

A Leader in Accounting Education

# Accountancy@UJ



## AUDITING 3B

### SUPPLEMENTARY ASSESSMENT OPPORTUNITY

December 2014

**FIRST EXAMINERS:** Ms Rozanne Smith  
Ms Belinda Schutte  
Ms Seabi Mokoena

**SECOND EXAMINER:** Prof Ben Marx

Mr Willem Malherbe

**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 questions carefully. If you are required to provide explanations, you must use full sentences.

**Question 1****(10 Marks)**

Jan Painting is the owner of Services (Pty) Limited. His company specialises in providing support services to accounting firms. He has approached the partners at your firm with the following proposal:


Services (Pty) Ltd can also assist the firm in expanding their base of audit clients. They believe their success lies in using any and all forms of communication: telephoning prospective clients; mailing, faxing and e-mailing brochures to clients. They also have software available that makes the mass sending of SMS messages possible.

The other partners want your comment on Jan's proposal in terms of obtaining potential clients. They know that you are familiar with the content of the SAIPA Code of Professional Conduct and would be able to explain whether the proposals are in accordance to the Code.

<b>You are required to:</b>		<b>Marks</b>
a)	Draft a letter to the other partners addressing the proposed marketing strategies above, in terms of the requirements of the SAIPA Code of Professional Conduct.	<b>(9)</b>
		<b>Presentation marks 1</b>

**Question 2****(20 Marks)****Part A****(10 Marks)**

Please indicate the correct answer with an X on the “multiple choice” answer sheet provided. For example:

101		A	B	C	D
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1. 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.
2. 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.
3. An auditor, nearly finished with an engagement, discovers that the director of marketing has a gambling habit. The gambling issue is not directly related to the existing engagement and there is pressure to complete the current engagement. The auditor notes the problem and forwards the information to the chief audit executive but performs no further follow-up. The auditor's actions would:
  - a. Be in violation of The IIA's Code of Ethics for withholding meaningful information.
  - b. Be in violation of the *Standards* because the auditor did not properly follow up on a possible indicator of the existence of fraud.
  - c. Not be in violation of either The IIA's Code of Ethics or *Standards*.
  - d. Both a and b.
4. Which of the following is the best reason for the chief audit executive to consider the board's strategic plan in developing the annual audit plan?
  - a. To ensure that the internal audit plan supports the overall business objectives.
  - b. To ensure that the internal audit plan will be approved by senior management.

- c. To make recommendations to improve the strategic plan.
  - d. To emphasize the importance of the internal audit activity.
5. 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.
6. Which of the following is **not** a responsibility of the chief audit executive?
- a. To communicate the internal audit activity's plans and resource requirements to senior management and the board for review and approval.
  - b. To coordinate with other internal and external providers of audit and consulting services to ensure proper coverage and minimise duplication.
  - c. To oversee the establishment, administration, and assessment of the organisation's system of risk management processes.
  - d. To follow up on whether appropriate management actions have been taken on significant reported risks.
7. Which of the following would be permissible under The IIA's Code of Ethics?
- a. In response to a subpoena, an auditor appeared in a court of law and disclosed confidential, audit-related information that could potentially damage the auditor's organisation.
  - b. An auditor used audit-related information in a decision to buy stock issued by the employer corporation.
  - c. After praising an employee in a recent audit engagement communication, an auditor accepted a gift from the employee.
  - d. An auditor did not report significant observations about illegal activity to the board because management indicated that it would resolve the issue.
8. 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 discernible 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 can provide documents of the new procedures.

9. A hospital is evaluating the purchase of software to integrate a new cost accounting system with its existing financial accounting system. Which of the following describes the most effective way for the internal audit activity to be involved in the procurement process?
- a. The internal audit activity evaluates whether performance specifications are consistent with the hospital's needs.
  - b. The internal audit activity evaluates whether the application design meets internal development and documentation standards.
  - c. The internal audit activity determines whether the prototyped model is validated and reviewed with users before production use begins.
  - d. The internal audit activity has no involvement since the system has already been developed externally.
10. A follow-up review found that a significant internal control weakness had not been corrected. The chief audit executive (CAE) discussed this matter with senior management and was informed of management's willingness to accept the risk. The CAE should:
- a. Do nothing further because management is responsible for deciding the appropriate action to be taken in response to reported engagement observations and recommendations.
  - b. Initiate a fraud investigation to determine if employees had taken advantage of the internal control weakness.
  - c. Inform senior management that the weakness must be corrected and schedule another follow-up review.
  - d. Assess the reasons that senior management decided to accept the risk and inform the board of senior management's decision.

**Question 2**  
**Part B**

**(10 Marks)**

Salt-n-Pepper (Pty) Ltd is a large logistical management company specialising in the distribution of large food retailers' products across the country. The chairman of the audit committee has asked you to assist in the search for Salt-n-Pepper (Pty) Ltd's new chief audit executive (hereafter CAE). The human resources department has done all the interviews and established a shortlist. The chairman of the audit committee had interviews with the candidates on the shortlist and reduced the list to two candidates. He has sent you the details of the candidates to assist him in making the final recommendation to the rest of the audit committee.

1. Jan McKay:	Qualified with a B. Information Systems degree cum laude in 2002. A member of the Institute of Internal Auditors for ten years. Currently one of three senior members of Salt-n-Pepper (Pty) Ltd's internal audit division, he is well respected for his business knowledge, independence and ethics. He relates well to staff at all levels.
2. Andy James:	A member of the Institute of Internal Auditors for 12 years. Resigned from his previous role as the Chief Audit Executive of Pie & Chips (Pty) Ltd (a national food manufacturer with a number of retail outlets) after a number of highly confidential recipes were obtained by a competitor. No charges were ever brought against Andy James but the rumour in the industry was that he was suspected of wrong doing, but sufficient evidence could not be gathered before he suddenly resigned.

You are required to:		Marks						
a)	<p>State for each candidate, whether they would be suitable or unsuitable for appointment to the position of CAE of Salt-n-Pepper (Pty) Ltd. Discuss your considerations to support your decisions. Your answer must convey that you are knowledgeable about the role of internal audit and the attributes the CAE should have.</p> <p><b>Your answer should be in the following format:</b></p> <table><tr><th>Suitable / Unsuitable</th><th>Considerations</th></tr><tr><td>1.</td><td></td></tr><tr><td>2.</td><td></td></tr></table>	Suitable / Unsuitable	Considerations	1.		2.		(10)
Suitable / Unsuitable	Considerations							
1.								
2.								
	<b>Total Marks:</b>	(10)						

**Question 3****(30 Marks)**

Greanleef Ltd, a provider of IT consulting services, is listed on the JSE Securities Exchange. Milly Schmilly is the Chief Executive Officer and one of four founding members of Greanleef Ltd. The four of them act as the executive directors of Greanleef Ltd. The executive directors' contracts states that their serving terms are 5 years and that they all receive a fixed remuneration, with a mandatory inflation adjustment and other salary increases which is to be approved by the shareholders. Milly Schmilly read something about a Code of Corporate Governance for South Africa (King III) requirement for non-executive directors. She is not sure what "non-executive director" means, but has subsequently appointed two directors in a non-executive capacity. The first non-executive director represents Greanleef's largest client and he holds a number of directorships; the other does not have any business involvement with Greanleef Ltd. He has just obtained his BA (Political Studies) cum laude and this is his first appointment as a director of a company.

At the first directors meeting Milly was elected as chairperson of the board. The four executive directors are actively involved in the business and meets regularly. The board therefore decided that they would delegate all functions to the four executive directors and only meet on an as needed basis.

As the board is not sure on what to report on they have not included any statements on corporate governance in the financial statements.

<b>You are required to:</b>		<b>Marks</b>
a)	Discuss whether Greanleef Ltd is in compliance with the recommendations of Code of Corporate Governance for South Africa (King III), based on the information above.	<b>(29)</b>
<b>Presentation marks 1</b>		

**Question 4****(32 Marks)**

You are a partner in the large audit firm of Nel, Maseko and Viljoen (NMV). You are currently busy with the audit of Star Properties Ltd for the financial year ending 30 September 2014. Star Properties is one of NMV's largest audit clients and has been a client for more than ten years.

Star Properties Ltd owns and manages a collection of 5-star hotels, resorts, lodges and game reserves. During the current year there were no changes in the directors of Star Properties Ltd. The executive directors of the company consist of:

- Mr Cairney
- Ms Dirker
- Ms Forte
- Ms NC Crosby

During your review of the audit working paper file you came across the following notes made by the trainee accountant Mr Daniel Epstein:

Entity Name:	Star Properties Ltd	Year end:	30 September 2014	A2/1
Prepared By:	Mr Daniel Epstein	Date:	18 November 2014	
Reviewed By:				
Subject:	Matters identified whilst gathering audit evidence			
Review of Minutes of Board Meetings held during the current year:				
MATTER 1:				
During June 2014 a decision was taken by the board of directors to sell the head office complex. The fair value of the owner-occupied building amounts to R12.5 million. The office complex will be sold to Moon Investments (Pty) Ltd for R12.5 million.				
<i>Mr Epstein noted that the Net asset value of Star Properties Ltd was R20 million and that Ms NC Crosby owns a number of business interests, including a large investment (55%), in Moon Investments.</i>				
MATTER 2:				
On 15 September 2014, the directors authorised Mr Cairney (CEO) to provide a loan of R2 million to Supernova Holdings Ltd.				
<i>Mr Epstein noted the fact that there was a share issue to Supernova Ltd on 25 September 2014 of 500 000 shares and that R2 million was deposited into the bank account of Star Properties Ltd on that date in full and final settlement for the shares. The shares were issued as fully paid up capital.</i>				
MATTER 3:				
On 20 September 2014 the directors discussed the possibility of issuing a dividend in the				



following financial year. They are considering a dividend of approximately R 1 per share.

You are required to:		Marks
a)	Discuss the Companies Act 71 of 2008 requirements which have to be met for the discussions and decisions taken at the meetings of the board of directors.	(31)
		Presentation marks 1

**Question 5****(18 Marks)**

A well-known State Owned Company has reached the end of its current reporting period. The Chief Financial Officer is busy reviewing all accounting records that have been presented to him by the accounting staff. The records are fully detailed as expected. Post his review he will compile a report of pertinent information that must be included in the financial statements, before they are presented to the accounting authority.

He also taken note of the directors who don't want all their remuneration disclosed. As a result of him being such a kind-hearted individual, he has assured them that he will only disclose what is necessary and required by the PFMA.

<b>You are required to write a report to the CFO that contains the following information :</b>		<b>Marks</b>
a)	Discussing the additional general responsibilities of the accounting authority.	<b>(5)</b>
b)	Listing the officials for whom remuneration must be disclosed in the financial statements of State Owned Companies in terms of the PFMA.	<b>(4)</b>
c)	List the specific remuneration disclosures for the officials as required by the PFMA.	<b>(5)</b>
<b>Precision and Interpretation Marks (4)</b>		

**Question 6****(15 Marks)**

Your friend Melissa Botha wants to open her own beauty salon in Feather Brook Estate. She is however not sure what process to follow to register this new business. She recalled that you study B Com Accounting and are currently in your third year. She therefore discussed the following concerns with you. Melissa wants to register a new Closed Corporation (hereafter CC) and then possibly convert it into a private company should the CC be successful in future. She is however not sure whether this is possible and what processes and procedures would be needed for the conversion. Melissa plans on appointing 5 members in the CC, and would like to add another member at a later stage that will also act as the accounting officer of the CC. Again, Melissa is not sure whether she will be allowed to appoint more members at a later stage, and who qualifies to be an accounting officer.

<b>You are required to:</b>		<b>Marks</b>
a)	Draft a <b>memorandum</b> to Melissa Botha responding to the concerns that she has in terms of the Closed Corporation Act as mentioned above.	<b>(15)</b>