Accountancy@UJ

UNIVERSITY OF JOHANNESBURG

DEPARTMENT OF ACCOUNTANCY

Governance and Control

GOC8X00/GAC8X00/RHR03X8

FINAL ASSESSMENT	**6 NOVEMBER 2017**

FIRST EXAMINERS:	Ms. Seabi Mokoena
INTERNAL MODERATOR:	Prof. Ben Marx
EXTERNAL MODERATOR:	Mr. Jonas Shai
TIME:	3 hours 45 minutes(excluding reading time)
MARKS:	150

1. This paper consists of 10 pages (excluding the required)
2. This documentation represents the scenario for the question
3. Thirty minutes (30) minutes of reading time is given for the paper, making the assessment session 4 hours and 15 minutes.
4. During the 30 minutes reading time, you may:
    1. Highlight the information presented in this document; and
    2. Make such annotations on this document as you consider appropriate.
5. At the close of the 30 minute reading period, you will be given the question (required) and stationery packs.
6. You will have 3 hours and 45 minutes in which to answer the required section.
7. No questions may be asked during the assessment.
8. Please write your name and student number clearly on your answer sheet.
9. Make assumptions if you are uncertain regarding the interpretation of the scenario.

You are a newly appointed internal audit manager at Mbokodo Inc. ('Mbokodo'), a large firm that provides accounting, advisory, internal audit and taxation services to their wide range of clients. After you completed the induction week at Mbokodo, you were allocated to the audit team of Avios Holdings Ltd ('Avios').

Avios regards internal audit as an important component of the entity's combined assurance model and wants to ensure that the internal audit status in the company is such that it is strategically positioned to achieve its objective. The internal audit team will perform a review of the systems and processes of Avios and report all findings to the audit committee.

You have been provided with the following information to help you obtain an understanding of the entity:
- Background information;
- Potential business contract with Ubber;
- Extract from the minutes of a meeting of the board of directors of Avios; and
- The following workpapers:

Description
C100 Extract of the system description for the recognition of revenue of Avios's car rental division
F200 Fixed assets – understanding the rental car fleet

1. Background information

a) Nature of operations

Avios was founded 15 years ago by Joe Bentley and as the company grew it became a listed on the alternative exchange of the Johannesburg Securities Exchange (JSE) in 2015. Immediately prior to listing, Joe Bentley retired as chief executive officer of the company and became the non-executive chairman of Avios.

Avios provides its customers with a range of integrated motor car solutions, including car fleet rental, fleet management and used car sales, through the successful operation of complimentary divisions and subsidiaries.

Avios' policy is to use new rental cars for a maximum period of two years. These cars are then replaced with new cars. The replacements are done in terms of a ten-year contract with suppliers of new cars, which were signed five years ago by the company's directors.

Cars that are two years old (based on the end of the month of first registration in the name of Avios), are sold through the company's used car sales division. However, it is taking longer and longer to sell the used cars due to a drop in demand for used cars, and there has also been a decrease in the demand for rental cars. Avios regards rental cars that have been rented out for less than five days in a month as idle rental cars.

The directors are uncertain about the reasons for the continued increase in idle rental car capacity of the company, partly because there is no risk committee and no investigation had yet been undertaken by the client's management.

One of the factors that is causing strain on the car rental industry is that international tourism to South Africa decreased by ±10% in 2015 (2014: 6%), partly because of the stricter visa requirements imposed by the South African government on persons travelling with minors. In addition, there has also been a decrease in local tourism over the past number of years.

Avios' average lost revenue due to idle rental cars for the first half of 2017 financial year had reached R10 million and the company does not at present have sufficient cash reserves to fund potential growth opportunities.

b) Shareholding and Governance structures

The current shareholders of Avios are as follows:

Bentley Family Trust	37%
Employee Staff Trust	5%
Unit trusts	8%
Carloworld Limited	12%
General public	38%

The current directors of Avios are as follows:

Mr. Joe Bentley	Non-executive chairman
Ms Jane Bentley-Cartier	Chief executive officer
Mr Sonny Buggatti, CA(SA)	Financial director
Mr Thabiso Mleng	Operations director
Mr Jan Dodge	Human resource director
Mr Jim Ferrari	Non-executive director
Ms Jayne Mustang	Independent non-executive director

All executive directors have employment contracts (dealing with salaries, benefits and performance incentive payments). In June 2017 the board approved a bonus incentive scheme applicable to all executive directors of Lannister. In terms of the bonus scheme, all executive directors will receive a bonus if the budgeted profit targets for the financial year are met.

Non-executive directors receive directors' fees plus fees for attending meetings of the board of directors and its sub-committees. The Remuneration Committee is responsible for setting and monitoring the remuneration policies of the group and approving incentive schemes. The members of the Remuneration Committee are Mr Dodge (chairman), Mr Bentley and Ms Mustang. Avios also has an Audit Committee consisting of Mr Ferrari (chairman) and Ms Mustang.

c) Accounting and Information systems

On 1 January 2017 Avios changed its information technology (IT) system from a number of separate, less sophisticated application modules to a real-time integrated online application system that combines all the previously standalone financial modules into one central application system called *Smart*Accounts.

Avios outsourced the development, testing and implementation of the new *Smart*Accounts IT application system to Bravos IT (Pty) Ltd ('BIT'). This included the migration of data, as well as post-implementation maintenance and support. The outsource agreement further includes training of Avios personnel, but because the accounting division of Avios has been understaffed and under pressure, no such training has yet taken place.

IFRS 15 *Revenue from Contracts with Customers* is only effective for reporting periods beginning on or after 1 January 2018, but Avios's board has made the decision to early adopt IFRS 15 from 1 July 2016. This is because Mr Sonny Buggatti convinced the board that applying the principles based on IFRS 15 would be easier than applying those of IAS 18 *Revenue*. Ms Buggatti is also of the opinion that complying with the *Companies Act*, 2008 (Act 71 of 2008), as amended, is a waste of time and money. Most of the personnel in the accounting division of Avios are family members of Mr Joe Bentley, with limited knowledge and experience of financial accounting standards.

d) External auditors

Dlamini and Partners Inc. has been the external auditors of Avios for the past nine years. The engagement partner for the past six years, Bob Dlamini, is an experienced auditor of car fleet management businesses.

2. Potential business contract with Ubber

In order to mitigate the current revenue losses, Avios is considering the conclusion of an agreement with Ubber.

Ubber provides innovative transport solutions, accessible by customers through a smart phone application (app) that can be downloaded free of charge. Customers using the app register their personal details and credit card details on Ubber's system by means of the app. Registered customers can then request transport of their choice by means of the app. Ubber is wholly owned by Petunia Buggati, Sonny's wife.

Ubber has provided Avios with a proposed written contract in terms of which Avios will make its idle rental car fleet available to Ubber for a period of four years.

The contract contains the following terms and conditions:
- If the board of Avios enters into the proposed contract with Ubber, 1 000 idle rental cars will be provided to Ubber on 1 January 2018.
- Ubber will partner with Avios by providing registered drivers who will utilise the cars provided by Avios. These cars will be under the full control of the drivers to whom they are allocated and be their responsibility.
- Ubber will pay Avios an annual fixed fee for the use of the total number of idle rental cars available plus a monthly fee for each kilometre of Ubber transport provided by Avios's rental cars.
- Avios will receive a fixed annual fee of R15 million on 1 January 2018 and again on January of each of the next three years.
- On the fifth business day of each month, Ubber will pay Avios R1,00 per km travelled by each Avios car during the previous calendar month. The fixed fee

payable to Avios per kilometre of Ubber transport will escalate by 25% per annum from 1 January 2019.

- Ubber's system automatically logs details of all trips accepted and undertaken by each driver, which will be used to account for each trip's transaction.
- Ubber will provide Avios with a copy of a system-generated summary of all the Ubber trips undertaken by each car to support the kilometre amount paid over.
- Ubber will return the cars to Avios's used car fleet at the end of December 2021. Ubber will have the option to buy the cars from Avios on that date for 65% of their market value.

The directors of Avios regard the proposed transaction with Ubber as a way to improve the company's profits, while also making a positive social impact in South Africa. The terms and conditions of the contract were unanimously approved at a directors' meeting on 15 June 2017 at which all the directors were present, for implementation in early 2018. The directors plan to sign the contract with Ubber as soon as possible.

The board of directors furthermore decided that the pricing be kept as stipulated in the contract proposed by Ubber, despite Avios pricing policy of R2,00 per km travelled in an Avios car after the first 100kms in a month.

3. **Extract from the minutes of a meeting of the board of directors of Avios Holdings Ltd**

MINUTES OF THE BOARD MEETING
held on 15 September 2017

Present

Directors	*Other attendees*	*Apologies*
Mr Joe Bentley	Mr Jimmy Porsche	Ms Jayne Mustang
Ms Jane Bentley-Cartier	(company secretary)	
Mr Sonny Buggatti		
Mr Thabiso Mleng		
Mr Jan Dodge		
Mr Jim Ferrari		

Approval of the minutes of the previous meeting – 15 June 2017

The minutes of the meeting held on 15 June 2017 were approved subject to a few editorial corrections.

Election of board chairman

Mr Bentley expressed the desire to step down as chairman because he wants to spend more time with his wife and grandchildren. Mr Bentley will remain on the board as a non-executive director. He proposed that, in line with the company track record of success due to tight family control, his daughter, Jane Bentley-Cartier, succeed him as chairman, while also remaining chief executive officer of the company.

After a short discussion by the board it resolved to appoint Ms Bentley-Cartier as executive chairman. It was further resolved that no 'big fuss' would be made regarding the appointment, and that except for a JSE SENS announcement, no further publicity will be given to this matter.

Audit Committee feedback

Mr Ferrari reported back on the recent Audit Committee meeting and raised a specific area of disagreement with the external auditors, namely that the external auditors are uncomfortable with the fixed annual fee of R15 million to be paid by Ubber. They are of the opinion that it is below cost to Avios and that the transaction is not at arm's length.

Mr Ferrari also explained that the 2017 integrated annual report of Avios would be compiled as follows:
- Page 1: The mission statement of the company "Growth for shareholders at all costs";
- Pages 2 to 10: The Board Chairperson's and CEO's report on the financial situation of the company;
- Pages 11 to 55: Reports from the Board Committees and disclosure relating to their functions and tasks;
- Pages 56 – 165: The condensed annual financial statements, containing the

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disclosures required by the International Financial Reporting Standards (IFRS) and the Companies Act. This information will be integrated with the company's sustainability information to show how avios generated their income and operated. Extensive use will be made of graphics to illustrate all six capitals of the company over which they have stewardship. Additional information will be available via links to the company's website;

- Page 166 and 167: Notice of the upcoming annual general meeting

Client: Avios	Prepared by: Grace Musimani	Date prepared: 11 October 2017	C100
Year end: 30 December 2017	Reviewed by: Cobus Laubsher	Date reviewed: 18 October 2017	
Subject: **Extract of the system description for the recognition of revenue of Avios's car rental division**			

Customers can only book rental cars via Avios's website, by visiting www.aviosrentals.co.za. All bookings take place directly on the *Smart*Accounts application system of Avios. Avios only accepts valid credit cards for making bookings and payment for car rentals. Avios uses firewalls which are updated continuously by BIT. All electronic communications between Avios's system and all other parties and devices are appropriately secured and function optimally.

1. ***Avios car rental services – booking of rental cars***

At the time of making a booking, a customer is required to provide personal, credit card and driver information as well as destination information and dates.
The system prepares a quote for the customer. The quote contains a message that informs the customer that –
- no changes are allowed to bookings once they have been accepted by the customer;
- if the car is not collected for rental on the exact booked date, the customer's credit card will be charged for the full amount of the quote on the day after collection should have occurred;
- the customer receives 100 km free travel per day and any distance travelled above this is subject to an additional charge;
- a specified amount of credit available on the credit card will be placed on hold when collecting the rental car to ensure that the customer's credit will be sufficient to cover the expected car rental charges; and
- the customer is required to take full insurance on the vehicle rented.

The customer is then prompted to tick a box to indicate agreement with these terms and conditions. Once ticked, the customer is prompted to change the booking or accept the quote.

Once the customer accepts the quote, the system generates a unique, pre-numbered preliminary invoice. The system automatically sends a copy of the preliminary invoice, with full details of the booking, to the customer's email address as well as an SMS to the customer's contact number with a unique, system-generated security code that the customer is required to use at the time of collection of the rental car.

2. ***Avios car rental services – collection of rental cars***

Once the customer arrives at the Avios Car Rental counter at the selected office, he/she is allocated a rental facilitator. Rental facilitators use *Smart*Readers to process customers' collection of rental cars. Each *Smart*Reader is a state-of-the-art, mobile, Wi-Fi enabled, smart reader with a biometric key lock. All *Smart*Readers are fully integrated with Avios's *Smart*Accounts application system by means of a private network. Avios operates its car rental business in a completely paperless environment.

The rental facilitator uses the *Smart*Reader to read the magnetic strip on the customer's credit card and the bar code on the customer's drivers' licence. The system automatically matches the information with the details provided when placing a booking. The details of the booking appear on the *Smart*Reader's screen. The rental facilitator then uses the *Smart*Reader to read the barcode on the relevant car's windscreen and the car's kilometre

reading on the car's control console.

The system and the screen of the *Smart*Reader are updated with the details of the car as well as the kilometre reading at the time of collection. The *Smart*Reader then displays a message that requires the customer to enter the unique, system-generated security code that was received via SMS at the time of the booking into the *Smart*Reader as confirmation of agreement with the information of the car.

As soon as the customer enters the security code, the system charges the customer's credit card with the payment as per the preliminary invoice and passes journal entries for the rental income and payment received. The system also generates a hold on the customer's credit card (for the amount specified at the time of the booking) and passes a journal entry to account for it.

The rental facilitator then releases the car to the customer.

3. *Avios car rental services – return of rental cars*

When the customer returns the rental car, a rental facilitator takes delivery of the car. The rental facilitator uses a *Smart*Reader to read the barcode on the car's windscreen and the kilometre reading on the car's control console.

The system is updated with the details of the car, the kilometres travelled at the time of return and if necessary, the date. The system then calculates the excess kilometres travelled by the car (in excess of the 100 km per day included in the preliminary invoice), records the journal entries for the additional revenue, generates a final invoice, and processes payment against the customer's credit card.

The hold on the customer's credit card is then released.

	Prepared by: Grace Musimani	**Date prepared**: 11 October 2017	**F200**
Client: Avios			
	Reviewed by: Cobus Laubsher	**Date reviewed:** 18 October 2016	
Year end: 30 December 2017			
Subject: **Fixed assets – understanding the rental car fleet**			

Avios's car rental fleet consists of some 6 000 vehicles at any given point in time.

Rental cars are carried at cost less accumulated depreciation and impairment losses in terms of IAS 16 *Property, Plant and Equipment*. Depreciation is calculated over a two-year period from the date of purchase and all rental cars have a residual value equal to 25% of their cost.

The managers of each of Avios's rental outlets are responsible for safeguarding the rental cars under the control of the outlet. Each outlet's manager is required to send a monthly report to Avio's head office that confirms the existence of each rental car under the control of the outlet and describes any operational problems of or damage to rental cars. Evidence of damage to rental cars is also provided by means of photographs. Mr Peter Toyota, the asset controller at Avios's head office, uses the monthly reports from outlet managers to perform the impairment calculation. Mr Buggatti signs these calculations as approval and Mr Toyota passes the necessary journal entries to update the accounting system.

The fixed asset register of Avios is fully automated and integrated with the company's *Smart*Accounts system and its general ledger.

The following are fields contained in the fixed asset register specifically for each rental car:
- Registration number
- Vehicle identification number
- Description of vehicle
- Date of first registration in the name of Avios
- Date of transfer to used car division
- Cost price
- Depreciation rate
- Residual value
- Carrying amount: 1 January 2017
- Opening balance, at cost
- Opening balance: Accumulated depreciation and impairment losses
- Depreciation for the current financial year
- Carrying amount: 31 December 2017
- Closing balance, at cost
- Closing balance: Accumulated depreciation and impairment losses

Source: June 2016 ITC (SAICA) - adapted