

INDEPENDENT REGULATORY BOARD FOR AUDITORS



The 2010 Public Practice Examination (PPE)

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IMPORTANT

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A:

**OBJECTIVES AND
CONTEXTUALISATION OF
THE PPE**



INDEPENDENT REGULATORY BOARD FOR AUDITORS

OBJECTIVES AND CONTEXTUALISATION OF THE PUBLIC PRACTICE EXAMINATION

1. THE DEVELOPMENT OF PROFESSIONAL COMPETENCE

The reputation, relevance and value of the auditing profession depends on the ability of its members to continually meet the expectations of stakeholders and provide a service appropriate to the needs of the South African economy within the global context. It is the responsibility of the Independent Regulatory Board for Auditors (IRBA) to ensure that all Registered Auditors (RAs) have the necessary professional competence at entry point to serve the public interest and the needs of the economy, and maintain and develop their competence thereafter.

Professional competence

The IRBA has a duty to ensure appropriate professional competence at entry point to the profession by means of academic, education, training and assessment programmes.

Professional competence is the ability to perform the tasks and roles expected of an RA to standards which are appropriate locally and comparable internationally.

Professional competence reflects the minimum expectations of the public and not the distinguishing attributes of those individuals who are considered to be especially effective. It requires an ability to continuously learn and adapt to change and thereby make a positive contribution to the profession and society throughout professional life.

The demonstration of professional competence is a necessary condition for registration as an RA. Accordingly, it can only be demonstrated in situations that reflect the multi-disciplinary public practice environment.

Professional competence is developed by means of an education and training programme that prepares individuals for entry into the public practice environment. The aim of the education programme is to integrate the core competence developed during the academic programme with practical experience gained in the training programme.

Core competence

Core competence is an integral component of professional competence and may be defined as the ability to apply the concepts and principles of the defined technical body of knowledge, skills and professional values in an integrated and analytical manner to a standard that provides a foundation appropriate for further professional development.

An appropriate degree of core competence is a prerequisite for the demonstration of professional competence. Core competence is developed by means of the academic programme and assessed in the core assessment programme.

A requirement for a successful education programme is that it must develop professional competence by means of an integration of practical experience and core competence, to an extent that will enable the student to continue to learn and adapt to change throughout professional life. Practical experience is gained in a training programme within the public practice environment.

2. ADMISSION REQUIREMENTS OF THE PPE

The IRBA has, in terms of the Auditing Profession Act determined the following admission requirements of the PPE:

Successful completion of-

- 2.1 a recognised academic programme. The only academic programme currently recognised by the IRBA is the Certificate in the Theory of Accounting (CTA) or equivalent offered by providers accredited by the South African Institute of Chartered Accountants (SAICA),
- 2.2 a recognised core assessment programme. The only core assessment programme that currently meets the recognition standards of the IRBA is Part I of the Qualifying Examination of SAICA,
- 2.3 a recognised training programme, that is registered with the IRBA, at least 18 months prior to the first day of the month in which the examination is to be conducted in a specific year. The only training programme currently recognised by the IRBA are the training contracts in public practice administered by SAICA and registered with the IRBA; and

2.4 a recognised education programme. The only education programme that currently meets the recognition standards of the IRBA is the auditing specialism course accredited by SAICA. This education programme will remain valid for admission purposes for a period of five calendar years, commencing after the calendar year in which the education programme was completed.

3. ASSESSMENT OBJECTIVES

The objective of the Public Practice Examination is to assess the professional competence of a candidate to apply integrated knowledge, skills and professional values appropriate to the practice of an RA at entry level and that will enable the candidate to continue to learn and adapt to change throughout professional life.

4. STANDARD OF ASSESSMENT

In determining the desirable level of professional competence, the IRBA has defined the following six professional competencies that embody its expectations of successful candidates of the PPE:

- i) The ability to apply concepts and principles of a defined technical body of knowledge and intellectual and technical skills in an integrated and analytical manner to complex situations that are likely to be encountered in the multi-disciplinary public practice environment.
- ii) The ability to draw on skills developed as a result of practical experience to solve problems related to the function of an RA.
- iii) The ability to apply professional judgment in assessing alternatives and recommending solutions to situations that reflect the public practice environment.
- iv) The ability to communicate effectively by formulating appropriate arguments and recommendations in a concise and logical manner appropriate to the specific user and particular level of assurance required.
- v) The ability to demonstrate and apply to public practice situations, a comprehensive understanding of professional values of the profession in general and the ethical requirements specific to the practice of an RA.
- vi) The ability to continue to learn and adapt to change through an awareness of current developments shaping the future of our profession.

The standard of assessment should require a candidate to demonstrate the level of professional competence appropriate for registration as an RA, i.e. a candidate's readiness to practice at entry level to the auditing profession.

5. FORM OF ASSESSMENT

The demonstration of professional competence is a necessary condition for registration as an RA. Accordingly, it should only be demonstrated in situations that reflect the multi-disciplinary public practice environment. Although actual workplace-based assessment may suite this criterion, it does not provide the high degree of objectivity required for an assessment designed to determine whether or not an individual should be admitted to the auditing profession.

The current form of the PPE, being a 5-hour open-book format written case-study examination (in 2 sessions of 2 ½ hours each) is considered most appropriate for this purpose. Comment received from academics and practitioners relating to the PPE conducted since 1999, has recognised the fact that the examination is moving closer towards a more practical assessment. More and more, candidates are being required to respond to scenarios in questions that reflect, as far as possible, situations likely to be encountered in the public practice environment.

The IRBA recognises that the PPE is not fully advanced in terms of the practical nature of the assessment. However, one must appreciate that education, and particularly educational change demands both caution and patience with the implementation of new practices. Any change in the form of assessment must be informed by change in the programmes, which underpin that assessment. It would therefore be premature for the IRBA to hasten to more practical forms of assessment, without giving the providers of recognised programmes sufficient opportunity to explore the implications of new assessment methodologies. Indeed, ultimately, such haste could only result in greater disadvantage to students.

IFAC recognises that professional designations are a combination of education and training and involve knowledge, skills and professional values. To be effective, the education system must assess all of these elements. In addition, IFAC specifically recommends that a final assessment of professional competence (PPE) must take place at the end of the training requirement, or as close to the end as possible.

B:
THE 2010 PPE QUESTION PAPER

QUESTION 1

You are an audit manager at A2Z Auditors, a firm of Registered Auditors. A2Z Auditors has been the Registered Auditor of Green Energy Holdings Limited (“GEH”) and its subsidiary, Wind Turbine Solutions (Pty) Ltd (“WTS”), for a number of years. In July 2010 A2Z Auditors was duly appointed as the Registered Auditor of Solar Panel Industries (Pty) Ltd (“SPI”) following GEH’s acquisition of a controlling share in this company and the resignation of the previous auditor.

In your planning meeting with the group engagement partner, he agreed that the following materiality figures be used for planning and performing the audits of the companies in the GEH group for the financial year ending 31 December 2010:

GEH – R8,1 million (group materiality)

WTS – R4,5 million

SPI – R5,9 million.

The audit deadline for this group is 31 January 2011 to enable GEH to publish its 2010 annual report by 15 February 2011.

You have been assigned responsibility for planning and performing the 2010 audit of GEH and WTS. It was decided that the East London office of A2Z Auditors would take responsibility for the 2010 audit of SPI. The engagement partner assigned to the audit of SPI is Thabiso Mothapo, while the audit manager is William Peterson.

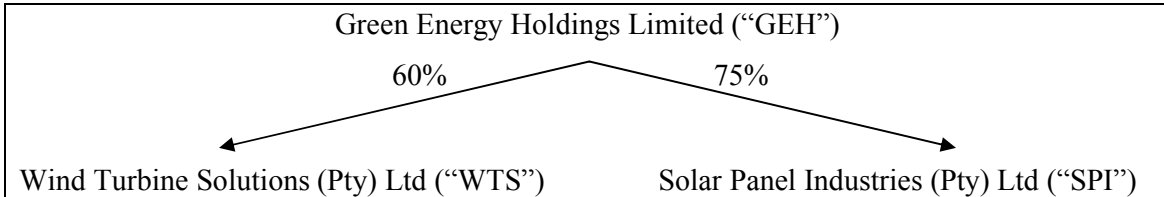
The following work papers and documents are available:

Work paper/document	Reference
<i>Relating to the audit of Green Energy Holdings Ltd group:</i>	
Understanding the group and its environment	110-01
Email communications between William Peterson and Alex Nkonde	A1
<i>Relating to the audit of Wind Turbine Solutions (Pty) Ltd:</i>	
Understanding the entity and its environment	800-01
Costing of wind energy farms and construction work-in-progress	833-02
Audit plan - costing of wind energy farms and construction work-in-progress	835-02

Client:	Green Energy Holdings Limited group	Year-end: 31/12/2010	110-01 Page 1/2
Prepared:	B Batman	Date: 01/11/2010	
Reviewed:		Date:	
Subject:	Understanding the group and its environment		

Green Energy Holdings Limited (“GEH”) is an investment company that was incorporated in 2004 and listed on the AltX in January 2009. The company’s vision is to become the largest provider of “green” energy in South Africa.

Group structure:



- WTS constructs and operates wind energy farms to generate electricity which is supplied to major end-users.
- SPI distributes solar panels for industrial and household use in South Africa.

The shares in SPI were acquired during July 2010, while the shares in WTS were acquired in 2005.

Location of operations:

GEH and WTS have their head offices in Cape Town, while SPI is based in East London.

Financial year-end:

The financial year-end of all companies in the group is 31 December.

Financial reporting framework:

Group policy requires that all companies in the GEH group comply with International Financial Reporting Standards.

Client: Green Energy Holdings Limited Group	Year-end: 31/12/2010	110-01 Page 2/2
Prepared: B Batman	Date: 01/11/2010	
Reviewed:	Date:	
Subject: Understanding the group and its operations		

Board of directors and board committees:

The board of directors of GEH comprises:

- Mr A Goar – Independent non-executive chairman
- Mr G Peace – Chief Executive Officer
- Mr D Black CA(SA) – Chief Financial Officer
- Adv. E Panda – Independent non-executive director [Advocate Panda is highly regarded for his knowledge of environmental law.]
- Mr S Umbala – Independent non-executive director [Prior to his retirement, Mr Umbala was the human resources director of a large JSE-listed mining company.]

The following directors serve as members of GEH’s board committees:

	<i>Audit Committee</i>	<i>Remuneration Committee</i>	<i>Investment Committee</i>	<i>Shareholder Relations Committee</i>
Mr A Goar		Chair	Member	Chair
Mr G Peace		Member		Member
Mr D Black			Chair	Member
Adv. E Panda	Member	Member		
Mr S Umbala	Chair		Member	

The Investment Committee is responsible, among other things, for:

- Evaluating possible investment opportunities prior to tabling a shortlist to the board for consideration; and
- Issuing instructions, as required, to the director(s) appointed by GEH on the board of an investee regarding, for example, board resolutions to be proposed and how to vote at board meetings.

The Shareholder Relations Committee is responsible, among other things, for:

- Identifying opportunities to promote the company to prospective investors; and
- Overseeing the preparation of special quarterly reports on the triple bottomline performance of the company for distribution to the major shareholders.

Financial directors of subsidiaries:

WTS: Ms Petunia Philander

SPI: Mr Alex Nkonde

From: William Peterson
Sent: 12 November 2010 03:56 PM
To: alexn-spi@geh.co.za
Cc: PPE Candidate; Thabiso Mothapo
Subject: RE: Meeting regarding audit and other matters

Dear Alex

Please refer below for my comments (each preceded by “[WP Comment:]”) and give me a call should you wish to discuss any of these in more detail.

Regards
William

William Peterson
Audit Manager
A2Z Auditors

From: alexn-spi@geh.co.za
Sent: 12 November 2010 02:45 PM
To: William Peterson
Subject: Meeting regarding audit and other matters

Dear William

Following our meeting and in anticipation of the upcoming audit, I would like to clarify a few matters with you:

1. Last year we had to change our financial reporting framework from GAAP for SMEs to IFRS for SMEs. I was surprised to learn at our meeting that for our 2010 annual financial statements you require us to make another change, i.e. from IFRS for SMEs to full IFRS. We cannot change frameworks every financial year! I can only conclude that this is a new way that auditors have found to increase their audit fees.

[WP Comment:] The time required to convert from IFRS for SMEs to full IFRS will be minimal as they are both international standards, and this conversion is unlikely to have any effect on the audit fee that will be charged.

2. During the strike in June 2010 we employed some temporary staff members in the finance department to help manage the workload. This morning I realised that on one occasion almost R10 000 was overpaid to SARS due to VAT inputs not being claimed. I don't think this was an isolated occurrence. Previously you mentioned that A2Z has a good VAT team. Can they undertake an investigation regarding the completeness of VAT inputs claimed for the four-week period of the strike? Your firm can keep 10% of the total savings. By the way, Mr Black (GEH's Chief Financial Officer) does not know about this and I would like to keep it that way!

[WP Comment:] No problem. I will ask the VAT team to do this work while we do the audit. I am a Registered Auditor – you can trust me to keep this matter confidential.

Client: Green Energy Holdings Limited group	Year-end: 31/12/2010	A1
Subject: Email Communications between William Peterson and Alex Nkonde		Page 2/2

3. Mr Black mentioned a problem regarding the purchase consideration that was paid by GEH for the acquisition of the SPI shares. Apparently the consideration was based on SPI's audited profit figure for the 2009 financial year. We only recently realised that we may have misinterpreted the sales contract with our main customer – which will mean that SPI's 2009 profit was significantly overstated. Mr Black added that GEH will sue the former shareholders. Obviously I am caught in the crossfire. I need help to sort out this mess.

[WP Comment:] As the matter does not relate to work that we performed, it has nothing to do with us – and we would prefer to stay out of this matter completely.

By the way, has there been any progress on the following query that I sent you two weeks ago?

SPI's inventory controller informed me that in July 2010 SPI's marketing manager lent John Jonas, one of the audit team members, two solar panels from our new range in order for him to try them out at home. Do you know when John will be returning these panels? We would like to have these items on hand when performing the year-end inventory count.

[WP Comment:] Sorry about this! Having investigated the matter, I found that the panels were stolen from the roof of John's house. As he does not really have the money to repay SPI, I have arranged for the cost of the solar panels to be deducted from John's salary over the next few months. As the money is collected, we will pay this over to SPI. I have asked John to personally apologise to you when he joins the year-end audit team within the next few weeks.

Cheers
AN

Alex Nkonde
Financial Director
Solar Panel Industries (Proprietary) Limited

Please consider the environment before printing this email.

Client:	Wind Turbine Solutions (Pty) Ltd ("WTS")	Year-end: 31/12/2010	800-01 Page 1/2
Prepared:	T Joker	Date: 9/11/2010	
Reviewed:		Date:	
Subject:	Understanding the entity and its environment		

Business model

WTS constructs and operates wind energy farms, each comprising a number of wind turbines, to generate electricity that is sold to major end-users. The intention is ultimately to sell electricity into the national grid, and negotiations for a power sale agreement with the national power utility have been in progress for a number of years.

In order to attract customers, the company's marketing strategy focuses on the environmental benefits of wind-generated energy, including the reduction of carbon-dioxide emissions. The company's major customers currently all have a track record of being environmentally conscious.

Wind energy farms

There are currently three fully operational wind energy farms: one in the Eastern Cape and two in the Western Cape. In addition, there are ten smaller-scale pilot sites that have been set up throughout South Africa.

The property on which the wind energy farms are constructed is either owned by WTS or is leased from third parties in terms of long-term lease agreements. If leased, the agreement typically contains a clause whereby WTS is required to restore the land to its original condition at the end of the lease period, and the lease agreement is accounted for as an "operating lease". If the property is owned, the portion of the land not used for the wind energy farm is leased to third parties in terms of three to five-year lease agreements, and such land is classified for accounting purposes as "investment property".

Accounting system

WTS operates an integrated computerised information system called "Accounting Solutions". Functions such as routine software maintenance and facilitating sound logical access controls have been outsourced to a third-party service provider (see point 1 below).

Recent developments

1. Following the non-renewal of IT Consulting CC's contract in March 2010, the IT Committee of WTS appointed a new service provider, AIC Solutions (Pty) Ltd, early in May 2010, after concluding a service level agreement.
2. During the 2010 financial year the national government Department of Energy awarded a grant of R10 million to WTS, conditional on the wind energy farms operating in the Western Cape from 2010 to 2020. The full amount of the grant was recorded as revenue in the 2010 financial year. Following this success, a number of other applications for government funding will be submitted early in the 2011 calendar year on the basis that, due to the higher cost of wind-generated energy, government subsidies are essential for the sustainability of the industry.

Client: Wind Turbine Solutions (Pty) Ltd ("WTS")	Year-end: 31/12/2010	800-01 Page 2/2
Prepared: T Joker	Date: 9/11/2010	
Reviewed:	Date:	
Subject: Understanding the entity and its environment		

Recent developments (continued)

3. As a result of customer dissatisfaction about the instability of the electricity generated from the wind turbines, WTS had to start investing in batteries to store the generated electricity before distribution to customers. While this has addressed customer concerns, it has increased the cost of generation by, on average, 35%.

4. WTS experienced a challenging October and November 2010 due to the extensive media coverage given to the adverse effects of the Eastern Cape wind energy farm on the local bat population. For example, an extract from an article that appeared in the Daily Update, a leading newspaper sold in Port Elizabeth, on 14 October 2010:

... the population of the black-haired bat, indigenous to this area and on the list of endangered species, has declined significantly since commencement of operations at the WTS wind energy farm ...

... the most shocking finding ..." The delicate lungs of the little bats actually explode when they pass through the low air pressure region surrounding the turbine blade tips!" Dr Suzie Matthews, a well-known environmentalist, explained.

And she added: "We will do everything in our power to terminate operations at the wind energy farm ... We urge you not to buy your electricity from WTS – it is vital in ensuring the survival of the black-haired bat."

In response, WTS formulated an action plan, which was communicated by way of the following press release:

WIND TURBINE SOLUTIONS (PTY) LTD PRESS RELEASE: Saving the black-haired bat

Friday 5 November 2010

Issued by: Brian Green – Chief Executive Officer

WTS was alarmed by the findings of the recent study regarding the decline in the black-haired bat population in the Eastern Cape. As a good corporate citizen acting in the best interests of all stakeholders, we pledge the following:

- To work with leading experts to look at ways of reducing any negative impact of our wind energy farms on the environment. We have already provided R1,5 million in our 2010 annual financial statements for this purpose.
- As from 1 January 2011 we shall donate 2% of the revenues generated by the Eastern Cape wind energy farm to the "SAVE THE BAT FUND", established by Dr Matthews, for as long as the farm is in operation.

Client: Wind Turbine Solutions (Pty) Ltd ("WTS")	Year-end: 31/12/2010	833-02 Page 1/2
Prepared: C Robin	Date: 13/11/2010	
Reviewed: PPE Candidate	Date: 15/11/2010	
Subject: Costing of wind energy farms and construction work-in-progress		

The following cost summary was prepared by Ms Philander, financial director of WTS:

ANALYSIS OF COSTS UP TO 31 OCTOBER 2010

	Construction work-in- progress R'000	Wind energy farms R'000
Opening balance: Cost of assets (1/1/2010)	40 680	90 090
Additions		
Cost of components acquired	50 000	-
Salary costs capitalised	6 059	-
Payments made to third-party contractors	3 670	-
Borrowing costs	5 420	-
Transfer of completed wind energy farms	(60 640)	60 640
Closing balance: Cost of assets (31/10/2010)	45 189	150 730

Systems description – costing of inventory

Cost of components acquired (wind turbines, other equipment and materials)

- The supplier invoice is captured by the creditors clerk, after matching the invoice details to the delivery note received from the site manager. If the cost per unit on the invoice differs from that on the company order, the purchase is captured at the invoice amount, but a sequentially numbered exception report is printed in duplicate. One copy of the exception report is filed in numerical sequence by the creditors clerk. The second copy is sent to the buying department for the company buyer to investigate the difference.
- For the imported components, the system automatically converts the foreign currency invoice amount to South African Rand using preloaded daily exchange rates.
- The creditors and general ledger modules are integrated and once the invoice is captured, the invoice amounts are automatically capitalised to the “construction work-in-progress” account in the general ledger.

Construction costs (salary costs capitalised and payments to third-party contractors)

- At the end of each month, the site manager emails to the chief accountant a computer spreadsheet reflecting the staff members who worked on the construction of the wind energy farm, together with the dates worked. The chief accountant then determines the salary costs of the staff members listed from the payroll and adds these costs to the spreadsheet. The total amount computed per the spreadsheet is then reallocated by general journal from the “salaries and wages” account to the “construction work-in-progress” account.
- Progress payments made to third-party contractors involved in the construction of the wind energy farm are coded in the cash book for posting to the “construction work-in-progress” account.

Borrowing costs

- The financial accountant obtains the monthly finance costs from the treasury manager and prepares a journal to capitalise these costs to the “construction work-in-progress” account.

Client:	Wind Turbine Solutions (Pty) Ltd ("WTS")	Year-end: 31/12/2010	833-02 Page 2/2
Prepared:	C Robin	Date: 13/11/2010	
Reviewed:	PPE Candidate	Date: 15/11/2010	
Subject:	Costing of wind energy farms and construction work-in-progress		

Transfer of completed wind energy farms

- Once construction of the wind energy farm is complete, the site manager submits a report to this effect to the asset controller. The asset controller then analyses the amounts debited to the "construction work-in-progress" general ledger account to identify those related to the completed wind energy farm.
- After preparing a schedule of the amounts identified, he records the items on the schedule as part of the "wind energy farm" in the fixed asset register, and then requests the financial accountant to transfer, by journal entry, the total cost of additions to the fixed asset register from the "construction work-in-progress" account to the "wind energy farms" account.

Client:	Wind Turbine Solutions (Pty) Ltd (WTS)	Year-end: 31/12/2010	835-02 Page 1/1
Prepared:	B Spydermann	Date: 16/11/2010	
Reviewed:		Date:	
Subject:	Audit plan – costing of wind energy farms and construction work-in-progress		

Area	Assessed risk of material misstatement ¹	Audit response
Opening balance	LOW <i>easy to audit</i>	Agree the opening balances for the 2010 financial year to the closing balances per the 2009 annual financial statements.
Cost of components and construction	MEDIUM <i>based on a sound system of internal control</i>	<p><u>Components costs:</u> For a sample of assets added to the fixed asset register during 2010:</p> <ul style="list-style-type: none"> • agree the cost of the components (excluding VAT) per the fixed asset register to the supplier’s invoice; • calculate the total variance (between order and invoice values) on the exception reports, and evaluate with reference to the materiality level; • if the supplier’s invoice is denominated in a foreign currency, reperform the conversion of the foreign currency amount to South African Rand using the preloaded daily exchange rates. <p><u>Construction costs:</u></p> <ul style="list-style-type: none"> • Relating to the company’s staff: Agree a sample of the payroll costs reflected on the computer spreadsheet to the payroll for the month. • Relating to third-party contractors: Agree the progress payments per the “construction work-in-progress” general ledger account to the cash book and bank statement.
Borrowing costs	LOW <i>computation done by senior staff</i>	Reperform the calculations on the borrowing costs schedule prepared by the financial accountant.
Transfer of completed wind energy farms	LOW <i>risk inherently low</i>	Perform analytical procedures, for example by comparing the amount transferred in respect of completed wind energy farms for the 2010 financial year to similar transfers for the 2009 financial year.
General		<ul style="list-style-type: none"> • Print out and reperform the casting of the fixed asset register. • Agree the totals on the fixed asset register to the general ledger control accounts, trial balance and the annual financial statements. • Review the general ledger accounts for any unusual entries. • Request that specific reference to the appropriate costing of non-current assets be included in the management representation letter.

¹ The reason for the risk assessment is indicated below the assessment in italics.

QUESTION 1

REQUIRED

SECTION A

(Answer in **PINK** answer book)

1. Draft a memorandum to the group engagement partner in which you identify and explain instances where the current corporate governance practices of Green Energy Holdings Limited do not comply with the King III Code of Governance Principles. Exclude from your memorandum any non-compliance identified at either of Green Energy Holdings Limited's two subsidiaries. (12)
2. Critically evaluate the comments made by William Peterson in responding to Alex Nkonde's email of 12 November 2010 (document A1). Motivate your answer fully. (26)
3. Describe, with reasons, the effect that the information contained in the emails relating to the audit of Solar Panel Industries (Pty) Ltd (provided as document A1) will have on your 2010 group audit plan for the Green Energy Holdings Limited group. (13)

SECTION B

(Answer in **YELLOW** answer book)

4. Discuss the effect that the information documented in work paper WP 800-01 will have on your assessment of the risk of material misstatement in the 2010 annual financial statements of Wind Turbine Solutions (Pty) Ltd.
Exclude from your discussion:
 - those risks already dealt with in WP 835-02 relating to the costing of wind energy farms and construction work-in-progress, and
 - risks relating to the assertions about presentation and disclosure. (21)
5. Consider WP 833-02 and WP 835-02 and document, with reasons, the review notes you would raise with the preparer of WP 835-02. Your review notes should not document the detailed audit procedures that are required.
The following table illustrates how you should document your review notes and supporting reasons. Do not repeat this example in your answer.

<i>Review note</i>	<i>Reason(s)</i>
Example: Are all imported assets recognised and recorded on the date that the risks and rewards of ownership pass to WTS, rather than the date on which the invoice is captured by the creditors clerk? Further audit procedures are required to respond to the related risks.	Example: In terms of IAS 21, a foreign currency transaction shall be recorded using the exchange rate at the date of the transaction – i.e. the date on which the transaction first qualifies for recognition in terms of IFRS.

Marks will be awarded as follows:
1 mark per valid review note;
1 mark per valid reason

(28)

QUESTION 2

You are an audit manager at Vouch & Co, a firm of Registered Auditors, and you have been assigned to the 2010 audit of Aybee Equip (Pty) Ltd. Your audit team is currently engaged with the statutory audit of this client's annual financial statements for the year ended 30 September 2010. Aybee Equip (Pty) Ltd has adopted International Financial Reporting Standards as its accounting framework.

Much of the audit work has already been completed, and you are currently preparing for a meeting with Mr Vouch, the engagement partner, to discuss, among other things, the implications for the audit of the resolutions passed at the board meeting of Aybee Equip (Pty) Ltd held on 22 October 2010.

The materiality figure for the audit is R375 000.

The following work papers and documents relate to the audit of Aybee Equip (Pty) Ltd:

Work paper/document	Reference number
Understanding of the entity and its environment	100-02
Extract from minutes of the board meeting held on 22 October 2010	A1
System description: Rental of scaffolding	A2
Inventory: Costing of raw materials	300-05
Extracts from notes to the draft 2010 annual financial statements	A3
Letter from concerned shareholder	A4
Final notes for attention of engagement partner	900-01

Client:	Aybee Equip (Pty) Ltd	Year-end: 30/9/2010	100-02 1/1
Prepared :	D Delta	Date: 5/10/2010	
Reviewed:	PPE Candidate	Date: 1/11/2010	
Subject:	Understanding of the entity and its environment		

Nature of business

Aybee Equip (Pty) Ltd manufactures various types of scaffolding products from steel. The steel is cut for the type of scaffolding to be manufactured, clamps are added to the cut steel, and the final product is galvanised. The completed scaffolding is either sold or rented to customers in the construction industry. Due to the short duration of rental agreements concluded, the scaffolding rented to customers is correctly accounted for as operating leases.

Since 2005 the business has done very well as a result of major construction projects being undertaken in anticipation of the 2010 FIFA World Cup. However, since April 2010 the company’s order book has declined significantly.

Accounting system and related controls

A combination of an off-the-shelf software package (“Accpro”) and manual records are used for accounting purposes. At the insistence of the minority shareholders, an internal auditor was appointed in 2008, primarily to monitor the effectiveness of the internal control systems.

Directors

Executive:

- Managing Director – Andrew Betta
- Operations Director – Bernie Betta (Andrew’s brother)
- Financial Director – Cedric Omega

Non-executive:

- Derek Betta (Andrew’s father) [Chairman]
- Siya Ntombela

Shareholders

The holders of the issued ordinary shares throughout the 2010 financial year were:

- Aybee Holdings (Pty) Ltd – 51% [Andrew, Derek and Bernie Betta are the directors and majority shareholders of Aybee Holdings (Pty) Ltd]
- XY Venture Capital – 30%
- Employees – 19%

Related party

International Marketing (Pty) Ltd – a wholly owned subsidiary of Aybee Holdings (Pty) Ltd, incorporated on 2 August 2010.

4. Internal audit findings

It was noted that at the May 2010 board meeting the internal auditor was requested to undertake a review of the internal control system for the rental of scaffolding due to directors' concerns about:

- the number of credit notes that were issued in respect of the rental of scaffolding; and
- rental assets delivered to customers not matching those reflected on the delivery note.

The systems description for the rental of scaffolding was tabled by the internal auditor [*refer document A2*], and the following key internal audit findings were noted:

- i. The directors' concerns were confirmed by the evidence gathered.
- ii. Credit notes had to be issued due to deficiencies in the internal control system giving rise to:
 - Customers being invoiced for rental charges for periods after the rental asset had been returned; and
 - Customer details (e.g. VAT numbers) being incorrectly recorded on rental invoices.
- iii. Adjustments recorded by customers on delivery notes indicated that not only were the incorrect rental assets delivered, but additional items were delivered in some cases, and in other cases a rental asset on the delivery note was not delivered at all.

Resolution 1-10/2010: The board RESOLVED that the external auditor be requested to assist the internal auditor in recommending improvements to the rental system to prevent, or detect and correct, a recurrence of the errors identified.

5. 2010 annual financial statements

The unaudited annual financial statements for the year ended 30 September 2010 were tabled by the financial director. He highlighted that while a loss of R2,4 million for the 2010 financial year was reported, the statement of financial position at 30 September 2010 remained healthy.

5.1 Adjustment to current assets required

The financial director explained that Aybee Equip (Pty) Ltd used a standard costing system to value its manufactured scaffolding inventory, and that the variances that had arisen during the financial year were capitalised to inventory (part of current assets). He noted that the external auditors normally proposed adjustments relating to these variances, which may result in changes to the figures presented in the unaudited annual financial statements.

5.2 Cash flow forecast for 2011 financial year

The financial director handed out the cash flow forecast for the 12 months ending 30 September 2011 and discussed the anticipated cash flows of Aybee Equip (Pty) Ltd. He noted that while there was a net negative cash balance of R7,112 million at the start of the 2011 financial year, this was projected to improve to a favourable balance of R2,475 million by the end of the 2011 financial year.

In compiling this forecast, the following was taken into account:

- Negotiations regarding the company's bank overdraft facility were in progress at the time, and it was understood that these facilities would be renewed, although at a slightly higher interest rate (from the current 12% p.a.).
- Aybee Holdings (Pty) Ltd in a recent letter stated that "...it is company policy to support Aybee Equip (Pty) Ltd should its own financial situation permit this...". On the strength of this letter, a cash inflow of R2,5 million in respect of a loan from Aybee Holdings (Pty) Ltd was included in the forecast.

The operations director reiterated that the difficult conditions in the South African market were likely to persist and that it was imperative that new markets be sought. He informed the board that the executive directors appointed International Marketing (Pty) Ltd to source new markets for Aybee Equip (Pty) Ltd on the following terms:

- 5% commission would be payable for any business secured outside South Africa; and
- an interest-free loan of R750 000 would be granted to International Marketing (Pty) Ltd to set up operations – the loan is repayable after three years.

The contract was signed by both parties on 1 September 2010, and the loan was duly advanced.

When Mr Ntombela enquired about the background of the new service provider and the terms of the deal, the chairman ruled that no more time would be devoted to this matter as it had already been approved by the executive directors. The financial director noted that, as the securing of new markets would take some time, and to be prudent, the effects of new business arising from this contract were not incorporated into the cash flow forecast.

Resolution 2-10/2010: It was RESOLVED that the cash flow forecast for the 12 months ending 30 September 2011 be approved.

5.3 Going concern

The managing director referred to note 22 of the financial statements [*refer A3*] and emphasised that a reconsideration of the long-term employee benefits was necessary in order to ensure the company's long-term sustainability.

Resolution 3-10/2010: It was RESOLVED that a task team (comprising Messrs A Betta and S Ntombela) would be set up to investigate the matter and report back at the next board meeting.

Resolution 4-10/2010: On the basis of the information presented, the board RESOLVED that it was appropriate to adopt the going concern basis in preparing the 2010 annual financial statements. However, a note would be added in the directors' report drawing attention to material uncertainties.

Aybee Equip (Pty) Ltd Systems description: Rental of scaffolding Prepared by: Internal Auditor	A2 1/2
Date: 30 June 2010	

	Activity	Procedures performed by employees of Aybee Equip (Pty) Ltd	Result	Other comments
1	Processing rental orders			
1.1	Receive an order for the rental of a scaffolding item.	The rental agent checks the availability of the item on the computerised rental asset tracking system ("the Tracking System")	The Tracking System reports assets available for rental, the location of the rental asset, and the approved rental charge.	The Tracking System does not interface with the Accpro software package.
1.2	Capture the rental order.	The rental agent captures the pertinent details of the rental order on the Rental Database on the Accpro software.	A sequentially numbered rental agreement is generated by the Accpro software in triplicate: <ul style="list-style-type: none"> o The 1st copy is given to the customer; o The 2nd copy is filed by the rental agent; and o The 3rd copy is automatically printed in the office of the asset controller (refer 2.1). 	The first two copies of the agreement are signed by the rental agent and the customer.
1.3	Dealing with a rental order from a new customer.	The credit controller undertakes a thorough credit check on the new customer.	For creditworthy customers, the senior admin officer updates the Customer Database in Accpro with the customer's data.	Once the Customer Database has been updated, the rental order is dealt with as per 1.1 and 1.2.
2	Distribution and delivery			
2.1	Initiate the filling of the rental order.	On receipt of the rental agreement (refer 1.2), the asset controller uses the Tracking System to select the tracking numbers of the items required per the agreement.	The Tracking System generates a rental delivery note in duplicate.	
2.2	Load the rental assets onto the truck.	The dispatch clerk scans the bar code of each item as it is moved from the warehouse to the truck.	The Tracking System is updated for the transfer of the rental asset to the customer.	The premises are secured with electrified fencing and a security guard is stationed at the gate.
2.3	Deliver to customer.	Once the rental asset has been delivered, the truck driver hands the customer-signed copy of the rental delivery note to the invoicing clerk (refer 3.1).		The customer retains the 2 nd copy of the rental delivery note.

Aybee Equip (Pty) Ltd Systems description: Rental of scaffolding Prepared by: Internal Auditor	A2 2/2
Date: 30 June 2010	

	Activity	Procedures performed by employees of Aybee Equip (Pty) Ltd	Output	Other comments
3	Invoicing			
3.1	Initiate invoicing.	The invoicing clerk captures the details per the customer-signed rental delivery note in Accpro (refer 2.3).	The Rental Database in Accpro is updated, and the agreement (created in 1.2) is “activated”.	
3.2	Generate monthly invoices.		The Accpro software at the end of every month: <ul style="list-style-type: none"> ○ automatically generates rental invoices for all “activated” agreements in the Rental Database not flagged as “closed”; ○ updates the customer accounts in the debtors ledger for the invoices generated; and ○ prints the rental invoices (for posting to customers). 	
3.3	Terminate invoicing.	When a rental asset return note (refer 4.1) is received, the invoicing clerk updates the particular agreement on the Rental Database as “closed”.	The agreement is flagged as “closed” on the Rental Database in Accpro and a final rental invoice is generated and processed.	
4	Rental asset returns			
4.1	Return of rental asset.	The returns officer scans the bar code of the rental asset returned by the customer.	The Tracking System is updated, and a rental asset return note is printed in triplicate: <ul style="list-style-type: none"> ○ The 1st copy is signed by the returns officer as proof of return and given to the customer. ○ The 2nd copy, together with the rental assets returned, is handed to the asset controller. ○ The 3rd copy is sent to the invoicing clerk to update the Rental Database (refer 3.3). 	

Client:	Aybee Equip (Pty) Ltd	Year-end:	30/9/2010	300-05 1/1
Prepared:	G Gamma	Date:	15/10/2010	
Reviewed:	PPE Candidate	Date:	1/11/2010	
Subject:	Inventory: Costing of raw materials			

Entries into accounting records

When raw materials are purchased, the transaction is recorded in the purchases module of the Accpro software package by allocating:

- the standard cost of the purchase to the “raw materials – at standard cost” account, and
- the variance, if any, to the “raw materials price variance” account.

When raw materials are issued to production, the following journal entry is recorded:

Dr Finished goods – at standard cost
 Cr Raw materials – at standard cost

Due to state-of-the-art machinery being used, there is minimal wastage of raw materials during the manufacturing process.

The balances on the variance accounts in the general ledger and the standard costs are reviewed only at year-end.

Balance at year-end

On 30 September 2010 the balance on the “raw materials control” account was R3 198 000, after closing off the following general ledger accounts:

	R
Raw materials – at standard cost	1 841 000
Raw materials price variance	1 122 000
Cost of relocating raw materials to the Alpha Road warehouse	235 000
	3 198 000

Further information

During discussions with Mr Omega, the financial director, and inspection of company records, the following was ascertained:

1. The amounts posted to the “raw materials price variance” account from October 2009 to July 2010 were immaterial. However, sizeable variances arose after an annually renegotiated fixed-price agreement with a long-term supplier became effective on 1 August 2010.
2. The total amount of purchases debited to the “raw materials – at standard cost” account in the general ledger for August and September 2010 was R4 800 000.
3. The raw materials on hand at 30 September 2010 were all purchased after 1 August 2010.
4. Included in the finished goods at 30 September 2010 were costs of R1 199 000 relating to raw materials purchased since 1 August 2010.
5. There was no work-in-progress on hand at 30 September 2010.
6. No scaffolding had been manufactured and included as “rental assets” during the 2010 financial year.
7. In September 2010, in order to improve control over inventory, certain raw materials were moved out of the Delta Street warehouse to the recently enlarged Alpha Road warehouse – the total relocation cost was R235 000.

22. Long-term employee benefits

	2010	2009
	R'000	R'000
22.1 Provision for bonuses		
At the beginning of the year	3 275	3 280
Service cost incurred during the financial year	1 050	900
Interest	375	355
Settled during the year	(1 095)	(1 180)
Change in estimates	230	(80)
At the end of the year	<u>3 835</u>	<u>3 275</u>
Less: Short-term portion	<u>(1 200)</u>	<u>(1 150)</u>
	<u>2 635</u>	<u>2 125</u>

Employees, including executive directors, are eligible for remuneration in terms of a deferred bonus incentive scheme. In terms of this scheme, 1% of the company's reported revenue is available to be paid as bonuses. This amount is allocated equally amongst employees by dividing the total bonus by the number of employees on the last day of the applicable financial year. In order to receive the amount allocated, the employee has to remain in the service of the company for the following three years.

Audit note: The provision for bonuses has been computed by the financial director on the basis of the reported revenues, the total number of qualifying employees and estimated staff turnover rates.

22.2 Post-retirement medical benefits

The company provides medical benefits after retirement to qualifying employees who remained in service until retirement. These benefits are valued by an independent actuary every year. The plan is unfunded.

The principal assumptions used in the actuarial valuation are:

Discount rate	9,5%	9,0%
Healthcare cost inflation rate	8,6%	8,2%
Retirement age	60	60

	2010	2009
	R'000	R'000
The movement in the provision is as follows:		
Balance at the beginning of the year	10 250	10 000
Increase	750	250
Balance at the end of the year	<u>11 000</u>	<u>10 250</u>

Audit note: The other required disclosures pertaining to this provision have been made in note 23 to the annual financial statements.

XY VENTURE CAPITAL

PO Box 1234
CAPE TOWN
8000
15 October 2010

The Engagement Partner of Aybee Equip (Pty) Ltd
Vouch & Co Registered Auditors
FAX NO: 031 888 1111

Dear Sir

Corporate governance abuses at Aybee Equip (Pty) Ltd

As you are the auditor of Aybee Equip (Pty) Ltd, we wish to draw your attention to the following:

1. The directors act as though Aybee Equip (Pty) Ltd belongs to them – and they completely ignore minority shareholders such as ourselves.
2. We have, on a number of occasions, complained at shareholder meetings that the company was not applying the corporate governance principles contained in the King III Report. But nothing happens.
3. Our attempt to have one of our managers appointed as a director at the last annual general meeting was also unsuccessful, as we were simply outvoted.

We know that you, as someone with the utmost integrity, will not remain silent about the abuse of power by the directors – hence we look forward to your dealing with this in your audit report.

Please provide us with a copy of your draft audit report so that we can have the opportunity to provide our inputs.

Yours faithfully

Mr X Yedwa

Senior Portfolio Manager

Client:	Aybee Equip (Pty) Ltd	Year-end: 30/9/2010	900-01 1/1
Prepared:	PPE Candidate	Date: 10/11/2010	
Reviewed:		Date:	
Subject:	Final notes for attention of engagement partner		

1. The audit team is satisfied that all misstatements identified during the course of the audit have been corrected, other than those dealt with in this work paper.
2. The loan of R750 000 to International Marketing (Pty) Ltd (refer document A1) is included in the “Non-current receivables” balance in the statement of financial position, and no related disclosures are provided in the 2010 annual financial statements.
3. Just a reminder of our meeting two weeks ago, where we agreed that:
 - material uncertainty exists relating to events or conditions that cast significant doubt on the company’s ability to continue as a going concern; and
 - I would inform you of the note included in the directors’ report to deal with this matter.

The following note has now been included in the draft 2010 annual financial statements of Aybee Equip (Pty) Ltd:

“The company has experienced difficult trading conditions subsequent to the 2010 World Cup. The directors have, accordingly, implemented measures to ensure the future viability of the business and have also received the assurance from the majority shareholder that it will support the company financially, if necessary.”
4. The board of directors has informed us that no adjustments or further disclosures will be made in respect of the above matters.

QUESTION 2

REQUIRED

SECTION A

(Answer in **ORANGE** answer book)

1. Describe the additional key controls, other than physical and logical access controls, that should be implemented by Aybee Equip (Pty) Ltd to address the following risks:
 - i. Customer data is incorrectly reflected on the rental invoice;
 - ii. Scaffolding delivered to customers do not match those on the rental delivery note; and
 - iii. Rental invoices are issued for periods after the rental asset was returned.

In answering this question:

- Consider documents A2 and A1 (specifically those aspects relating to board resolution 1-10/2010).
- Consider the use of automated controls, as the existing software functionality has not been fully exploited. However, those procedures currently performed by Aybee Equip (Pty) Ltd employees should not be automated.
- Assume that appropriate safeguards have been implemented to address any related threats to the auditor's independence. (21)

2. Refer to work paper WP 300-05 and prepare the required adjusting journal entries relating to the costing of inventory. Motivate fully why each adjusting journal entry is required and provide all your workings. Ignore any tax effects of these adjustments. (12)

3. With reference to documents A1 and the "Cash flow forecast for the 12 months ending 30 September 2011" (attached hereto as document A5), describe the audit procedures that should be performed to ascertain whether the following items have been included at the appropriate amounts in the forecast:

- (i) Loan from Aybee Holdings (Pty) Ltd;
- (ii) Administration costs;
- (iii) Finance charges; and
- (iv) Capital expenditure. (18)

SECTION B

(Answer in **BLUE** answer book)

4. Having considered document A3, describe the substantive procedures that should be performed to obtain sufficient appropriate audit evidence about the following disclosures in the draft 2010 annual financial statements of Aybee Equip (Pty) Ltd:
 - (i) the accuracy of the line items "Service cost incurred during the financial year" and "Change in estimates" in note 22.1; and
 - (ii) the principal assumptions in note 22.2 – per the approved audit plan, there is no need for the auditor to appoint a further expert (either internal or external) when performing these audit procedures. (16)
5. Having considered document A4, describe, with reference to the duties and responsibilities of the auditor, the matters that the auditor should raise in a response to Mr Yedwa. (9)
6. Having considered WP 900-01 and document A1, discuss, with reasons, the impact that the agreement with International Marketing (Pty) Ltd and the material uncertainty regarding going concern will have on the audit report on the 2010 annual financial statements of Aybee Equip (Pty) Ltd. (24)

TOTAL (100)

Aybee Equip (Pty) Ltd
Cash flow forecast for the 12 months ending 30 September 2011

A5
1/1

	Oct to Dec	Jan to March	April to June	July to Sept	Totals
	2010	2011	2011	2011	2011
	R'000	R'000	R'000	R'000	R'000
Opening cash balance	(7,112)	(9,620)	(6,952)	(2,626)	
Cash Inflows	44,035	46,000	47,250	53,000	190,285
Cash receipts from trading	41,535	46,000	47,250	53,000	187,785
Loan from Aybee Holdings	2,500	-	-	-	2,500
Cash Outflows	46,543	43,332	42,924	47,899	180 698
Raw materials	7,490	7,850	8,200	9,050	32,590
Manufacturing costs	16,850	18,250	20,550	20,400	76,050
Selling and marketing costs	2,950	3,100	3,250	3,150	12,450
Administration costs	6,200	5,800	6,150	5,600	23,750
Loans repaid	7,500	-	-	-	7,500
Finance charges	603	657	524	399	2,183
Payments to SARS	3,450	7,175	4,250	9,300	24,175
Capital expenditure	1,500	500	-	-	2,000
Closing cash balance	(9,620)	(6,952)	(2,626)	2,475	
Banking facilities	10,000	10,000	10,000	10,000	
Undrawn facility	380	3,048	7,374	12,475	

C:
**THE 2010 PPE FINAL MARK
PLAN**

QUESTION 1A	Marks out of 51
Part 1, 2 & 3	

Part 1: MEMORANDUM			
TO:	The Group engagement partner	<i>Memo Presentation</i>	<i>1 1</i>
FROM:	PPE Candidate		
DATE:	20 November 2010		
SUBJECT:	Inconsistencies with the King III Code of Governance Principles		
The following instances of non-application by Green Energy Holdings Ltd of the King III Code of Governance Principles have been noted:			
1.	No risk committee has been established, despite this being recommended practice per the King III Code.	<i>No risk committee</i>	1
2.	No nomination committee has been established, despite this being recommended practice per the King III Code.	<i>No nomination committee</i>	1
3.	The Audit Committee comprises only two non-executive members, while the King III Code recommends that the committee should comprise at least three members, the majority should be non-executive.	<i>Audit Comm = 2 members</i>	1
4.	As neither of the members of the Audit Committee appears to have a good understanding of accounting and/or auditing requirements, it must be questioned whether the committee collectively has sufficient qualifications and experience to fulfil duties such as:	<i>Audit Comm = qualifications & experience</i>	1
4.1	Overseeing integrated reporting, internal audit and external audit, ensuring that a combined assurance model is applied and satisfying itself about the adequacy of the company's finance function.	<i>Any valid examples of role of Audit com</i>	1
5.	The Shareholder Relations Committee comprises a majority of executive directors, while the King III Code recommends that committees other than the risk and audit committees should comprise a majority of non-executive directors, of whom the majority should be independent.	<i>SR Comm s/b >Majority non-execs</i>	1
6.	The Investment Committee's practice of issuing instructions to the directors appointed to the boards of key investees is contrary to the recommendation of the King III Code that the holding company must respect the fiduciary duties of the directors serving in a representative capacity on the subsidiary's board.	<i>Directors act in best interest, not on instructions</i>	1
7.	The directors acting on the instructions of the Investment Committee may therefore not respect the rights of minority shareholders in the investee companies or may not be acting ethically towards all stakeholders.	<i>Respect minority rights</i>	1
8.	The Shareholder Relations Committee oversees the preparation of quarterly reports on the triple bottomline performance, while the King III Code recommends that this function should be performed by the Audit Committee.	<i>SR Comm oversee 3X bottomline reporting</i>	1
9.	The special quarterly reports appear to be distributed to only the major shareholders, contrary to the King III Code recommendations that:	<i>Equitable</i>	
9.1	Companies should ensure the equitable treatment of shareholders.	<i>treatment of s/h</i>	1
9.2	The board should ensure that the company complies with applicable	<i>Comply with</i>	1

	laws.	<i>laws</i>	
9.2.1	The practice of disclosing price-sensitive financial information selectively to certain shareholders is likely to constitute insider trading, an offence in terms of the Securities Services Act.	<i>Price-sensitive info = insider trading</i>	1
10.	All current board members appear to be male. In terms of the King III Code, the board should consider whether its demographics make it effective.	<i>Board members = male</i>	1
11.	The composition of the remuneration committee does not comply with the King III code in that: - Executive directors should not be members of the committee - The chairman of the board should not also be chairman of Remuneration committee	<i>Remco No Executives No Board chairman</i>	1 1
<i>Where only one mark has been allocated to a particular matter, this should be awarded for the appropriate identification and explanation of the non-application of the King III Code by Green Energy Holdings Ltd. No mark will be awarded simply for restating the content from the King III Code (note: this is a permitted text in the PPE).</i>			
		Maximum	12
Part 2 - The comments by William Peterson (WP) on Alex Nkonde's thoughts/queries are inappropriate for the following reasons:			
1. <i>Financial reporting framework selected</i>			
1.1	WP's comment that the time to convert from IFRS for SMEs to full IFRS will be minimal is not factually correct, as the differences between IFRS for SMEs and IFRS are fairly significant.	<i>Conversion time not minimal</i>	1
1.1.1	The changeover will require additional time and resources, first to identify the differences between the current accounting policies and IFRS and then to effect the required changes to the accounting policies to align with IFRS.	<i>Add resource to: -Identify the diff -Effect changes</i>	1
1.1.2	Specifically, the requirements of IFRS 1 ¹ will have to be adhered to – IFRS 1: “First-time Adoption of International Financial Reporting Standards” sets out the procedures that an entity must follow when it adopts IFRSs for the first time as the basis for preparing its general-purpose financial statements.	<i>Adoption of IFRS - Adherence to IFRS 1</i>	1
¹ <i>Note that as IFRS 1 is not specifically examinable in the PPE 2010, hence this is considered to be a bonus mark.</i>			
1.2	In terms of section 11.4 of the IRBA's Code of Professional Conduct (IRBA Code) the audit fee should be based on the time spent and calculated on the basis of the skill and knowledge, experience and investment in technology required to perform the engagement.	<i>Audit Fee = time spent/knowledge technology</i>	1
1.2.1	The changes to the financial reporting framework will increase the risk of material misstatement (both in respect of the current period and opening balances), requiring the auditor to spend more time on the audit, and may also require the assignment of more experienced audit staff to the engagement.	<i>Increase risk = more time on audit & exp staff</i>	1
1.2.2	It is therefore probable that an increase in the audit fee will result – contrary to the comment made by WP that there will be no effect on the audit fee to be charged.	<i>Increase audit fee</i>	1
1.3	WP should have pointed out that in terms of the Companies Act 1973, as amended, SPI (Pty) Ltd is a widely held company – being a	<i>SPI = Widely Held Co.</i>	1

	subsidiary of Green Energy Holdings Ltd, a listed company.		
1.3.1	As such, in terms of section 285A of the Companies Act 1973, SPI (Pty) Ltd must comply with financial reporting standards – i.e. “statements of Generally Accepted Accounting Practice adopted by the Accounting Practices Board” (section 1)	<i>Co. Act = SPI comply FRS,</i>	1
1.3.2	The change in framework is a management decision (in this case determined by group policy) and not a decision of the auditor and therefore not simply a new way that auditors have found to increase their audit fees.	<i>Management decision not auditor</i>	1
1.4	Although IRFS for SMEs does provide an exemption for widely held companies to not apply full IFRS, this does not apply in this case as SPI is required by group policy to comply with full IFRS	<i>IFRS for SME is not Group policy</i>	1
1.5	In terms of ISA 210, Agreeing the Terms of Audit Engagements, determining whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable is a matter that should have been considered and discussed with management prior to the audit having been accepted.	<i>Prior accepting audit, framework in AFS = acceptable</i>	1
1.5.1	Moreover, the agreed terms of engagement, as recorded in the audit engagement letter, should include the identification of the applicable financial reporting framework for the preparation of the financial statements.	<i>Terms include id of framework applied AFS</i>	1
1.5.2	WP should therefore have drawn Alex’s attention to the discussions about the financial reporting framework that presumably had taken place and the engagement letter that presumably has been signed – therefore an omission on his part.	<i>Discussions framework & Eng letter - omission</i>	1
1.6	Management and employees may not be familiar with the application of full IFRS, which increase the risk of material misstatement and may require more audit work and a higher audit fee.	<i>Client unfamiliar with IFRS increase risk and fee</i>	1
2. VAT investigation			
2.1	It is inappropriate for WP to respond immediately that the VAT investigation will be performed without following procedures to evaluate whether the requirements of ISQC 1.26 for the acceptance of specific engagements are satisfied.	<i>Procedures to evaluate accept of specific eng</i>	1
2.1.1	Given the short time that elapsed prior to WP’s response, it is doubtful whether he ascertained the availability of those “VAT experts” to undertake the investigation – in order to satisfy the ISQC 1 requirement that the firm is competent to perform the engagement and has the capabilities, including time and resources, to do so.	<i>Competence, capabilities/time, resource to perform engagement</i>	1
2.1.2	In certain circumstances and with the necessary safeguards, a RA is allowed to provide non-audit services to an audit client.	<i>Can provide other services - safeguard</i>	1
2.1.3	The undertaking of a service of this nature is also likely to create unacceptable threats to independence – which will not satisfy the ISQC 1 requirement that the firm can comply with relevant ethical requirements in performing the engagement. <ul style="list-style-type: none"> No reference is, however, made in the comment to the need to ensure that the audit firm has no involvement in nor assumes responsibility for management decisions relating to this matter (IRBA Code section 7.16). 	<i>Threats to independence</i>	1
2.1.4	In terms of section 11.15 of the IRBA Code an auditor may not perform work relating to the attest function, nor may s/he prepare an	<i>Auditor cant make management decisions</i>	1
		<i>No contingency fee</i>	1

	amended tax return, for a contingent fee. This is reiterated by the IRBA’s Disciplinary Rule 2.1.9.		
2.1.4.1	WP did not, however, comment on the inappropriateness of the basis for the fee determination proposed by the client.	<i>Fee not appropriate</i>	1
2.2.	A separate engagement has been accepted without WP making any reference to the need for the terms of the engagement to be agreed and recorded in an engagement letter.	<i>Separate Eng - Not terms, eng letter</i>	1
2.2.1	The engagement letter signed for the purposes of the statutory audit will not cover the rights and responsibilities for this special engagement.	<i>Audit eng letter not for special eng</i>	1
2.3	WP’s comment that the client can “... trust me to keep this matter confidential” is inappropriate, as it poses a threat to the fundamental principles of objectivity and integrity.	<i>Comment inappropri</i> <i>integrity</i>	1
2.3.1	A practitioner should be free and be seen to be free from any influence, interest or relationship, whether direct or indirect, which might be regarded, whatever its actual effect, as being incompatible with integrity, objectivity and independence (section 6.1 of the IRBA Code; section 44(6) of the Auditing Profession Act).	<i>RA = free & seen free from all that risk independence, obj & integrity</i>	1
2.3.2	By siding with Alex in keeping the matter confidential, his ability to perform the audit in accordance with ISAs (e.g. meeting the requirements of ISA 600 and the 700 series) is potentially undermined.	<i>ISA audit undermined</i>	1
2.3.3	The auditor is required by ISA 265 to communicate significant breakdowns in controls to those charged with governance –WP may not comply with ISAs if it is “kept confidential”.	<i>Report weaknesses</i>	1
3. Problem with the purchase consideration paid for the SPI (Pty) Ltd shares			
3.1	WP’s comment that his firm would “prefer to stay out of this matter completely” is inappropriate, as:	<i>Comment inappropriate</i>	1
3.1.1	The incorrect interpretation of a sales contract could materially affect the recognition and measurement of revenue in SPI (Pty) Ltd’s financial statements, and as such is likely to give rise to a significant risk of material misstatement in the occurrence and accuracy of revenue assertions. <ul style="list-style-type: none"> In terms of ISA 315.29 the auditor shall obtain an understanding of the entity’s controls, including control activities, relevant to that risk – he cannot simply ignore this, as proposed. In terms of ISA 330.21 the auditor is also required to perform substantive procedures that are specifically responsive to the risk. 	<i>O & A Revenue recognition = Increase risk</i>	1
		<i>Cannot ignore controls</i>	1
		<i>Perform Sub Proc response to risk</i>	1
3.1.2	It appears likely that this matter will give rise to a material prior period error; it will also be necessary for the audit team of SPI to obtain sufficient appropriate audit evidence that the matter has been correctly accounted for, including the restating of the comparative amounts.	<i>Material PY error – restate comparatives</i>	1
3.1.3	In terms of ISA 600.41 the component auditor (A2Z) is required to communicate any significant matters pertaining to the group financial statements to the group auditor.	<i>Component report matters to Group</i>	1
3.1.4	The existence of a possible reportable irregularity (possible	<i>RI evaluated</i>	1

	fraudulent reporting) should be evaluated, and if an unlawful act that also satisfies all the other criteria per the Auditing Profession Act is found to have taken place, this should be reported to the IRBA.	<i>and reported</i>	
3.2.	WP is, however, correct in not agreeing to help the client “sort out this mess”, as this will give rise to threats to independence.	<i>Helping = threat to independence</i>	1
3.3.	WP is incorrect in that it has nothing to do with them as it will affect the at acquisition assets and liabilities and recognition of goodwill on the consolidated financial statements	<i>Goodwill and at acquisition</i>	1
3.4.	ISA 510 require and auditor to specifically audit opening balances when a new audit appointment is made – WP does not appear to fulfil the requirements of this ISA.	<i>Opening balances</i>	1
4. Trainee’s use of two SPI (Pty) Ltd solar panels			
4.1.	WP should have referred to the action that has been taken against the trainee for his inappropriate conduct – the tone of WP’s comments borders on trying to defend the trainee’s actions.	<i>Defend trainee?</i>	1
4.1.1	The conduct of the trainee was contrary to the principle of integrity – he accepted a gift from the client (i.e. free use of two solar panels) and remained silent after the panels had been stolen from his house.	<i>Trainee no integrity = accept gift</i>	1
4.1.2	This conduct is in breach of the IRBA and SAICA Code of Conduct that require RAs and their staff to act at all times in a manner that will not bring the profession into disrepute.	<i>Breach of CoC</i>	1
4.2.	In terms of section 7.25 of the IRBA Code goods should not be accepted by practitioners except on business terms that are no more favourable than those generally available to others.	<i>Not accept goods > more favourable</i>	1
4.2.1	WP offers to reimburse the “cost” of the solar panels on extended payment terms, which will create an unacceptable threat to independence, as these terms are not available to others.	<i>Repayment terms = threat to indepen</i>	1
4.2.2	Also, as the trainee took up the offer of using the solar panels at no cost, he is in contravention of the above principle.	<i>Accept @ no cost = contravention</i>	1
4.3	The offer to repay the debt in instalments is inappropriate as:		
4.3.1	the trainee has been assigned to the audit of SPI (Pty) Ltd – the amount owing, which is no doubt material to the trainee, will create threats to his objectivity/independence in fact or in appearance; and	<i>Amt material = threat to independence/o bj</i>	1
4.3.2	it is contrary to the principle of professional behaviour – as WP is unilaterally proposing a scheme that will be to the detriment of the client (no interest will be received on the debt).	<i>Not prof behaviour</i>	1
4.4.	The Registered Auditor is responsible for the conduct of their staff and should therefore ensure policies and procedures are in place to ensure staff comply with the relevant Code of Conducts	<i>RA responsible for staff conduct</i>	1
4.5.	WP should consider whether the staff member should not be removed from the audit team and not just accept that he will be on the team for the final audit	<i>Remove staff from team</i>	1
		Presentation	1
		Maximum	26
Part 3 - Description, with reasons, the effect of information in email w.r.t. the audit of Solar Panel industries (Pty) Ltd (A1) on 2010 group audit plan for Green Energy Holdings Ltd			

<i>1. Overall concerns about the <u>quality of the audit team</u> of the SPI subsidiary</i>			
1.1	Given William Peterson’s apparent lack of objectivity/independence, and the lack of integrity/independence of one of the trainees assigned to the audit, it is doubtful whether the component auditor understands and will comply with the ethical requirements that are relevant to the group audit (ISA 600.19(a)).	<i>Component auditor not comply ethical requirements</i>	1
1.2	As William Peterson’s comments are contrary to the requirements of ISAs, the IRBA Code of Professional Conduct and applicable legislation, the professional competence of the audit manager assigned to SPI (Pty) Ltd must be questioned (ISA 600.19(b)).	<i>Competence of component auditor question</i>	1
1.3	Accordingly, in terms of ISA 600.20 the group engagement team will have to consider:	<i>Group - Change</i>	
1.3.1	seeking to change the audit team assigned to audit the component, if possible; or	<i>Component team</i>	1
1.3.2	becoming involved in the work of the component auditor, or performing its own further procedures (risk assessment or further) on the financial information of SPI (Pty) Ltd.	<i>Group - own add procedures on SPI</i>	1
1.4	Consider the following overall responses in view of the issues identified:	<i>Increase scepticism</i>	1
1.4.1		<i>Reconsider materiality</i>	1
1.4.2	Increase professional scepticism in view of the increase in risk	<i>Less reliance on man rep</i>	1
1.4.3	Reconsider planning materiality and lower materiality if necessary	<i>Less control environment</i>	1
1.4.4	Because of the concerns of the competence and integrity for the subsidiary’s finance director, less reliance should be placed on management representations	<i>Increase level of substantive test</i>	1
1.4.5		<i>Team more experienced</i>	1
1.4.6	Reconsider whether reliance can be placed on controls and the control environment in the group	<i>Unpredictability</i>	1
1.4.7	Reconsider the extent of substantive audit procedures at both group and subsidiary level and consider increasing	<i>Timing</i>	1
1.4.8	Reconsider whether the group audit team need to include more experienced members to address the higher risk at the component Incorporate additional elements of unpredictability in the selection of further audit procedures to be performed (nature). Conduct more audit procedures as of the period end rather than at an interim date.		
<i>2. Assessment of increase in <u>the risk of material misstatement</u> in the financial statements of the SPI subsidiary</i>			
2.1	The risk of material misstatement in the financial statements of SPI is increased by:		
2.1.1	The appointment of temporary staff in the finance department to help manage the workload during the period of the strike – in view of the concerns expressed by the financial director about possible errors, it is possible that these staff members either lack the required competence to do their assigned jobs or were not supervised adequately, which may translate into errors beyond merely the incorrect treatment of VAT.	<i>Temp staff errors beyond tax</i>	1
2.1.2	Other components of the group audit may also have been affected by the strike and the use of temporary staff which may require a reassessment of the audit plans of all components of the group.	<i>Reconsider impact of temp staff – all comp</i>	1
2.1.3	The integrity of SPI’s finance director being questionable due to, for example, his request to keep information from Mr Black.	<i>SPI FD integrity?</i>	1
2.1.4	The competence of SPI’s finance director being questionable due to, for example, his misinterpretation of a major sales contract – which	<i>Competence of SPI FD</i>	1

	caused a “significant” overstatement of the 2009 profits.	<i>questioned</i>	
2.2	These risks should be responded to when the nature, timing and extent of further audit procedures required to obtain sufficient appropriate audit evidence in respect of the 2010 financial information of SPI (Pty) Ltd are determined, or the component auditor is requested to do so, resulting in, for example:	<i>Reconsider nature, timing, extent</i>	1
2.2.1	Obtaining more extensive audit evidence, specifically taking care to ensure that transactions recorded during the period of the strike are adequately included in audit tests (extent).	<i>More audit evidence – strike period</i>	1
3. Financial reporting framework selected			
3.1	Risk assessment procedures should be included in the group audit plan to obtain an understanding of:		
3.1.1	the adequacy of instructions issued by group management to components (as the preparation of the financial statements in accordance with IFRS is perceived by Alex Nkonde to be a new requirement introduced by the auditors); and	<i>Adequate group instructions</i>	1
3.1.2	the financial reporting framework adopted by SPI, and the process, if any, followed by SPI (Pty) Ltd to change its accounting policies to be IFRS compliant.	<i>SPI change to IFRS</i>	1
3.2	Further procedures should be performed (by the group or component auditor) to respond to the assessed risk in order to gather sufficient appropriate evidence about:		
3.2.1	If the accounting policies have been changed to be in accordance with IFRS: the appropriate recognition, measurement and disclosure of financial statement elements affected by the change(s).	<i>Acc policies</i>	1
3.2.2	If IFRS for SMEs is the accounting framework adopted by SPI, whether the financial information of the component has been appropriately adjusted for purposes of preparing and presenting the group financial statements (ISA 600.35).	<i>IFRS 4 SME – adjusted for group</i>	1
4. VAT investigation			
4.1	Risk assessment procedures should be included in the group audit plan to obtain an understanding whether this investigation was undertaken, and if so, what the key findings were and whether these point to more pervasive problems.	<i>Investigate Pervasive problems?</i>	1
4.2	Further procedures should be performed (by the group or component auditor) to respond to the assessed risk in order to gather sufficient appropriate evidence that no material misstatement has arisen due to the incorrect accounting for VAT, for example by:	<i>Further procedures</i>	
4.2.1	Considering the competence and objectivity of the consultants or client staff investigated the incorrect VAT treatment ;	<i>Evaluate competence</i>	1
4.2.2	Evaluating the nature and scope of the work undertaken to investigate the VAT issue;	<i>Nature/scope?</i>	1
4.2.3	Determining whether all adjustments required as a result of the findings of the investigation have been correctly recorded; and	<i>All adjustments made?</i>	1
4.2.4	When performing the normal audit procedures, paying increased attention to the correct treatment of VAT when recording transactions.	<i>Normal procedures – VAT</i>	1
5. Problem with the purchase consideration paid for the SPI (Pty) Ltd shares			
5.1	Risk assessment procedures should be included in the group audit	<i>Understand</i>	1

	plan to obtain an understanding of the content of the sales contracts of SPI, the claim against the former shareholder and the resulting restatements to the financial statements required.	<i>SPI sales contracts/ claim, AFS effect</i>	
5.2	Further procedures should be performed (by the group or component auditor) to obtain sufficient appropriate audit evidence that:	<i>Further procedures:</i>	
5.2.1	The recording of revenue of SPI for the 2010 financial year is consistent with the requirements of the sales contracts (for the major customer and other customers).	<i>2010 Sales contracts</i>	1
5.2.2	The restatements due to the prior year error, if material, have been correctly accounted for and disclosed in the financial statements.	<i>Mat PY correctly disclosed/acc</i>	1
5.2.3	The accounting of goodwill, at acquisition assets and liabilities and sundry receivables are free from material misstatement Obtain a confirmation from attorneys handling the claim against the former shareholder to evaluate the probability of recovery of monies.	<i>Goodwill, acqui assets, liabilities</i>	1
5.2.4		<i>Confirm recovery of claim</i>	1
6	The auditor may also have additional responsibilities to communicate with the client and those charged with governance regarding the restatement of prior year results	<i>Communicate restatement</i>	1
7	If the further procedures responding to significant risks are performed by the component auditor, and the group auditor intends to rely thereon, the group audit plan should provide for an evaluation of the appropriateness of the further audit procedures performed by the component auditor.	<i>Plan = evaluate further proc by Component auditors</i>	1
		Maximum	13

If reference is made to SAICA Code of Conduct instead of/in addition to the IRBA Code of conduct, marks should be awarded

QUESTION 1B	Marks out of 49
Part 4 & 5	

PART 4: Effect of information on the risk of material misstatement				
At the financial statement level				
1	The following factors will increase the risk	INCREASE		
1.1	The inappropriate use of the <i>going concern</i> assumption in the preparation of the WTS financial statements, because:	Going concern problems	1	
1.1.1	The company's major customers have a track record of being environmentally conscious – the negative publicity surrounding the decline in the bat population could result in a loss of customers and/or undermine the ability to attract new customers (reputational risk).	Loss of customers due to negative publicity re bats/ also reputational risk	1	
1.1.2	Negotiations for a power sale agreement with the national power utility have been in progress for a number of years, and may never be concluded.	Power sale agreement not concluded	1	
1.1.3	The significant increase in the cost of generating electricity as a result of the investment in batteries that had to be made will increase the cash outflows from those originally projected	Significant increase in cost of batteries	1	
1.1.4	The pledge to donate 2% of the revenues from the Eastern Cape wind energy farm to the “Save the Bat” fund will reduce cash inflows from those originally projected.	2% donation of revenue –save the bat	1	
1.1.5	It is questionable whether all ten of the pilot sites that have been set up will be viable and whether each one of them will have recoverable amounts in excess of the site's carrying amount	Viability of pilot sites/recovering cost not certain	1	
1.1.6	It is stated that “government subsidies are essential for the sustainability of the industry” – while a number of applications for government funding will be submitted early in the 2011 calendar year, there is no guarantee that these will be successful.	No guarantee that government subsidies will be received	1	
1.2	The risk of <i>fraudulent financial reporting</i> will increase as management has an incentive when preparing the 2010 annual financial statements to overstate costs, understate assets and overstate liabilities ,because:	Fraud financial reporting misstmt (impact): costs/assets/liabl	1	1
1.3	The <i>integrated nature of the “Accounting Solutions” software</i> inherently increases the risk of material misstatement due to, for example:	Integrated IT system	1	
1.3.1	Unauthorised changes to software and/or data, which result in invalid standing or transaction data – thereby corrupting the processing of <i>potentially numerous transactions</i> , and undermining the integrity of the company's financial information	Unauthorized sys changes impact numerous trans		Ma x 2 for eg's
1.3.2	Errors arising from incorrect input and processing of data at one point in the system perhaps being perpetuated through the system, thereby potentially corrupting many account balances.	Errors in one system impact numerous acc		
1.3.3	Risk of business continuity and loss of data should a problem exist in one application	Bus continuity/loss of data		
1.4	The non-renewal of the previous IT service provider's contract,	No service	1	

	together with there being <i>no service provider for part of March and the whole of April 2010</i> , increases the above risks further.	provider for 2 months		
1.5	The <i>new service provider</i> may not fully understand the business and current systems and controls, thereby increasing the risk of material misstatement due to:	New service provider not familiar with buss	1	
1.5.1	The increased likelihood of inappropriate software changes being made, causing transactions to be recorded incorrectly or not at all; and existing controls to be removed	inappropriate software changes	1	
1.5.2	The access profiles not being maintained appropriately, undermining sound segregation of duties among users of software	access profiles / seg of duties	1	
1.6	<i>Outsourcing of certain IT functions such as system maintenance and access controls</i> increases the risk of material misstatement, due to	Outsourcing of It functions	1	
1.6.1	Third parties having access to client systems and loss of confidentiality of data	Loss conf data/access	1	
1.6.2	Continuity of business operations at risk if system maintenance not done correctly/dependency on 3 rd party.	Business continuity	1	
1.6.3	Risk of weak controls at service provider (control environment and specific controls) – ISA 3402	Controls at SP/ISA 3402	1	
1.7	Risk of <i>non-compliance with laws and regulations</i> , especially environmental laws such as NEMA, resulting in	Non compl with laws and regs	1	
1.7.1	Possible reportable irregularities (with appropriate reason)	RI (reason)	1	
1.8	Tight reporting deadline increases the risk of material misstatement as possible subsequent events might not be accounted for/risk of incorrect accounting for contingencies at year end, example environmental issues.	Tight reporting deadline	1	
1.9	There is various complex accounting issues which increases the risk of material misstatement in financial reporting, such as the leases, investment property, etc.	Complex accounting issues	1	
1.10	The widespread nature of the wind farms and operations could impact negatively on the control environment and the effectiveness of controls (control exp, costs, assets, etc)	Widespread nature of operations	1	
2.	The following factors will decrease the risk	DECREASE		
2.1	The risk that the going-concern assumption is inappropriately applied is decreased because: - The company provides a “green” product that is in demand, as companies look at ways of reducing their carbon footprints - The national power utility’s electricity reserve margins are under pressure, and there is a growing demand to obtain electricity from other sources - The application for funding for government assistance, as well as the granting of R10million grant	Going concern risk reduced: - green products in demand -growing demand for electricity Government assistance & grants	1 1 1	
2.2	The existence of an IT Committee and a service level agreement with the service provider may, however, decrease the above risks for the latter part of the financial year.	IT committee Service level agreement	1 1	
3	Conclusion: Risk at overall financial statement level will be high, given above risk	Concl: High risk	1	
At the assertion level (mark the risk and not necessarily the assertion)				
4.	Wind energy farms : The risk will increase because	INCREASE		
4.1	The <i>valuation of wind energy farms</i> is at risk, as an impairment of the	GC problems	1	

	carrying amount of the asset may be required in view of the going-concern indicators listed	(valuation/impairment)		
5	Land : The risk will increase because	INCREASE		
5.1	There is a risk that the lease is incorrectly accounted for (accounting treatment): - should only be capitalised if it meets the requirements of a finance lease (completeness of land); - if operation lease, not straight lined and correctly accounted for (accuracy and cut-off). - also the risk that the reconstruction of cost not correctly accounted for as contained in the lease agreement	Acc treatment of lease: -Fin vs oper -Oper not str lined - reconstruction cost not ito lease agreement	1 1 1	
5.2	The <i>completeness of land</i> is at risk if lease is a finance lease as the long-term lease agreements concluded might not include all costs (e.g. should the present value of the minimum lease payments be equal to substantially all of the fair value of the land at the inception of the lease)	Not all costs included if finance lease (completeness of land)	1	
6	Revenue : The risk will increase because	INCREASE		
6.1	The nature of the company's product (electricity) is such that there is no tangible handover of products or services, making it more difficult for the client's staff to detect invoicing errors (<i>occurrence and accuracy</i>).	No physical handover of prod/services(all assertions)	1	
6.2	As the full amount of the government grant has been accounted as revenue in the 2010 financial year, there is a significant risk that revenue has been overstated /fraud risk ito ISA 240 (<i>occurrence, accuracy, cut-off</i>).	Full amount of gov grant in 2010 recognised/ fraud risk(occurrence/ accuracy/cut-off)	1	
6.3	The grant should be recognised in profit or loss over the periods in which the entity recognises as expenses the related costs (IAS 20.12) (<i>occurrence and accuracy</i>)	Revenue recog as cost incurred (occur & accuracy)	1	
7	Provisions : The risk will increase because	INCREASE		
7.1	Restoration of land: Computation of the provision to be recognised in respect of lease agreement requiring the restoration of land is complex and will involve the application of judgement (e.g. estimates of restoration costs) (<i>valuation</i>).	Restoration of land – complex computations (valuation)	1	
7.2	Wind Farms: R1.5 million provision raised to “look at ways of reducing the negative impact” of the wind energy farms might not satisfy the recognition criteria as no legal or constructive obligation might exist(existence), and The amount of the provision must be “the best estimate of the expenditure required to settle the present obligation” – is it not probable that an amount greater or smaller than R1,5 million will be spent? (<i>valuation</i>)	Wind farms Might not satisfy recognition criteria (existence) Difficult to estimate amount (valuation)	1 1	
7.3	Disposal of Batteries: A constructive or legal obligation might exist to dispose of the batteries (used to store electricity) at the end of their useful life in a “green” manner – increasing the risk in respect of the <i>existence/obligation/completeness</i> assertions.	Batteries: obligation to dispose at end (Exist/obligation/c completeness)	1	
8	8. Investment Properties : The risk will increase because	INCREASE		
8.1	The portion of the land not used for the wind energy farm is classified as investment property for accounting purposes. In terms of IAS 40 such	Incorrect accounting	1	

	treatment is only appropriate if the portions that are owner-occupied and leased can be sold (or leased out under a finance lease) separately. Thus the <i>existence of investment property (alt: classification of investment property)</i> is at risk as	treatment Might not exist/incorrect classified	1	
9	Inventory : The risk will increase because			
9.1	Electricity stored in the batteries at year-end may not be costed appropriately in terms of the requirements of IAS 2, Inventories – i.e. the costs incurred in the generation of electricity may be incorrectly computed or allocated (<i>valuation of inventory</i>).	Incorrect costing (valuation)	1	
10..	Other valid risk (specify): FS level : Assertion level	Max (1) Max (1)	1 1	
		Maximum	2 1	

PART 5				
Opening balance				
The mere fact that the opening balance is “ <i>easy to audit</i> ” does not mean the <i>assessed risk of material misstatement in respect of the opening balance is “low”</i> . Reconsider the risk assessment or the reason for the risk assessment. Was the schedule of audit difference referred to regarding effect on opening balances	The risk of material misstatement, by definition (refer Glossary of Terms), is the risk that the financial statements are materially misstated prior to audit – and is unrelated to detection risk (the risk that the audit procedures will not detect material misstatements).	(RN): Risk assessment as low (RN) Schedule of Aud diff re O/B (W): Easy to audit not reason for low risk (W): Consider risk of MM	1 1 1 1	
Cost of components and construction				
Risk assessment & controls The risk of material misstatement is <i>assessed as medium on the basis of a sound system of internal control</i> . There is, however, no indication in the “audit response” that the <i>operating effectiveness of the controls in the system is being tested</i> . Either include such tests of control or revise the risk assessment	Risk assessment & controls ISA 330.08: the auditor is required to design and <i>perform tests of control</i> to test the <i>operating effectiveness of relevant controls</i> if the assessment of the risk of material misstatement at the assertion level includes an expectation that the controls are operating effectively	Risk ASS & controls (RN) Have controls been tested (W) Can only reduce risk if controls tested	1 1	
Based on the systems description documented per WP 833-02, <i>very few strong controls</i> that warrant reliance <i>have been documented</i> . If controls are to be tested, <i>update the systems description to reflect</i> the strong controls identified.	ISA 315.32 the auditor is required to <i>document key elements</i> of the understanding of each of the <i>internal control</i> components, including those control activities used to assess the risk of material misstatement	(RN) Was system updated/key controls ID’ed (W) ID key controls/update system controls	1 1	
Component costs				
FA Register The assets in the fixed-asset register are used to select the sample for testing the accuracy of costing. Have you performed tests to verify that all wind energy farm additions have been recorded in the asset register (<i>completeness of fixed</i>	Conclusions can only be drawn from the population from which the sample has been drawn (ISA 530) – therefore, if the asset register is incomplete (e.g. for construction work-in-progress), <i>no conclusions can be drawn about the appropriate</i>	FA Register (RN) Compl of WEF additions checked (W) If not recorded, cannot test costing	1 1	

<i>asset register)</i>	<i>costing of those assets not included in the fixed-asset register.</i>			
All additions included in WIP Audit procedures must be added to the audit plan to respond to the <i>risk relating to the incorrect costing of additions</i> to Construction work-in-progress (all additions included value and quantity).	The <i>additions</i> to Construction work-in-progress not transferred to the asset register (R45 million) are of a <i>magnitude that could result in material misstatements</i> to the financial statements.	All add in WIP (RN) are transfers from WIP correct (W) Transfers may be wrong & amt is significant	1 1	
Variance The total variance between the order and invoice values is a meaningless figure – rather <i>ascertain whether adjustments are made to the cost of the assets</i> if the supplier subsequently reduces the amount payable for the asset.	IAS 16.15: PPE that qualifies for recognition as an asset shall be measured at its cost. If credit notes are subsequently issued by supplier, these should be offset against cost; if no adjustments made and invoice amount paid, initial entry is correct.	Variance (RN) Are adjustments made to cost for CN issued (W) CN reduce cost of asset	1 1	
Exchange rates Have you tested the <i>controls over the “preloaded daily exchange rates”</i> file or otherwise verified that the exchange rates recorded thereon correspond to the actual exchange rates?	ISA 500.9, when using information produced by the entity for audit purposes, the auditor shall evaluate whether it is reliable for audit purposes by obtaining audit evidence about the accuracy and completeness of the information.	Exchange rates (RN) Controls tested of exchange rates (W) Test reliance on controls/info supp by client	1 1	
Cost not included Have no <i>shipping or other costs been incurred</i> on the importation of the wind turbines?	IAS 16.16: the cost of an item of PPE includes “ <i>any costs directly attributable to bringing the asset to the location and condition necessary</i> ”.	Cost not incl (RN)No other cost incurred/ impairment (W) All qualifying cost be included in PPE	1 1	
Construction cost		Construction cost		
Staff Audit evidence about the validity, accuracy and completeness of <i>staff members involved in the construction</i> of the wind energy farms per the computer spreadsheet, as well as the dates worked, must be obtained. (Are those included valid, are any omitted).	IAS 16.19: <i>administration and general overheads do not form part of the cost</i> of PPE – it is therefore necessary to obtain evidence that the times allocated to the employees on the spreadsheet relate to the construction of the energy farms. <i>All qualifying staff cost should however be included.</i>	Staff (RN) are all staff costs are complete (RN) are staff costs are valid (W) Non qualifying staff cost must be excluded.	1 1 1	
Overheads <i>Have no overhead costs relating to the construction of the wind energy farms been incurred?</i> Further audit procedures must be performed to verify whether there are costs eligible for capitalisation and, if so, the amounts thereof.	IAS 16.16: the cost of an item of PPE includes “ <i>any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management</i> ”.	Overheads (RN) No other overhead cost (W) All qualifying costs must be included	1 1	
Spreadsheets The <i>accuracy of the computations/formulae</i> used in the computer spreadsheet must be tested.	It <i>cannot simply be assumed</i> that the formulae used in the spreadsheet are <i>correct</i> .	Spreadsheets (RN) Accuracy of spreadsheet formulae tested (W) Need to test	1 1	

<p>3rd party contractors Ascertain what amounts are due to the third-party contractors involved in the construction of the wind energy farms at 31/12/2010.</p>	<p>Work performed by third-party contractors is being accounted for on a <i>payments basis, rather than an accruals basis</i> as required by IAS 1.27. Audit work must therefore be performed to quantify the resulting misstatement, after which it can be evaluated against the materiality limits (amount not recorded).</p>	<p>3rd party contractors (RN) Assess amounts due to contractors at Ye (W) Not accrual basis (W) Amount of understatement</p>	<p>1 1 1</p>	
Borrowing Costs				
<p>Risk assessment The mere fact that the computation was done by senior staff (financial accountant/treasury manager) will not result in a <i>low risk of material misstatement</i>. Reconsider the risk assessment or the reason.</p>	<p>Incentives for management to understate the amount capitalised by overstating the borrowing cost expense - e.g. in order to qualify for special green energy incentives from government. The <i>computation is fairly complex</i>– there is a risk that the senior staff involved do not fully understand these requirements.</p>	<p>Risk assessment (RN) Risk assessment not LOW (W) Not enough that senior staff does this (W) Mnt incentive to understate costs capitalised</p>	<p>1 1 1</p>	
<p>Borrowing cost Further audit procedures must be performed to verify that:</p> <ul style="list-style-type: none"> <input type="checkbox"/> Borrowing costs <i>qualify for capitalisation</i> in terms of IAS 23 (meets requirements) <input type="checkbox"/> have been <i>correctly computed</i> in accordance with IAS 23 and <input type="checkbox"/> are capitalised on <i>qualifying assets</i> from the commencement date, as defined in IAS 23.17. 	<p>As the risk of material misstatement must be <i>assessed at a level higher than “low”</i>, it is unlikely that the response currently proposed will provide sufficient appropriate audit evidence, hence <i>additional procedures are required</i>.</p>	<p>Borrowing cost (RN) Does it meets criteria for capital (acc treatment) (RN) Correctly calculated (RN) done on qualifying assets/loans (W) High risk</p>	<p>1 1 1 1</p>	
Transfer of completed WEF				
<p>Risk assessment Reconsider the <i>risk assessment in respect of this component, as it is not low</i></p>	<p>Given the poor system in place to identify the cost of constructing the wind energy farm, <i>the risk that the costing of the completed wind farm is done incorrectly</i> is high.</p>	<p>Risk Assess (RN) risk not low (W) poor internal controls</p>	<p>1 1</p>	
<p>No substantive tests <i>Substantive tests of detail must be performed to respond to the (revised) assessed risk.</i></p>	<p><i>Analytical procedures in isolation will not provide sufficient audit evidence</i> given the poor controls for the determination of the cost.</p>	<p>No SP of detail (RN) Do substantive Tests (W) high risk</p>	<p>1 1</p>	
General				
<p>CAATS In re-performing casting and calculations (fixed-asset register, analytical procedures, etc) have we used the firm’s audit software, rather than performing the test manually?</p>	<p>Improve <i>audit efficiency</i> by saving a lot of time.</p>	<p>CAATS (RN) Use CAATS (W) audit efficiency /time/etc</p>	<p>1 1</p>	
<p>Journal entries Have the <i>manual journal entries been reviewed</i> and authorised by another member of management? If not, consider the need</p>	<p>ISA 240.A43 states that one of the factors to consider when identifying and selecting journal entries and adjustments for testing is the</p>	<p>Journal entries (RN) Have jnl entries been reviewed</p>	<p>1 1</p>	

to increase the extent of testing of journal entries throughout the financial year.	adequacy of the controls over journal entries and adjustments	(RN) if not, test jnl's over year (W) controls over jnl important.	1	
Other valid points (specify) :RN & Reason		Other valid: max 2	2	
		Max	2 5	
		Presentation: Max Table for Part 5 (1) Logic, language (2)	3	

QUESTION 2A Part 1, 2 & 3	Marks out of 51		
PART 1			
General issues applicable to all three areas: <ul style="list-style-type: none"> • Exception reports and review thereof by management • Segregation of duties • Control accounts and suspense accounts • Management review • Control environment 	Exception reports Review thereof Segregation Control accounts/ Suspense accounts Management Environment	2	
1. The customer data is incorrectly reflected on the invoice			
1.1. The staff capturing data (specifically the senior admin officer) should be trained how to identify the data correctly from source documents, and how to capture the data correctly in the Accpro package.: Alternatives: <ul style="list-style-type: none"> • Staff to check customer details. • On line option to capture details. 	Train staff Alt: Check details On line capture	1	
1.2. To ensure the accuracy of the customer standing data:			
1.2.1. New customers must be requested to complete and sign a “new customer application form” containing all the relevant customer details, which must be handed to the senior admin officer.	New customer application	1	
1.2.2. Suitable edit checks must be utilised to ensure accuracy of input, for example, field size check on VAT number. Mark for the concept – edit checks – plus marks for examples.	Edit checks Detail	1 1	
1.2.3. Once the data has been captured, a sequentially numbered “client update” log should be generated by the system, reflecting the standing data captured.	Update log	1	
1.2.4. This “client update” log should be given to the customer for review and approval, evidenced by signature. Once signed, this should be included in the customer’s file.	Checked and signed	1	
1.2.5. A member of management should review the complete sequence of “client update” logs for the signatures of customers confirming their agreement with the standing data captured.	Review update log for signature	1	
1.3. The rental database and the customer database should be “linked” to ensure that the customer data does not have to be captured twice, e.g. through the use of a common customer account number.	Link rental database to customer details	1	
1.3.1. When the rental database is updated by the rental agent for a new contract, the customer information should be extracted from the customer database, and incorporated into the rental agreement for the customer to check and sign.	Check details for new contracts	1	
2. Scaffolding items delivered to customers do not match those on the delivery note.			
2.1. To ensure that the item description linked to a tracking number is correct			

on the tracking system, the following controls should be implemented when updating the rental-asset master file for a new item or items returned by customers:			
2.1.1. Once the standing data has been captured to the rental-asset master file, a sequentially numbered tracking system update report should be generated, reflecting the data captured for each new scaffolding item.	Tracking update report	2	
2.1.2. The asset controller (who is not responsible for capturing the standing data) should compare the details on the update report to the physical item of scaffolding before accepting the item into the warehouse.	Check scaffolding received or returned		
2.1.3. Counts should be performed to ensure that physical items on hand correspond to the rental-asset master file	Stock count		

2.2. When a delivery is to take place, the asset controller (and his staff) should hand over the items to the dispatch clerk for loading onto the truck – who should compare the goods to the rental delivery note.	Check goods to D/N	1	
2.3. As each item is scanned by the dispatch clerk, the tracking system should verify that the bar code number scanned is valid for that particular rental delivery note.	Verify details by scan	1	
2.3.1. If it is not a valid bar code number for the delivery note, the system should alert the dispatch clerk (e.g. by way of a buzzer).	Alert if bar code not valid	1	
2.3.2. To proceed, the electronic approval of the asset controller should be required (which should only be done once he has investigated the problem – and, if appropriate, returned the item to the store).	Approval by asset controller	1	
2.4. The tracking system should display a message “delivery note filled” on the scanner, thereby allowing additional deliveries to be processed, only when:	Display “filled” only when:		
2.4.1. All items on the picking slip have been scanned by the dispatch clerk; or	All items scanned	1	
2.4.2. The asset controller has initiated an override function, which is restricted solely to his user ID.	Approval by asset controller	1	
2.5. The gate security guard should, for all trucks leaving the premises, undertake a comparison of the items on the truck to those on the (new) rental delivery note, and stamp the delivery note as evidence of the check.	Gate security	1	
2.6. The truck is closed/sealed during delivery.	Truck sealed	1	
2.7. The customer should be required to count the delivered inventory prior to signing the delivery record.	Customer count and sign	1	
3. <u>Invoices are issued for periods after the rental asset was returned</u>	Agreements must specify:		
3.1. The rental agreement should contain standard clauses stipulating:			
3.1.1. The anticipated period of the rental.	Rental period	1	
3.1.2. That all rental asset returns must be evidenced by a signed “rental-asset return note” (so that the customer will be expecting this source document when goods are returned).	Returns signed for	1	
3.2. When the tracking system generates rental-asset return notes, they should be numbered in sequential order.	Sequential return documents	1	
3.3. Before invoicing commences, one of the managers (e.g. the chief accountant) should log on to the Accpro system and generate a report in numerical sequence of the rental-asset return notes captured for the month.	Invoicing report check by client as follows:		
3.3.1. The chief accountant should:			

• review the report for any gaps in sequence,	Sequence	4	
• review situation where rentals continue after the anticipated return date.	Rentals after return date		
• agree the last rental return note number on the Accpro generated report to the last document number issued for the month per the Tracking System;	Check last return note		
• agree the date the rental asset was returned per the return note to the date of return captured per the Accpro system; and	Agree date of return		
• investigate and resolve any errors detected before the invoicing module is run.	Errors followed up	1	
3.4. The Accpro system should be programmed to compute the rental charge only up to the date of the rental-asset return note (which should be captured by the invoicing clerk as part of the update).	Computer invoices only up to return date		
4. <u>Other valid and/or creative controls:</u> FOR EXAMPLE:	OTHER VALID KEY CONTROLS	2	
4.1. Interface between Tracking System and Rental Database where returns result in daily “Closed Reports” from which the final invoicing can be done.			
4.2. Once a job is closed and invoiced, the Rental Database should not allow any further invoices against that job.			
4.3. Reconciliation between rental assets sent to customers and items invoiced.			
4.4. The system should be able to “reserve” items pending finalisation of a rental agreement.			
Presentation (description of controls)	Presentation	1	
	Maximum	21	

PART 2				
Dr	Relocation costs	R235 000	1	
	Cr	Raw material control	R235 000	1
<i>To reallocate the relocation costs capitalised</i>				
Reason: Per IAS 2 the cost of inventory comprises, among other things, the costs incurred in bringing inventories to their present location and condition. The cost of moving inventory from one warehouse to another to improve controls does not fall into this class of costs, and hence cannot be capitalised.			1	
Dr	Cost of sales	R411 400	1	
Dr	Finished goods control	R280 266	1	
	Cr	Raw material control	R691 666	1
<i>To reallocate the price variance not relating to raw materials on hand at year-end</i>				
Reasons:				
•	IAS 2 permits a standard costing system to be used for inventory valuation as long as it approximates actual cost.		1	
•	Therefore, the adverse price variance is a cost that must be included in the inventory valuation (it is not a cost that has to be excluded per IAS 2 para 16).		1	
•	However, by including the full price variance in raw materials, the raw material cost is overstated, as part of the variance relates to the cost of finished goods (as the raw materials were used in the manufacturing process) and cost of sales (as the manufactured goods were sold).		1	
Workings:				
Cost of sales adjustment = $(4\ 800 - 1\ 841 - 1\ 199) / 4\ 800 \times 1\ 122 = R411\ 400$			2	
Finished goods adjustment = $1\ 199 / 4\ 800 \times 1\ 122 = R280\ 266$			2	
Mark plan guidance:				

In awarding marks for the journal entry, one mark is allocated to the correct account being debited or credited without the rand amount necessarily being correct, provided that the entry balances. If out of balance, award 1/2 (First) or 2/3 (2nd).			
	Maximum	12	

PART 3			
1	Review the overall cash flow projection		
1.1	Obtain an understanding of the process followed in preparing the cash flow forecast (e.g. who was involved) by enquiry from the financial director and assess the validity of the assumptions underpinning the forecast..	Review Cash Flow Forecast: <ul style="list-style-type: none"> • Process/ Assumptions • Detail • Competence • Prior periods • Past periods • Recent / Current info • Enquiry • Minutes 	5
1.2	Pay particular attention to the quarters where the net cash position is close to overdraft limit, and if necessary, request that management provide a month-by-month analysis of cash flows for these periods.		
1.3	Consider the reliability and competence of the persons who prepared the forecast.		
1.4	Compare forecasts for previous periods to assess reliability of forecasting process.		
1.5	Compare the cash flow forecast for the 2011 financial year with actual results achieved to date.		
1.6	Compare the prospective financial information (cash flow forecasts) for recent prior periods with historical results.		
1.7	Enquire from management to identify whether there are any additional facts/information that has become available since the date on which management made its assessment.		
1.8	Inspect board minutes after year-end for information per above.		
1.9	Request written representations from management regarding its plans for future actions and the feasibility of these plans.	Representations	1
1.10	Reperform the clerical accuracy of any workings supporting the components of the forecast.	Recalculate schedules	1
2	Loan from Aybee Holdings (Pty) Ltd		
2.1	Inspect the wording of the letter from Aybee Holdings (Pty) Ltd to ascertain the conditions attached to the funds, including any upper limit on the amount of the funds that will be advanced.	Inspect correspondence	1
2.2	Enquire if the cash inflow of R2,5 million has occurred before the audit is finalised, and if so, inspect the cash book and bank statement for evidence of receipt.	Inspect bank documents	1
2.3	Consider whether the company has the power to borrow the funds. (Memorandum and Articles, Borrowing Powers Other Loan covenants.)	Borrowing power	1
2.4	If the cash inflow has not occurred before the audit is finalised:		
2.4.1	Confirm with Aybee Holdings (Pty) Ltd that it still intends making funds available (in the region of R2,5 million) when required by Aybee Equip (Pty) Ltd; and that it has adequate funds to make such financing available.	Confirm funds available	1
2.4.2	Request a copy of Aybee Holdings (Pty) Ltd's latest annual financial statements, and if received, assess the company's solvency and liquidity position.	Review Aybee's financials	1
2.4.3	Obtain legal opinion from an independent and competent attorney as to whether Aybee Holdings (Pty) Ltd has a legal obligation to provide funding to Aybee Equip (Pty) Ltd on the basis of the content of the letter.	Lawyer – Does Aybee have a firm commitment	1
3	Administration costs		
3.1	Request a schedule reflecting the constituent components of the R23,75 million for the 2011 financial year.	Schedule Admin costs	1
3.2	Inspect the cash books for the 2010 financial year, the minutes of board meetings, and the trial balance at 30 September 2010 for any expenditure that may have been omitted from the schedule of administration costs (completeness).	Review for completeness	1
3.3	Perform analytical procedures by comparing the individual line items on the schedule to the comparative actual cash flows in the general ledger accounts for the 2010 financial year (accuracy/completeness/occurrence).	Analytical by line item	1
3.4	When inspecting the general ledger accounts, also ascertain the timing of the expenditures – i.e. are they paid evenly throughout the financial year, which appears to be the assumption made in the cash flow forecast (timing)?	Review for timing of cash flows	1
3.5	Investigate any material differences by enquiry of management and inspection of supporting documentation.	Investigate anomalies	1
3.6	Inspect the minutes of board meetings for any resolutions that may impact on the quantum of the administrative expenditure (e.g. salary increases, rental of new office	Inspect minutes for new developments	1

	accommodation) and ensure that these have been taken into account (accuracy/completeness/occurrence).			
4	Finance charges			
4.1	Request a schedule containing the workings to compute the quarterly finance charges and reperform the clerical accuracy thereof.	Schedule Finance costs	1	
4.2	Inspect the loans audit work paper to identify the loans outstanding at 30 September 2010, and	Inspect audit W/P	1	
4.2.1	For each of these loans, inspect the loan agreements for the interest rates applicable to the outstanding loans.	Inspect agreements	1	
4.2.2	Compare the loan balances on the schedule to those outstanding at 30 September 2010, adjusted for any repayments on the cash flow forecast.	Compare to loans at 30 Sept	1	
4.3	Inspect the correspondence with the bank to ascertain the likely interest rate that will apply once the current overdraft facility terminates, and compare it to that used in the schedule.	Inspect bank correspondence	1	
4.4	Agree the balance of the projected bank overdraft per the cash flow forecast to the amounts used to compute the interest on the bank overdraft.	Recalculate interest	1	
5	Capital expenditure			
5.1	Inspect the contracts/other documents/board minutes relating to the capital expenditure, totalling R2 million, included in the cash flow forecast to verify (i) the amount and (ii) the date(s) when payment will be required.	Inspect documents for planned capex.	1	
5.2	Identify capital projects that have been contracted for/are currently under consideration, as follows:	Identify pending capex.		
5.2.1	Enquire from management whether any capital investment will be required in order to support the expansion of sales into new markets (following the International Marketing (Pty) Ltd agreement) and request written representations to support the response.	Enquiry about necessity for new capex.	1	
5.2.2	Inspect the minutes of board meetings to identify any board resolution relating to capital expenditure.	Inspect minutes	1	
5.2.3	Inspect the contracts file for any new contracts involving capital expenditure, and the timing of payments Inspect the contracts file for any new contracts involving capital expenditure, and the timing of payments	Inspect contracts file	1	
5.2.4	Review future capital budgets and compare past budgets to actual expenditure.	Capex Budget	1	
	Other valid issues	Other valid issues	1	
	Presentation for proper description of procedures.	Presentation	1	
		Maximum	18	

QUESTION 2B Part 4, 5 & 6	Marks out of 49
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Part 4(i)			
1	Inspect the contract or board minutes relating to the deferred bonus incentive scheme to ascertain the terms and conditions applicable to the deferred bonus (and agree to those in note 22.1 of the annual financial statements).	1	
2	Request a schedule reflecting the computation of the “service cost incurred during the financial year” and the “change in estimate”, and verify that the totals thereof equal R1,05 million and R230 000 (as per the note in the financial statements / TB/ GL / previous years working papers).	1	
3	Re-perform/ Cast and cross cast all calculations on the schedule to compute the “service cost incurred during the financial year” (using 1% of the revenue figures).	1	
4	For the 2010 bonus computation:	1	
4.1	By inspection, agree the revenue figures used in the calculation to the 2010 income statement.		
4.2	Verify the accuracy of the total number of qualifying employees on inception of the 2010 scheme by counting the number of employees’ names appearing in the September 2010 payroll.	1	
5	For 2008 and 2009 bonus computation:	1	
5.1	Compare the total number of employees on inception of the scheme and revenue figures per the 2010 schedule to the numbers appearing on the schedule in the prior year work papers.		
6	Evaluate the reasonableness of management’s estimate of projected staff attrition rates by:	1	
6.1	enquiring as to the process followed in order to arrive at the estimated number of qualifying employees after three years.		
6.2	comparing management’s previous estimated attrition rates with the actual attrition rate after three years.	1	
6.3	reviewing the statistics of staff terminations for the last five years (extracted from the HR system).	1	
6.4	extracting a report of actual staff terminations from the HR system during 2009 and 2010, as well as their date of appointment, to compute the current actual number of qualifying employees for the 2008 and 2009 bonus (for comparison to the estimated numbers used in the computation of the 2010 provision for the 2008 and 2009 bonuses).	1	
6.5	enquiring from the managing director whether any retrenchments are under consideration given the drop off in the demand for the company’s products, and evaluate whether this has been factored into the attrition rates.	1	
7	Verify the accuracy of the change in estimate by recomputing the difference between the prior year provision per the 2009 schedule and the revised provision using the revised estimates.	1	
8	Inspect the financial press on 30 September 2010 to ascertain the market yields on high quality corporate/government bonds with one/two/three years to maturity (in order to assess / evaluate the reasonableness of the discount factor applied) and compare to the discount rate used in the calculation of the provision.	1	
9	Consider the reliability of the payroll used as basis of providing the required information used in the calculations in the provision for bonuses.	1	

	PART 5		
1	The auditor has been appointed to audit the annual financial statements of the company in accordance with International Standards on Auditing.	1	
2	The objective of the audit per the International Standards on Auditing (as well as the Companies Act 1973, section 300 and 301, and the Auditing Profession Act, section 44) is to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error,	1	
2.1	thereby enabling the auditor to express an opinion on whether the financial statements fairly present, in all material respects, the financial position, financial performance and cash flows in accordance with International Financial Reporting Standards and in the manner required by the Companies Act.	1	
3	An audit is not undertaken to evaluate the corporate governance practices of Aybee Equip (Pty) Ltd.	1	
4	It should be noted that corporate governance disclosures typically do not form part of a company's annual financial statements (e.g. King 3 report principles could be implemented on an "apply or explain" basis and the auditor does not per se have the duty to report on governance matters).	1	
5	The examples mentioned in Mr Yedwa's letter are not likely to affect the fair presentation of the financial statements (unless further information is forthcoming) – in which case the auditor will not deal with Mr Yedwa's concerns in his audit report.	1	
6	If corporate governance abuses that constitute "unlawful acts or omissions" and also satisfy the other criteria for a "reportable irregularity" are detected by the auditor, these must be reported in the audit report in accordance with the requirements of the IRBA Guide on Reportable Irregularities.	1	
7	In planning the audit, the auditor will consider the content of Mr Yedwa's letter as part of his understanding of the entity and its environment, and will consider the implications thereof, if any, for the audit (e.g. impact on audit risk assessment / materiality).	1	
8	The auditor will unfortunately not provide Mr Yedwa with a copy of the draft audit report, or take his comments thereon.	1	
8.1	Auditors are required to adhere to the fundamental principle of objectivity – which imposes an obligation on them not to compromise their professional judgement because of the undue influence of others.	1	
9	It should also be noted that the auditor does not accept any liability to Mr Yedwa and his company in relation to his possible reliance on the audit report.	1	
10	ISA 720 – The auditor needs to consider other information issued with the AFS as part of his / her responsibilities (e.g. the King 3 report information.)	1	
11	Discussion on the auditor's responsibility towards third parties ito of the APA.	1	
12	Presentation (appropriate wording of matters)	1	
	Available (14) Maximum (9)		
	PART 6		
1	<u>Measurement of the loan to International Marketing (Pty) Ltd</u>		
1.1	The measurement of the loan to International Marketing (Pty) Ltd in the amount of R750 000 constitutes a factual misstatement due to the failure to comply with the requirements of IFRS – the company's financial reporting framework.	1	
1.1.1	In terms of IAS 39.43, when a financial asset is recognised initially an entity shall measure it at its fair value plus transaction costs that are directly attributable to the financial asset.	1	

1.2	Using the bank overdraft rate as a reasonable proxy for a market-related interest rate on the loan, the loan is overstated by R216 165 on initial recognition	1	
1.3	At year-end a net misstatement of R210 827 will result (after taking into account the interest of R5 338 for September 2010).	1	
1.4	The recoverability of the loan to be assessed and the possible impact thereof on the audit opinion should be considered (Potentially irrecoverable/ uncertainty on recoverability- could be material and pervasive).	1	
<u>Disclosure of the related party relationship/loan advanced</u>			
2.1.1	The lack of disclosure of the particulars of the loan in the financial statements will give rise to further factual misstatements: In terms of section 37 of the Companies Act of 1973, if a loan is made to a fellow subsidiary, particulars of the loan must be disclosed in the company's financial statements for every year the loan is in operation, in accordance with the requirements of para 37 of Schedule 4.	1	
2.1.2	As this loan also appears to fall within the ambit of a loan granted to a company controlled by the directors (section 226), the amount and particulars of the loan shall be provided in terms of section 295 of the Companies Act of 1973.	1	
2.1.3	Para 17 of IAS 24 - Related Party Disclosures also requires that if there are transactions between related parties (such as Aybee Equip (Pty) Ltd and International Marketing (Pty) Ltd), the nature of the relationship, information about the transactions, and the outstanding balances must be disclosed.	1	
<u>3. Approval of the International Marketing transaction</u>			
3.1	No resolution to approve the loan was tabled at a meeting of the board of directors – rather it was approved by the three executive directors, two of whom have material conflicts of interest.	1	
3.1.1	It is likely that the transaction with International Marketing (Pty) Ltd will fall within the ambit of section 234 of the Companies Act of 1973 – three of the directors appear to have a direct material interest in the contract.	1	
3.1.2	However, given Mr Ntombela's query about the background of the new service provider, there is strong reason to believe that the directors with interests in International Marketing (Pty) Ltd did not declare such interests, nor provide full particulars thereof; nor could this have been done previously (as the company was only incorporated in August 2010).	1	
3.1.3	Should the requirements of sections 234 (interest in directors contracts) and 235 not be complied with the contract may be voidable at the option of the company and the executive directors who did not disclose the interest in the contract will be liable to the company for any losses.	1	
3.2	As the loan is granted to a company controlled by the directors, section 226 of the Companies Act of 1973 must be complied with, which means that the loan may not be granted without the prior consent of all shareholders or a special resolution approval of a general meeting.	1	
3.3	If these sections have not been complied with, the loan will not be "non-current", but should instead be disclosed as a current asset, thereby constituting a factual misstatement regarding the manner in which the loan is classified.	1	
<u>4. Reportable irregularities</u>			
	A reportable irregularity may have to be reported to the IRBA, as the auditor could have reason to believe that a number of unlawful acts or omissions have been perpetrated by the company's director, specifically:	1	
4.1	Unlawful act		
4.1.1	Failure to disclose the loan to the fellow subsidiary – which constitutes an offence in terms of section 37(2) and 295 of the Companies Act of 1973;	1	
4.1.2	Approving a section 37 loan on terms that may be prejudicial to the company;	1	

4.1.3	Granting a loan to a company controlled by the directors without obtaining the requisite shareholder approval in terms of section 226;	1	
4.1.4	Failure to make the required disclosures of directors in an interest in a contract in terms of section 234 of the Companies Act of 1973; and	1	
4.1.5	Preparing the annual financial statements in a manner that is false or misleading in a material respect (section 287A of the Companies Act of 1973).	1	
4.2	Committed by persons responsible by management		
4.2.1	Directors resolution w.r.t. loan / disclosures is in contravention of the Companies Act made by the company's directors	1	
4.3	Material financial loss/ Fraud / breach of fiduciary duties :		
4.3.1	Contravention of the companies act mentioned above by the directors constitute fraud and breach of fiduciary duties	1	
	Capping @ 5 marks		
5.	Qualified Audit opinion		
5.1	As R210 827 (fair value of loan) amount is below the materiality guidelines (R375 000), this misstatement in isolation is not considered material and no modification to the audit report is required.	1	
5.2	In view of the statutory requirement for disclosure (failure to disclose constitutes an offence for the directors involved-(refer 2.1.1, 2.1.2), and the interest of one of the major shareholders in corporate governance abuses, this misstatement is regarded as qualitatively material.	1	
5.3	The factual misstatement regarding the manner in which the loan is classified will be qualitatively material due to the non-adherence to the Companies Act of 1973 and a material shareholder's interest in corporate governance abuses.	1	
5.4	Section 295(4) of the Companies Act of 1973 specifically requires that, if the above information is omitted, the auditor must in his audit report include a statement containing such information about the loan as he is reasonably able to furnish.	1	
5.5	To give effect to the requirement contained in section 44(2) and (3) of the Auditing Profession Act that an unqualified audit opinion cannot be expressed if a reportable irregularity has taken place:	1	
5.5.1	A separate section should be added to the audit report following the opinion paragraph, subtitled "Report on other legal and regulatory requirements"	1	
5.5.2	This section should disclose the information pertaining to the reportable irregularity (in accordance with the requirements of the IRBA Guide on Reportable Irregularities)	1	
6	Going concern		
6.1	In terms of IAS 1.25 when material uncertainties exist related to events or conditions that may cast doubt on the company's ability to continue as a going concern, the entity shall disclose these uncertainties. It is submitted that the disclosures of the nature of the uncertainties in the current note are inadequate to satisfy the requirements of IAS 1.25	1	
6.2	In terms of ISA 570.A20 in determining the adequacy of the disclosures, it should be determined whether the information draws the user's attention to the possibility that the company may be unable to continue realising its assets and discharging its liabilities in the ordinary course of business. The current note does not contain such disclosures and therefore the audit opinion is qualified.	1	
6.3	As the information does not explicitly draw the reader's attention to the possibility that the entity may be unable to continue as a going concern, an emphasis of matter paragraph would be inappropriate.	1	
6.4	The factual misstatement arising from the incomplete / vague disclosures about the going concern uncertainties, will be qualitatively material – as there is little doubt that	1	

	this could reasonably influence the economic decisions of users.		
7	General comments on impact on audit opinion (loan agreement and going concern)		
7.1	Given the material misstatement arising from the treatment of the loan to International Marketing (inadequate disclosure and/or inappropriate classification) and the inadequate going concern disclosures, the audit opinion should be modified and	1	
7.2	include (immediately before the opinion paragraph) a paragraph providing a description of the matter giving rise to the modification, including a description of how the disclosures are misstated.	1	
7.3	In determining whether the effects of the misstatement on the financial statements are material and pervasive, it must be evaluated whether the misstatements in the disclosures are “fundamental to users’ understanding of the financial statements”.	1	
7.4	Having undertaken this evaluation, a qualified opinion should be expressed if considered material, but not pervasive.	1	
7.5	An adverse opinion should be expressed if impact is material and pervasive (not likely in this case).	1	
8	Layout		
8.1	Presentation (logic and structure of answer)	1	
8.2	Handwriting	1	
	Mark plan guidance: The marks available for the discussion of whether a “reportable irregularity” has taken place are capped (at 5 marks), as the focus of the requirement is on a discussion of the impact of the loan to International Marketing on the audit report – not on whether an RI has occurred or not.		
			Available (37) Maximum (24)