

A Leader in Accounting Education

Accountancy@UJ



AUDITING 3B

FINAL ASSESSMENT OPPORTUNITY

31 October 2015

First examiners: **Ms Rozanne Smith**
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Total time: **2.5 hours**

Total marks: **125 marks**

Instructions:

1. This paper consists of 11 pages. If your paper does not contain all the pages, please put up your hand so that a replacement paper can be handed to you.
2. Answer all the questions.
3. Calculate the time that you should spend on each question and part of a question by multiplying the number of marks by 1.2 to determine the time, in minutes, available for each question. Adhere to these time constraints in order to finish the paper in the given time.
4. Delete all (even single open lines) open spaces on your answer sheets with pen. Pages on your answer sheets that contain open spaces will be marked as such and those pages will not be eligible for a remark.
5. No tippex or pencil may be used on your answer sheets. Pages on your answer sheets that contain pencil or tippex will be marked as such and those pages will not be eligible for a remark.
6. All the examination regulations of the UJ and the policy document for students of the Department of Accounting will apply before, during and after this test.
7. The neatness, disclosure and presentation of your answers will be taken into account when marking your paper.
8. Read the questions carefully. If you are required to provide explanations, you must use full sentences.

Question 1**(25 Marks)**

You have recently registered with The South African Institute of Professional Accountants (SAIPA). One of your clients, Building Supplies (Pty) Ltd, is one of the largest building material wholesalers in South Africa, and they provided you with the following minutes of their directors meeting.

<p style="text-align: center;">Building Supplies (Pty) Ltd Rosebank Johannesburg Lavender Building 3, Block C 08:00</p>
<p><u>Attendees:</u> All members of the board were present.</p> <p><u>Matter discussed:</u></p> <p>The vice president of corporate development at Building Supplies, Sarah Lubbe, asked for an opportunity to speak at the meeting. Sarah expressed her concerns about Building Supplies' accounting practices utilised in preparing their financial statements. Sarah also mentioned that she had inside information that executive management employed accounting loopholes and poor financial reporting practices to hide thousands of Rands of debt from failed projects. The executive management team was shocked at this announcement and asked that Sarah be removed from the meeting immediately.</p>

The executive management team also provided you with the following information regarding the company:

- Building Supplies' current turnover is R7.59 million.
- Their employees at the beginning of the year was 80 and at the end of the year was 60.
- The amount Building Supplies owes to third parties for the current year is R1.5 million.
- The total number of individuals with a direct interest in Building Supplies is five and the total number of individuals with an indirect interest in Building Supplies is four.

You are required to:

- a) Discuss whether an independent review should be performed for Building Supplies. Also explain examples where an independent review would not be necessary. (6)
- b) Discuss what an independent professional accountant is. (5)
- c) You investigated the allegations made by Sarah Lubbe and you believe that Sarah has a valid point. Discuss your responsibilities with regards to this matter should you provide an independent review to Building Supplies? (7)
- d) Describe the three aspects that should be considered when planning the independent review engagement. (7)

Question 2

(30 Marks)

Prasa loses millions to wasteful expenditure

06 Oct 2013 13:37 Sapa, Mail and Gaurdian

After failing to meet 52% of its targets in the year, it has been reported that Prasa has lost millions to irregular spending.

According to the report, Prasa did not meet its targets on rail passenger safety and rail fatalities increased during the year.

The Passenger Rail Agency of South Africa (Prasa) has lost millions of Rands to irregular and wasteful expenditure, the *Sunday Independent* reported.

There was irregular spending of R14.9-million due to procurement awards being made without quotations.

Fruitless and wasteful expenditure of more than R3-million was incurred because invoices were not paid on time and disciplinary processes were not conducted with the required 30-day period.


Forensic investigations were underway into an accounting official who was referring fleet vehicle repairs to a service provider in which he had a business interest, and into a middle management official accused of unethical behaviour. The forensic investigators also discovered that no risk assessment was done in the past 3 years.

You are required to:

- a) Discuss in detail why the actions of the accounting authority of Prasa contravened the Public Finance Management Act (PFMA). (27)
(You are not required to discuss the consequences)
- b) According to the PFMA, discuss in detail what an internal audit activity must prepare, in consultation with and for approval by the audit committee. (3)

Question 3**(20 Marks)****Part A****(10 Marks)**

Please indicate the correct answer in your answering sheet. For example:

101		B	C	D
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1. Which of the following is not true with regard to the internal audit charter?
 - a. It defines the authorities and responsibilities for the internal audit activity.
 - b. It specifies the minimum resources needed for the internal audit activity.
 - c. It provides a basis for evaluating the internal audit activity.
 - d. It should be approved by senior management and the board.
2. To minimise potential financial losses associated with physical assets, the assets should be insured for an amount that is:
 - a. Supported by periodic appraisals.
 - b. Determined by the board of directors.
 - c. Automatically adjusted by an economic indicator such as the consumer price index.
 - d. Equal to the book value of the individual assets.
3. Which of the following controls would prevent the ordering of quantities in excess of an organisation's needs?
 - a. Review of all purchase acquisitions by a supervisor in the user department prior to submitting them to the purchasing department.
 - b. Automatic reorder by the purchasing department when low inventory level is indicated by the system.
 - c. A policy requiring review of the purchase order before receiving a new shipment.
 - d. A policy requiring agreement of the receiving report and packing slip before storage of new receipts.
4. Upon obtaining factual documentation of unethical business conduct by the chief executive officer (CEO) to whom the chief audit executive (CAE) reports, the CAE should:
 - a. Conduct an investigation to determine the extent of the vice president's involvement in the unethical acts.
 - b. Confront the vice president with the facts before proceeding.
 - c. Schedule an audit of the business function involved.
 - d. Report the facts to the chief executive officer and the audit committee.
5. A chief audit executive (CAE) for a very small internal audit department has just received a request from management to perform an audit of an extremely complex area in which the CAE and the department have no expertise. The nature of the audit engagement is within the scope of internal audit activities. Management has expressed a desire to have the engagement conducted in the very near future because of the high level of risk involved. Which of the following responses by the CAE would be in violation of the Standards?

- a. Discuss with management the possibility of outsourcing the audit of this complex area.
 - b. Add an outside consultant to the audit staff to assist in the performance of the audit engagement.
 - c. Accept the audit engagement and begin immediately, since it is a high-risk area.
 - d. Discuss the timeline of the audit engagement with management to determine if sufficient time exists in which to develop appropriate expertise.
6. Which of the following represents the best governance structure?

	Senior Management	Board of Directors	Internal Auditing
a.	Responsibility for risk	Oversight role	Advisory role
b.	Oversight role	Responsibility for risk	Advisory role
c.	Responsibility for risk	Advisory role	Oversight role
d.	Oversight role	Advisory role	Responsibility for risk

7. As part of a company-sponsored award program, an internal auditor was offered an award of significant monetary value by a division in recognition of the cost savings that resulted from the auditor's recommendations. According to the International Professional Practices Framework, what is the most appropriate action for the auditor to take?
- a. Accept the gift since the engagement is already concluded and the report issued.
 - b. Accept the award under the condition that any proceeds go to charity.
 - c. Inform audit management and ask for direction on whether to accept the gift.
 - d. Decline the gift and advise the division manager's superior.
8. According to the International Professional Practices Framework, internal auditors should possess which of the following skills?
- I. Internal auditors should understand human relations and be skilled in dealing with people.
 - II. Internal auditors should be able to recognize and evaluate the materiality and significance of deviations from good business practices.
 - III. Internal auditors should be experts on subjects such as economics, commercial law, taxation, finance and information technology.
 - IV. Internal auditors should be skilled in oral and written communications.
- a. II only.
 - b. I and III only.
 - c. III and IV only.
 - d. I, II and IV only.
9. The internal audit activity should contribute to the organisation's governance process by evaluating the processes through which:
- I. Ethics and values are promoted.
 - II. Effective organisational performance management and accountability are ensured.
 - III. Risk and control information is communicated.

- IV. Activities of the external and internal auditors and management are coordinated.
 - a. I only.
 - b. IV only
 - c. II and III only.
 - d. I, II, III and IV.

- 10. During a review of purchasing operations, an auditor found that procedures in use did not agree with stated company procedures. However, audit tests revealed that the procedure in use represented an increase in efficiency and a decrease in processing time, without a noticeable decrease in control. The auditor should:
 - a. Report the lack of adherence to documented procedures as an operational deficiency.
 - b. Develop a flowchart of the new procedures and include it in the report to management.
 - c. Report the change and suggest that the change in procedures be documented.
 - d. Suspend the completion of the engagement until the engagement client documents the new procedures.

Part B**(10 Marks)**

You were recently employed as an internal audit manager at CableCo (Proprietary) Ltd (Hereafter CableCo). CableCo is a subsidiary of a global company that manufactures and distributes high quality copper cables. CableCo was founded forty years ago by Mr. Spark to explore the opportunities in the copper cable market in South Africa. CableCo has a strong visionary management team, led by Mr. Ndlovu. The management team strongly believes that all activities should be compliant with applicable laws and regulations. Management is dedicated to the growth and the development of the company and has a positive attitude towards a sound control environment. Mrs. Robyn Ally is the chief audit executive of the internal audit activity and is assisted by six other internal audit employees. The team of six includes Ben, an internal auditor that was also recently employed after graduating with a diploma in internal auditing.

Several activities related to the internal audit activity took place during the year and are described below:

Scenario 1:

Robyn has become good friends with one of your internal audit colleagues, John. A complex financial audit in New York was requested by the audit committee. John has never been overseas and begs Robyn to send him. Robyn knows he does not have any experience in that field of work and is not really available at the time of the engagement, but decided to send him anyway.

Scenario 2:

A former cashbook clerk performed a review of internal controls over cash receipts and cash payments four months after being transferred to the internal audit activity. He also provided advice with regard to the implementation of an electronic funds transfer system to the management of a major branch in Gauteng.

You are required to:

Identify possible violations of the IIA's Code of Ethics, International Standards for the Professional Practice of Internal Auditing (IPPF Standards) and Interpretations in the scenarios. If applicable, briefly state the rule/(s) of conduct or specific standard/(s) that is/were violated, discuss the violation and recommend the correct action that should have been taken.

Marks will be allocated as follows:

- Scenario 1 (6 Marks)
- Scenario 2 (4 Marks)

Question 4**(19 Marks)**

Lizamore Plumbing CC (hereafter Lizamore) is an established organisation that specialises in plumbing services. Lizamore was formed by three university friends while they were still studying, because they wanted to make some extra money. They only recently heard about the amendments that were made to the Closed Corporation Act, in light of the changes that were made to the Companies Act 71 of 2008.

The founding member Mr. Richard Lizamore has asked you for some advice on the operations of the corporation. Mr. Richard Lizamore provided you with the following information regarding Lizamore:

Descriptions of the operations of Lizamore CC	
1.	The members of Lizamore decided that they are not going to appoint an accounting officer, because they are of the opinion that they are relatively good with mathematics and will be able to look after the finances of the closed corporation.
2.	Mr. Richard Lizamore also made the decision to grant a loan to the one of the members, because he needed money for personal reasons. The loan was approved even through the third member did not vote in favour of this decision.

You are required to:

Discuss the contraventions of the Closed Corporation Act 69 of 1984 that are evident from the above scenario and provide suitable recommendations for the contraventions. Your recommendations must include specific guidance from relevant sections of the Closed Corporation Act 69 of 1984. (15)

Precision and interpretation 4 Marks

Question 5**(26 Marks)**

Simply Beads (Pty) Ltd (hereafter SB) is a company that sells jewellery made from wooden beads. SB has various employees who are responsible for design and manufacturing of the wooden jewellery. The wooden jewellery is then sold to the local public.

Since SB is a newly formed company, the financial manager isn't sure whether there are any risks affecting SB and whether they have controls in place to address the risks. The financial manager recently read something in an accounting magazine about the Committee of Sponsoring Organisation (COSO) of the Treadway Commission and that they have introduced an internal control integrated framework as well as an enterprise risk management (ERM) integrated framework.

You are currently in your final year of your B Com Accounting studies and have just attended a lecture regarding COSO and ERM. The financial manager of SB has asked you for some advice.

Part A**(15 Marks)**

You are required to:

Write a report to the financial manager of SB explaining to him exactly what this internal control integrated framework entails. In your report you have to make reference to the following points regarding the internal control integrated framework:

- Definition of internal control including the fundamental concepts. (4)
- An explanation of the components of the internal control integrated framework. (10)

Presentation (Report Format) (1)

Part B**(11 Marks)**

The financial manager provided you with the following system descriptions regarding SB's operations:

Simply Beads (Pty) Ltd Information regarding operations	
<ul style="list-style-type: none">• SB has grown rapidly over the past few years and their wooden jewellery is becoming very popular. As a result of the growth in the business, the employees were expected to work longer hours per week, for the same salary. Some of the employees were very upset with the new working hours and started a massive strike. The strike continued for 3 weeks, and there were very limited staff available to assist in the designing and manufacturing of the jewellery.• SB also realised that their manual system for placing orders had become inadequate and they decided to change to a computerised system. All conversion controls were adequately implemented.	

You are required to:

Identify and discuss the risks being faced by SB in terms of the ERM integrated framework. (10)

Your answer should be presented in the following format:

Name of risk
Scope of risk
Nature of risk
Stakeholders
Quantification of risk
Risk Tolerance or Appetite
Risk treatment and control mechanisms
Potential action for improvement
Strategy and policy development

Presentation (Format) (1)

Question 6**(5 Marks)**

Planning For Your Future Ltd (hereafter PFYF) is a trusted partner for their clients on their journey to financial wellness. PFYF offers a wide range of products and services to assist their clients in planning for their future after retirement. PFYF prides themselves in providing the best advice and guidance to all of their customers.

The Chief Executive Officer (CEO) of PFYF recently attended a seminar on the new Protection of Personal Information (POPI) Act. After the seminar the CEO was quite worried that PFYF might not comply with the requirements of the POPI Act and since they have a large customer database they could face severe penalties and fines if they do not comply with the requirements in protecting all of their client's personal information.

The CEO of PFYF asked you, the internal auditor, to provide him with assurance that PFYF is complying with the POPI Act.

You are required to:

Explain to the CEO how you would go about to give assurance that PFYF is complying with the POPI Act. (5)