Part (e) Identify and outline the key factors that Lannister should consider from a business and strategic perspective prior to entering into the proposed agreement with 2Go

2Go

- The reputation & credibility of 2Go. Lannister should consider the reputation risk aspects of having 2Go as a strategic business partner. i.e. Lannister could be adversely affected should 2Go prove to be an unscrupulous operator.  
  
- The financial strength / creditworthiness of 2Go. Any solvency / liquidity issues associated with the strategic business partner may significantly affect the viability the plan.  
  
- Whether 2Go’s revenue billing system is reliable? Will 2Go capture and record all trips (Completeness) and correctly (Accuracy)?  

- The nature of the contractual relationship and the legal right to recourse held by Lannister:  
  - Will the strategic business relationship be with 2Go directly (2Go acting as principal) or will the strategic business relationship be with each individual driver provided (2Go acting as an agent).  
  - Lannister will effectively lose control of the vehicles and the drivers will have control of vehicles – hence Lannister will not be able to direct how the vehicles are driven and maintained, where it is parked etc.

Strategy and finance

- Lannister should conduct a cost/benefit analysis (financial and non-financial) using relevant performance metrics relevant to their industry. i.e. IRR, WACC, RoE, RoA, Impact on Free Cash Flow and reported profits/losses net of taxation, Regulatory Capital requirements etc.  
  - The sensitivity of the different business models’ cost/benefit analysis should be assessed in respect to capital market expectation and the nature of revenue being generated (2Go’s more stable fixed revenue stream).  
  - Entering into the arrangement could ideally be a beneficial solution for Lannister’s idle car capacity in order to use these cars for a return.  
  - The large fixed fee and well as per km fee can alleviate the lack of sufficient cash reserves currently being experienced by Lannister.  
  - However, will the agreement with 2Go provide more stable revenue than is currently experienced? Will the fixed fee be sufficient to provide relief to company’s revenue and cash flows (seeing that the loss in revenue for the first 6 months have already been R10m)?  
  - The alternatives to this agreement should be evaluated for example selling idle cars immediately and perhaps renegotiating the contract with car suppliers to purchase less cars.  
  - How does the profitability of the agreement compare with the “stay-as-is” scenario?  

- Lannister should investigate the reasons for idle rental cars and the persistence of the factors responsible – is it due to declining tourism or are there other long-term factors affecting the car rental industry?  

- Is there likely to be an increase in the demand for rental cars in the short to medium term (e.g. due to relaxation of visa requirements/the weakening Rand/Dollar exchange rate might result in improved growth in the tourism industry) – which may place the car rental division in the difficult position of having to decline car rental bookings if vehicles are tied up in the 2Go contract?  

- Providing 2Go with 1 000 vehicles represents a significant portion of the total fleet (6 000). Will Lannister be able to cope with less vehicles in peak periods (school holidays/Easter)?
Lannister and 2Go operate in a similar environment and are exposed to similar risks and returns. 2Go might therefore equally be negatively affected by a decline in tourism and poorer economy. Even though Lannister will receive the fixed fee, the per km fee might decline in times of low use.

Supplying vehicles to 2Go/drivers may in effect be introducing an indirect competitor – 2Go provides a competing offering to car rental firms & could permanently take market share from the car rental industry.

Lannister purchases new vehicles every two years – the alliance with 2Go covers a four-year period. Will Lannister be in breach of its terms of agreement with vehicle suppliers?

Will the deal have a negative effect on the used car division if they are supplied for 4 years (and not sold after 2 years as normal)?

Also, what impact will the agreement have on the condition/value of vehicles if 4 years old (more wear & tear etc.)

The used car division might also have less cars to sell if the vehicles are sold to 2Go (at 65% of market price which seems generous).

Regulatory issues

Are drivers required to register with government bodies given that they will be transporting passengers? With what rules and regulations does it need to comply with?

Who is responsible for injuries to passengers? Is Iterage legal liability of Lannister (vehicle owner), drivers or 2Go?

Revenue

Do annual fixed fees escalate annually or is it R15m in each year?

The escalation of the fixed fee per km (25%) is very favourable for Lannister (generally much higher than inflation)

How does R1/km compare to normal car rental rates/revenue? Is it sufficient to cover normal wear & tear?

What is the forecast revenue from 2Go arrangement? What is the average monthly km’s to be travelled by drivers

How can Lannister confirm monthly km’s driven per vehicle if it doesn’t have access to odometer readings? (Accuracy)

Are drivers able to bypass 2Go’s system and use vehicles for personal gain? (Completeness)

Operating costs

Who is responsible for monthly operating costs (fuel, service and maintenance, insurance, e-tolls)?

Will Lannister be able to collect traffic fines paid for but incurred by drivers?

Are drivers responsible for damages to vehicles? If so, are drivers credit worthy? Will Lannister be able to recoup damages from the drivers?

Other issues

Any other valid point (max 2)

Available 36

Maximum 20

Communication skills – clarity of expression; logical argument 2

Total for part (e)
### Part (f)

Identify and discuss Lannister’s performance obligations included in the SLA with AirBook, including how the performance obligations should be recognised and measured, in terms of IFRS 15 Revenue from Contracts with Customers.

#### How should Lannister account for this ‘advertising income’ revenue streams in terms of IFRS 15?

1. **The core principle of IFRS 15 is that an entity shall recognise revenue to depict (reflect) the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services (IFRS 15.02).**

   Although the cash flows are received quarterly and per redirection, revenue recognised shall not be based on the receipt of the cash flows, but rather on the basis of the core principle which is in a manner which depicts the transfer of the promised service to the customer.

#### Step 2: Identify the performance obligations in the contract

At the inception of a contract, Lannister should identify the performance obligations contained in the contract (IFRS 15.22).

The performance obligations should be identified for each promise to transfer to the customer either – a good or service that is distinct; or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (IFRS 15.22 (a) – (b)).

A good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer, and
- (b) The entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (IFRS 15.27 (a) – (b)).

2. The services transferred to AirBook for each redirection of customers to their website and the service to provide the banner on its website, are 2 distinct services given that:

   1 - The customer (Airbook) can benefit from the banner (advertising) and the redirection (referral) separately, as the customer can obtain benefit from the banner without redirection; and the redirection benefits the customer without the need for the banner.

   2 - The obligation to provide the banner and the obligation for redirection upon a booking are services that are separately identifiable in the contract because the 2 services can be contracted for separately and the individual services are not used to provide a combined output; they do not significantly modify or customise the other service; and are not highly interdependent or interrelated with each other. Each service will not alter the promise to deliver the service expected in terms of the other performance obligation.

3. Lannister therefore has 2 performance obligations, namely:
   - Obligation to provide a banner on their website
   - Obligation to redirect a customer (upon making a booking with Lannister) to Airbook’s website.

   The performance obligations should be recognised and measured as follows:

   **Recognition:**

4. **Step 1: Identify the contract with a customer**

   The signing of a service level agreement (SLA) between Lannister and Airbook on 1 January 2015, with the SLA having commercial substance and it being regarded as being probable that Lannister will collect the consideration suggest that a contract exists with a customer. (IFRS 15.09(a)).

   **Step 2: already discussed**

5. **Step 5: Recognise revenue when the entity satisfies a performance obligation**

   Lannister should recognise the revenue from the transactions with AirBook when (or as) Lannister satisfies the performance obligation by transferring the promised services to AirBook (IFRS 15.31). Revenue will accordingly be recognised either at a point in time or over a period of time as Lannister satisfies their performance obligations in respect of the advertisement services and redirection services.

   The revenue relating to the performance obligation to provide the banner is satisfied over time in accordance with IFRS 15.35 when AirBook simultaneously receives and consumes the benefits:

   - In the scenario, AirBook simultaneously receives and consumes the benefit of the banner (being an advertisement) over the period the banner is displayed. Various methods (input or
output methods) can be used to determine how to recognise revenue over time, with the most likely being the **fee is spread equally** over the three-month period (quarter) to which the payment relates.

6 The revenue relating to the performance obligation to redirect a customer (**redirect fees**) are recognised **at a point in time** as each customer is redirected. This is because the service is rendered (& the performance obligation satisfied) as the customer clicks on the link.

Revenue will be recognised at a point in time if the criteria for over a period of time are not satisfied. It is evident that the redirection service is not satisfied over time because:

- Airbook does not simultaneously receive and consume the benefits provided by Lannister’s performance as the entity performs **because the benefit is only received when the redirection button is clicked**.
- The entity’s performance does not create or enhance an asset or create an asset with an alternative use **as no asset is created**.

The fee is raised and recognised as revenue (with a corresponding receivable) **as customer clicks on the link**.

### Measurement:

#### Step 3: Determine the transaction price and Step 4: Allocating the transaction price to performance obligations

7 The transaction price in respect for each performance obligation is known and allocation will be based on the transaction price as follows –

- a fixed fee for the banner (payable every quarter upfront). As the fee is received upfront every 3 months, the practical expedient of financing applies.
- a fee per redirect in 2016 which is set out and agreed upon in the SLA (IFRS 15.47). The fee per redirect will depend on whether the client was redirected before or after making a reservation.

### Other considerations

8 Principal vs agent (triggered by ‘a referral icon on Lannister’s website to go to AirBook’s website’): although customers first go to the website of Lannister, it will have **no further performance obligation to fulfil once the link is clicked** as Airbook will continue with the contract for accommodation. Lannister **receives no commission** on Airbook’s accommodations bookings if the customer was redirected through Lannister’s website. **Lannister therefore acts as principal** in respect of the banner and redirect services.

| Available | 17 |
| Maximum   | 8  |
| **Total for part (f)** | 1  |