have a safe way of getting back home after a night of fun and alcohol consumption. Customers are entitled to two free trips per annum over the 36 month contract.

At the end of the 36 month contract, C-track removes the tracking unit from the customer's vehicle. C-track will then refurbish the unit at a cost of R1 200, whereafter it can be used again for one further 36 month contract. Customers can elect to receive either a new unit or a refurbished unit. If they elect the refurbished unit, they do not have to pay the R700 installation fee.

C-track's accounting policy states that the vehicle tracking units are accounted for as Property, Plant and Equipment.

C-track Ubuntu Engineering Bursary Fund Trust

On 1 June 2014, C-track established the C-track Ubuntu Engineering Bursary Fund Trust ("the trust") to support the development of education within rural communities. Appeals were made to large corporate investors who held C-track shares, to donate some of their shares to the trust as a means of financing the trust. The response was exceptional, and a total of 60 000 shares were donated by various large corporate investors on 31 July 2014.

In order to promote the reputation and prominence of the trust and to encourage further corporate donations, C-track hand-picked the trustees of the trust from a small pool of well-known South African business people who are independent of C-track. The trust deed, established by C-track, contains specific guidelines on how the funds of the trust should be distributed. The beneficiaries of the trust will be selected by the trustees; however the trust deed specifies that the bursaries should be distributed to promising local engineering students based in the communities and areas where C-track has operations. C-track believes that this will be a viable way for it to create and attract new talent in future to its technology division for future product development and advances going forward.

C-track is committed to this project as part of its corporate social responsibility initiatives, and has indicated that should the trust ever experience financial problems, that it would step in to assist in order to ensure the continued sustainability of the trust in its important role in community development.

The chief financial accountant of C-track, Mrs. Sippy has indicated that she has reviewed the requirements of IFRS 10 *Consolidated Financial Statements* and concluded that it is appropriate to consolidate the trust in the consolidated financial statements of the C-track Group.

Unresolved issues

C-track Group had a profit attributable to owners of the parent amounting to R11 210 000 before any of the following issues were taken into account:

1) Long term incentive programs of C-track

The group has various long term incentive programs for certain key staff. The following information relates to the programs currently in force at C-track:

Forfeitable Share Plan ("FSP") - Equity settled share based payment

The FSP was introduced as a long-term incentive for 13 executive directors, who received ordinary shares in the company on grant date for no consideration. The directors are entitled to all rights and benefits relating to the shares, including voting rights and any dividend payments, but will not be entitled to dispose of the shares until vesting date. The shares are therefore held in by an agent (Afri-Bank) during the vesting period for the benefit of the directors.

The purpose of the FSP is to provide both an incentive to directors to deliver the Group's business strategy over the long-term and to act as a retention mechanism. There are two types of share awards based on retention and performance. The **retention share awards** vest over a period of 5 years of continued employment. The vesting of the **performance share awards** are subject to continued employment over a 4 year vesting period and meeting certain financial performance targets relating to profit. If the conditions are not met on both awards, the unvested shares are forfeited, and are immediately sold back to the market by Afri-Bank for their own benefit. In the event of death or termination, the unvested shares will vest immediately, whilst in the event of resignation, the unvested shares will be forfeited by the director.

On 1 February 2014, C-track repurchased 130 000 shares from the open market at R45 each, for the purpose of the FSP (10 000 shares per director). These shares were reissued to the agent Afri-Bank on 1 March 2014 at the same value (the market value on 1 March 2014 was R47), who will hold the shares on behalf of the participants until the shares vest. The shares were granted to the directors on the same date, 1 March 2014. Afri-Bank charges an annual up-front commission of R2 500 for its services as a nominee shareholder over the vesting period on the anniversary of the grant date. 40% of these shares related to the retention share awards (service condition), whilst the remaining 60% of the shares related to the performance share awards.

By 31 December 2014, 1 of the directors had died and 2 had resigned. Management anticipates a forfeiture rate of 10% due to resignation of remaining directors before vesting date, with a 56% probability of achieving the performance target.

Share Appreciation Right's ("SAR's")

C-track granted 500 000 SAR's to the employees of one of its subsidiaries, DigiCore (Pty) Ltd on 1 February 2013. These SAR's vest over three years and contain a performance condition relating to the achievement of specific average annual profit targets over the vesting period. In terms of the agreement, the fair value of the SAR on exercise date will be equity settled by C-track issuing its own C-track shares to the employees if the required profit targets have been achieved. The SAR has been appropriately accounted for in the separate financial statements of C-track and DigiCore. The following information relates to the SAR's that were granted:

	1 February 2013	31 December 2013	31 December 2014
<i>Fair value of one SAR including the performance condition</i>	R58	R54	R51
<i>Fair value of one SAR excluding the performance condition</i>	R62	R59	R55
<i>% of SAR's already forfeited due to employee resignations</i>	0%	2%	3%
<i>% of additional SAR's expected to be forfeited due to employees resignation prior to vesting</i>	2%	3%	4%
<i>Performance condition expected to be met</i>	Yes	Yes	No*

* At 31 December 2014, the average annual profit target was met by DigiCore (Pty) Ltd. However, the expectation at the 31 December 2014 year-end, is that the required average annual profit targets will not be achieved or maintained by the vesting date.

C-track Defined Benefit Plan

Per the actuarial valuation report, a defined benefit obligation of R8.6 million existed on 31 December 2014 (2013: R7.8 million), with plan assets of R9 million (2013: R7 million). Current service costs for the 2014 year were R450 000. Benefits and contributions paid were R280 000 and R360 000 respectively and were all paid on 30 June 2014. Any surplus related to the defined benefit plan is attributed to employees and C-track is not able to benefit from it. The discount rates relevant to the defined benefit plan at 1 January 2014 and 31 December 2014 were 5% and 6% per annum respectively. The balance in equity relating to actuarial gains and losses at 1 January 2014 amounted to R1.3 million.

2) Concerns around metal supply

C-track imports certain key metals that are used in the production of some of the component parts used in the tracking devices. During 2013, the global supply of metal became particularly unpredictable due to civil and political unrest in the countries in which the metals are mined, and C-track became concerned that there would not be enough metal to meet production schedules. As a result, the company decided to source additional inventory of metal to prevent production interruptions.

C-track has a policy of always taking out forward cover at the date on which the need to import is identified as it is considered highly probable at that date that an order will be placed. On 30 September 2013, it was agreed that an order should be placed with the Spanish supplier and a 4-month forward exchange contract (FEC) for €400 000 was taken out with a reputable bank. C-track designated the FEC as a hedging instrument for the anticipated order of inventory.

On 31 October 2013, a non-cancellable order for €450 000 of metal was placed. The metal was shipped "free-on-board" on 30 November 2013 and the cargo reached C-track's premises on 15 December 2013. The amount owing was paid on 31 January 2014.

As it happened, sufficient metal was supplied in 2013 and none of the imported metal had been used by 31 December 2013. The material was used in the production of finished goods sold during 2014.

It is the accounting policy of C-track to designate all cash flow hedging relationships in respect of only the changes in the spot element of FECs. Amounts presented in OCI relating to cash flow hedges are reclassified to profit or loss when the hedged item affects profit or loss. Hedges of foreign currency risk of firm commitments are designated as fair value hedges. You can assume that all hedge criteria per IAS39.88 have been complied with by C-track including hedge effectiveness.

3) Convertible debenture issued

On 30 June 2012, C-track issued 10 000 five year R100 mandatorily convertible debentures. These debentures bear coupon interest which is paid semi-annually in arrears. Per the contract, these debentures are mandatorily convertible after 5 years into ordinary shares at a rate of 2 ordinary shares per debenture held.

The entire issue was taken up by Libertas Life Pension Investment (Pty) Ltd ("LLPI") who intends to use the debentures as an investment opportunity for their pension fund investments. Transaction costs of R2.50 per debenture were paid by LLPI to its broker to facilitate the deal.

On 30 September 2014, C-track offered LLPI 25 000 ordinary shares as early settlement of the convertible debentures. This offer was accepted by LLPI.

4) Integr8-IT Inc

C-track acquired a 60% controlling interest in Integr8-IT Inc ("Integr8"), an IT startup company incorporated in Germany, on 30 September 2013 for €1 200 000 when the company had 500 000 shares in issue. C-track elected to measure the non-controlling interest at fair value of €735 000 at the acquisition date. All the assets and liabilities of Integr8 were fairly valued at the acquisition date, except for a building which was overvalued by €24 000 and that had a remaining useful life of 12 years. On 1 November 2014, Integr8 issued 70 000 additional shares at €3.20 per share. C-track purchased 30 600 of these shares, while the remaining shares were taken up by the non-controlling shareholders.

The carrying amount of the equity of Integr8 was as follows on various dates:

	30 Sep 2013	31 Dec 2013	1 Nov 2014	31 Dec 2014
	€	€	€	€
Stated capital	650 000	650 000	874 000	874 000
Retained earnings	330 000	385 000	478 000	502 000
	980 000	1 035 000	1 352 000	1 376 000

Integr8 declared an interim dividend of €0.05 per share on 30 June 2014. No other dividends were declared.

Integr8 has not yet been consolidated in the annual financial statements of the C-track Group.

Additional information:

- Ignore tax for all parts of this question.
- The following exchange rates may be relevant:

1€:R	Spot rates	Forward rates			
		4 months	3 months	2 months	1 month
30 September 2013	13.95	14.20	14.15	14.10	14.00
31 October 2013	14.10	14.45	14.38	14.25	14.18
30 November 2013	14.35	14.80	14.72	14.63	14.57
15 December 2013	14.40	NA*	NA*	NA*	NA*
31 December 2013	14.50	15.00	14.90	14.78	14.60
31 January 2014	14.85	NA*	NA*	NA*	NA*
30 June 2014	14.88	NA*	NA*	NA*	NA*
1 November 2014	14.75	NA*	NA*	NA*	NA*
31 December 2014	14.90	NA*	NA*	NA*	NA*
30 September 2013 – 31 December 2013 (average)	14.15	NA*	NA*	NA*	NA*
1 January 2014 – 1 November 2014 (average)	14.78	NA*	NA*	NA*	NA*
1 November 2014 – 31 December 2014 (average)	14.85	NA*	NA*	NA*	NA*

**NA = Not applicable*