



**UNIVERSITY OF JOHANNESBURG**

**DEPARTMENT OF ACCOUNTANCY**

**AUDITING 200 – 2014**

**FINAL ASSESSMENT OPPORTUNITY**

**NOVEMBER 2014**

**FIRST EXAMINERS:** MS. C HOHLS  
MS. M MARCHBANK

**TIME:** 150 MINUTES

**SECOND EXAMINER:** MRS D MARE  
MRS I NEL

**MARKS:** 125 MARKS

**INSTRUCTIONS:**

1. This paper consists of **ELEVEN** 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. Answer each question on a **separate folio**.
4. Calculate the time that you should spend on each question by multiplying the number of marks for each question 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.
5. 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.
6. 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 will not be eligible for a remark.
7. All the examination regulations of UJ and the policy document for students of the Department of Accounting will apply during this assessment.
8. Keep this paper for your record purposes.
9. The neatness, disclosure and presentation of your answers will be taken into account when marking your paper.
10. Read questions carefully, if you need to provide explanations you should always use full sentences, refrain from simply naming facts.

## QUESTION 1

51 MARKS

You are the senior manager in charge of the audit of Moonchild & Roth (SA) Ltd hereafter referred to as ("MR SA") and are currently engaged in planning the audit for the year ended 30 June 2014.

Refer to annexure A for the copy of the engagement letter which was issued by Number Cruncher Auditors Incorporated (hereafter NCAI).

MR SA is the African arm of the Roth Corporation, a multinational based in the south of France.

MR SA is listed on the Johannesburg Securities Exchange and is jointly controlled by Roth Corporation and the Moonchild Family Trust. Each shareholder owns 35% of the shares in the company and the general public hold the remaining 30%. Dexter Moonchild is the Chairman and Chief Executive of the South African company.

The principal activity of the company is the importing and distribution of the Moonchild & Roth brand of sparkling wines.

The sparkling wines are produced at a wine farm located in Tuscany, Italy that is operated by Moonchild & Roth (Italy) Ltd, hereafter referred to as "MR Italy", a wholly owned subsidiary of MR SA.

MR Italy imports various types of grapes from South Africa and is funded mainly through Euro and Rand denominated loans.

MR SA imports their entire inventory, i.e. cases of sparkling wine from MR Italy.

As it is the policy of the Roth Corporation to appoint your firm as auditors of all Roth Corporation companies, you are also the auditor of MR Italy. Your staff considers it a privilege to be allocated to this audit because of the opportunity to travel.

All sparkling wines are distributed through a network of boutique liquor stores throughout South Africa. The branches also provide wine tasting experiences for customers. Although the hosts of the wine tastings are located at the various branches, the Wine Tasting Division is a separate profit centre and maintains separate accounting records. The Division derives revenue from:

- Wine Tastings – This is the principal source of revenue and customers are charged either an annual membership fee (to join the Wine Tasting held on a monthly basis) or an event fee based on the specific tasting you would like to attend.
- Sale of debuting sparkling wines at the event.

MR SA's sparkling wines are distributed throughout South Africa through a network of Franchised Distributors. These distributors pay MR SA royalties based on turnover and are also obliged to buy their inventory from MR SA.

MR SA Head Office derives revenue from:

- Franchise Fees – New Franchised Distributors are required to pay a franchise fee in order to secure appointment as an approved MR SA Distributor.
- Royalties
- Mark-ups on products supplied to Franchised Distributors.

MR SA also operates a Group Treasury function. The principal activity of the Treasury is to manage the group's exposure to foreign exchange fluctuations and this is achieved through a mix of Forward Exchange Contracts and various Structured Derivative Instruments. Because the company is a major trader in sparkling wines, the Treasury also deals in various sparkling wine-related Futures and Options.

The 2014 financial year has been catastrophic for MR SA owing to declining turnover in a competitive market, adverse economic circumstances, devaluation of the Rand, losses on various financial instruments and major frauds perpetrated in the accounting department of MR SA.

The following is a summary of the company's consolidated management accounts for the current year:

	<b>Note(s)</b>	<b>R'000 Budget Year to 30-06-14</b>	<b>R'000 Actual Year to date 31-05-14</b>	<b>R'000 Audited Year to 30-06-13</b>
<b>Income statement</b>				
Gross operating revenue	<b>1.</b>	445 000	180 000	300 000
Franchise fees		55 000	26 000	45 000
Royalties		65 000	40 000	57 000
Margins on sales to Franchisees		40 000	22 000	33 000
Abnormal bad debts		-	(95 000)	-
Profits on dealing in financial instruments		22 000	(93 000)	25 000
Profits on foreign currency transactions		-	(98 000)	-
Head office costs		(250 000)	(150 000)	(240 0000)
Interest paid		(45 000)	(50 000)	(40 000)
Net income before taxation		332 000	(218 000)	180 000
<b>Balance sheet</b>				
Development costs	<b>2.</b>	-	10 500	-

**Note 1:**

Gross operating revenue includes some contentious amounts relating to 2015's financial year end. There appears to be a consignment of sparkling wines that have been sold to Kenya for R1 000 000. Your audit clerk noted that the sales delivery note indicated a date of 02 August 2014 and not the actual invoice date of 02 June 2014. Included in the R1 000 000 are invoices that were quoted for as sales but these sales were never accepted by the customers.

**Note 2:**

Development expenditure represents expenditure incurred by MR Italy on the development of a new range of sparkling wines. These wines have pieces of fruit infused in the sparkling wine, making ready-made mimosas. MR SA plans to import these products from MR Italy and supply them to the international markets

**Going concern**

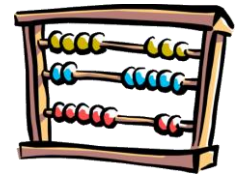
For obvious reasons you have identified the going concern as an audit risk and has already discussed this with management. Dexter has informed you that the following is important to note:

- The group has full support of its bankers and Roth Corporation the holding company,
- Losses resulted mainly from non-recurring items and has returned to profitability
- Company is expecting increased profitability in 2015

**Other specific audit difficulties**

Recent media coverage has surfaced about the company being involved in running a brothel in France. It has been alleged that the females are sought from South Africa and sent to France. One of your clerks was informed that there was one of a number of payments made to third parties. These payments were noted as being made for Custom and work passes officials in order to ensure the safe passing of the females into France, Lyon. These costs have been called entertainment expenses in the current financial statements

## ANNEXURE A – Copy of engagement letter



Number Cruncher Auditors Incorporated

7 Beans Avenue

Counterland

2222

The shareholders of Moonchild & Roth (SA) Limited  
14 Wessels Road  
Sandton  
2198

Dear Whom It may concern,

I trust this engagement letter finds you well. Having carried out the preliminary investigation into your company, we are pleased to record our acceptance of the appointment as auditors and hereby confirm the terms of the engagement as follows:

- We will conduct our audit for the year-end for which we have been appointed,
- The engagement will be completed by 31 August,
- Our role is to certify the fair presentation of the financial statements,
- Your role as management will be to provide our staff with all the information we require to gather sufficient, appropriate evidence of fair presentation,
- We do not guarantee an unqualified audit report as auditing does not have its limitations and
- Fees will be a matter negotiation but will be based on prior years.

Please would you sign this letter, retain a copy, and return the original to us.

I look forward to working with you and auditing!

Signed: xxx  
Audit manager

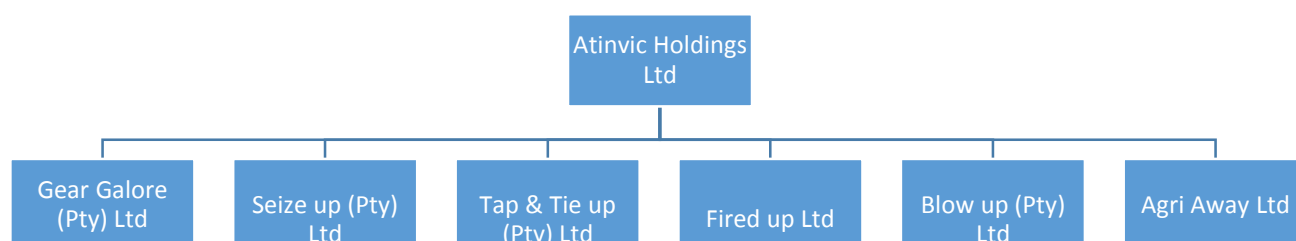
<b>YOU ARE REQUIRED TO:</b>		<b>MARKS</b>
<b>a.</b>	Discuss the weaknesses that are evident in the engagement letter. You are not required to re-draft the engagement letter.	<b>(15)</b>
<b>b.</b>	<p>i) Identify the risks of material misstatement on financial statement level apparent from the above information that you would consider during the planning of the MR SA audit.</p> <p>ii) Discuss how the risks identified in part (i) above will influence your assessment of  Inherent risk (IR) (6)  Detection risk (DR) (6)  Control risk (CR) (4)  And conclude.</p> <p>iii) With respect to the Note 1 above:  a) What assertion(s) is affected?  b) Provide substantive procedures that could be followed by the auditor in respect of the assertion(s) you identified in (a) above.  c) For the substantive procedures above, what would you say is the direction of the testing? Justify your answer.</p>	<p><b>(12)</b></p> <p><b>(16)</b></p> <p><b>(2)</b></p> <p><b>(4)</b></p> <p><b>(2)</b></p>
<b>TOTAL</b>		<b>(51)</b>

## QUESTION 2

60 MARKS

You are the audit senior in charge of the Atinvic Holdings Ltd (hereafter AH) for the 2014 financial year end. This has been by far the worst audit of your three years working at Carefree Auditors Inc. This year communication between all the relevant parties have really taken a turn for the worst. There was no meetings held between AH's management and the audit manager and partners before the audit commenced and no indication of deadlines were communicated to the audit team. Halfway through the audit the team were informed of the audit's deadline, which was only 14 days away. The client's year end is 31 July 2014 and they want the auditors out of their offices three days after yearend. This gives the auditors effectively only 11 days still to audit.

AH consists of a lot of smaller entities (as indicated in the diagram below) and thus there is a lot of related party transaction that took place during the year and a lot of intercompany financing. AH prefer to make use of intercompany financing as it is cheaper compared to the interest rates charged by financial institutions.



Part of our repetitive audit procedures every year is to determine whether the Private Companies in the group have to be audited. All the companies have been assessed except for Gear Galore (Pty) Ltd, which still needs to be assessed. Management has provided you with the following information:

<b>Employees at the end of the financial year:</b>	100 (there has been an increase of 20 employees from the beginning of the year.)
<b>Turnover:</b>	R 2 502 953
<b>Third party liabilities:</b>	R 5 392 045 (Of these liabilities, R 1 000 000 relates to a loan received from Atinvic Holdings Ltd)
<b>Security holders:</b>	6

As per the prior years, Gear Galore (Pty) Ltd compiled their own financial statements again.

During the year Blow Up (Pty) Ltd and Agri Away Ltd were acquired in a financing scheme and also to avoid a high tax charge in the current year, these companies were purchased by means of cash to reduce the cash reserves. Blow Up (Pty) Ltd will be audited by their own external auditors, as that was part of the sale agreement and we will have to rely on their auditor's work.

Since there are quite heavy time constraints this year, management thought it to be a good idea to give Agri Away Ltd to the first year as it is a relatively small company and will save time if only one person needs to obtain information about the company and explain transactions. Further reasoning for giving the entire company to the first year is because the first year came straight from varsity the year before and should therefore be academically on top of things.

Due to the fact that this is the first year's first "audit on his own" he made some mistakes caused by stress. Instead of preparing the accounts receivable confirmations on his own, and sending it to the debtors, he asked the bookkeeper, who is trying to pass APC for the last 5 years and is writing again in two months' time, to fill in the confirmations, and send them out. Needless to say, the debtors replied directly to her on email and she forwarded the email to you.

The first year calculated planning materiality, but the audit manager didn't have time to review it and asked you to review the work done by the first year. The work paper for planning materiality is shown on the next page:

Prior to reviewing the work paper, the first year told the following:

"During my discussions with the client in order to obtain information about them and the industry they are in, they told me the following:

- In the current year Agri Away Ltd converted to a new computer system. Everything is working perfectly except for the access controls where they still cannot quite get a handle on.
- During the current year the Human Resources director resigned and the board decided, without holding a shareholders meeting, on the amount to be paid out to him. Within 5 days a new HR Director has been appointed. He was appointed without following the proper procedures since he is the CEO's best friend.
- Their previous auditors gave them a clean audit report for the previous two years and the going concern status of the company is also not an issue.
- During the current year, the bookkeeper were booked off sick for two months during which time no one did her work.
- In the current financial year there's been a big Upturn in the agricultural sector and sales went through the roof during March and April 2014
- Since Agri Away Ltd's primary business is the selling of agricultural machinery, their primary value driver is their turnover.



- Prior year figures were not considered for calculating materiality as an old system is used and there is a lot of changes that took place during the current year, it is also not readily available in electronic format.
- Upon your request to the accountant you were provided with a set of figures for the 2013 financial year as indicated in annexure A below.
- Agri Away Ltd year end is also 31 July 2014.
- Audit risk is assessed as high, taking all factors into account.

<b>Client:</b> Agri Away Ltd	<b>Period end:</b> 31 July 2014	<b>35A</b>			
<b>Prepared by:</b> A Student	<b>Date:</b> 30 August 2014				
<b>Reviewed by:</b>	<b>Date:</b>				
<b>Calculating planning materiality</b>					
<ul style="list-style-type: none"> <li>- Due to the fact that Audit risk is assessed as being high, the high range of materiality will be chosen.</li> <li>- Calculation: The figures used is the figures from the trial balance up until 31 May 2014 as it was readily available.</li> </ul>					
Indicator	Parameter	Trial balance	Annualise	Low range	High range
Turnover	½% - 1%	453 000	No	2 265	4 530
Gross Profit	1% - 2%	352 000	No	3 520	7 040
Nett Profit	5% - 10%	235 235	No	11 761.75	23 523.50
Total Assets	1% - 2%	320 000	No	3 200	6 400
Equity	2% - 5%	125 325	No	2 506.50	6 266.25
<ul style="list-style-type: none"> <li>- Conclusion: Thus, a materiality figure of R 23 000 will be chosen</li> </ul>					

### **ANNEXURE A**

<b><u>ACCOUNTS</u></b>	<b><u>2013 AUDITED AMOUNTS</u></b>
<b>Turnover</b>	R 324 065
<b>Gross profit</b>	R 289 653
<b>Net profit</b>	R 175 354
<b>Total assets</b>	R 200 035
<b>Equity</b>	R 135 035

<b>YOU ARE REQUIRED TO:</b>		<b>MARKS:</b>
<b>a.</b>	Explain to the management of Agri Away Ltd the importance of having access controls and give examples of access controls that can be implemented.	<b>(5)</b>
<b>b.</b>	Based on the information provided to you by the first year clerk, criticise his planning materiality calculation on WP 35 and provide advice on what had to be done. Use calculations where needed.	<b>(15)</b>
<b>c.</b>	Based on your understanding of the International Standards on Auditing (ISA's): <ul style="list-style-type: none"> <li>1. Describe the procedures you would perform on the auditors of Blow Up (Pty) Ltd in terms of ISA 600.</li> <li>2. In terms of ISA 550, discuss the procedures you would perform with regards to the related party transactions taking place, especially regarding the intercompany financing</li> <li>3. Discuss the auditors responsibility when it comes to communicating with those charged with governance in terms of ISA 260</li> <li>4. Criticise the accounts receivable confirmation process as performed by the first year clerk.</li> </ul>	<b>(5)</b> <b>(5)</b> <b>(5)</b> <b>(5)</b>
<b>d.</b>	Discuss the fundamental principles on which the theory of audit is based	<b>(4)</b>
<b>e.</b>	Discuss the Company Act requirement for conducting Agri Away Ltd's Annual General Meeting (AGM)	<b>(5)</b>
<b>f.</b>	Discuss the types of audit approaches that could be considered for the audit of Agri Away Ltd and conclude on which approach should be followed	<b>(5)</b>
<b>g.</b>	Based on the information provided, discuss whether Gear Galore (Pty) Ltd will have to be audited.	<b>(6)</b>
<b>Total</b>		<b>(60)</b>

**QUESTION 3****10 MARKS**

You are the technical partner of Coetsee and Partners, a medium sized auditing firm with a broad client base. The firm consists of 5 partners, 10 audit managers and 17 trainee accountants.

It is standard practice that, in accordance with the firm's quality control policy, all the technical queries are referred to you for consultation. The following independent matters were referred to you for advice

1. One of the partners, Peter Ndlovu, recently met William Harris, the marketing director of your audit firm Coetsee and Partners. He wants to know from Peter what the requirements of the CPC are regarding advertisements, before they start with their new aggressive new marketing campaign. (5)
2. As the audit partner of Dodgy Deals (Pty) Ltd, Tony Edwards has become aware of tax evasion taking place at his client.  
He is considering reporting this to the South African Revenue Services and would like to know from you what his responsibilities are in terms of client confidentiality, before doing so. (5)

<b>YOU ARE REQUIRED TO:</b>	<b>MARKS:</b>
Provide answers and advice in respect of each of the queries listed above with reference to the relevant ethics, rules of conduct and code requirements.	<b>(10)</b>

<b>Overall precision and interpretation marks</b>	<b>(4)</b>
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