

**AUE2602**

May/June 2016

**CORPORATE GOVERNANCE IN ACCOUNTANCY**

Duration : 2 Hours

100 Marks

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**EXAMINATION PANEL AS APPOINTED BY THE DEPARTMENT.**


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Use of a non-programmable pocket calculator is permissible.

Closed book examination.

This examination question paper remains the property of the University of South Africa and may not be removed from the examination venue.

THIS PAPER CONSISTS OF **SIX (6)** PAGES.

This paper consists of the following questions and main topics:

QUESTION	MAIN TOPIC	MARKS
1	Corporate governance and payroll and personnel cycle	50
2	Internal control as well as inventory and production, revenue and receipts, and acquisition and payments cycles	50
		<b>100</b>
		<b>===</b>

**NOTE:**

Although the primary purpose of the examination is to test your knowledge and application of the subject matter, your ability to organise and present such knowledge in written language of an acceptable standard will be taken into consideration by the examiners.

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## Background information to all the questions

The firm ACG Auditors (ACG), where you are a trainee auditor, was recently appointed as the auditor of Freshline Ltd (hereafter referred to as Freshline) a JSE-listed company. Freshline sells fresh produce to leading supermarkets in South Africa and abroad.

## QUESTION 1

50 marks

### Working paper A: Abstract of the minutes of the first client meeting

ACG Auditors	<b>Client name:</b> Freshline Ltd	<b>Working paper reference:</b> A
	<b>Document name:</b> Minutes of the first client meeting	<b>Financial statement year-end:</b> 29 February 2016
	<b>Prepared by:</b> WB	<b>Date:</b> 15 February 2016

#### Present at the meeting

Chief executive officer (CEO): Terry Berry (TB)  
Audit partner: Tito Mboweny (TM)  
Second-year trainee: Warren Buffet (WB)

#### Corporate governance

**TB:** "My knowledge of the Companies Act of 2008 and the King III Report is not up to date. Freshline wishes to appoint additional members to its audit committee but I am not sure who qualifies to be on the audit committee. I have the following individuals to choose from:

1. **Pinki Granny** – the financial director of Freshline
2. **Yvonne Grape** – an independent non-executive director who is a retired engineer
3. **Peter Orange** – the company secretary of Freshline
4. **Mandla Beets** – registered auditor, the wife of one of the major suppliers of inventory to Freshline. Mandla Beets's firm is not involved in rendering any services to Freshline.

I am also not sure if it is the board or the audit committee that is responsible for the following functions:

- a) Governance of risk
- b) Overseeing internal audit
- c) Recommending the appointment of the external auditor and overseeing the external audit process
- d) Ensuring the integrity of the company's integrated report."

**TM:** "According to **section 94** of the **Companies Act** certain individuals are not allowed to form part of the audit committee of a company. We will provide you with feedback on this."

#### Payroll and personnel

**TB:** "We are expanding and therefore employing more personnel. Management is in the process of designing appropriate internal controls to ensure that only valid new employees are added to the masterfile and only valid changes are made to the employee masterfile. The payroll system is computerised.

We also changed one of the controls over **timekeeping** to the following:

On arriving at or leaving work, employees tick off their names on a "daily time list", entering their time of arrival or departure in the space provided. A large clock is located in the gate hut. The other controls relating to payroll remained the same."

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### King III Report

During a training session, the following worksheet on the recommendations of the King III Report was given to the first year trainee auditors. They were required to match the statements from 1.3.1 to 1.3.6 to the correct information given in (i) to (vi).

1.3.1	Should assist the board in setting and administering remuneration policies	(i)	The audit committee
1.3.2	Performing an objective assessment of the effectiveness of risk management	(ii)	The board
1.3.3	Meet at least four times a year	(iii)	Nomination committee
1.3.4	The chairman should be the chairman of the board	(iv)	Internal audit
1.3.5	Meet at least twice a year	(v)	Remuneration committee
1.3.6	Assist the nomination committee with the appointment of directors	(vi)	Company secretary

### REQUIRED

### Marks

1.1 Based on the information contained in working paper A dealing with **corporate governance**:

1.1.1. **Indicate** whether or not each of the individuals mentioned in 1 to 4 could be appointed as a member of the audit committee according to section 94 of the Companies Act of 2008.

(4)

1.1.2. Give a **reason** for each answer.

(6)

**Present your answer in the following format:**

(2)

Individual	1.1.1 Yes/No (1 x 4 = 4 marks)	1.1.2 Reason (1.5 x 4 = 6 marks)
1. Pinki Granny	...	...

1.2 Based on the information contained in working paper A dealing with **corporate governance**:

**Indicate** who is responsible for the functions listed in **a–d**.

(6)

1.3 **Match** the statements from **1.3.1 to 1.3.6** to the correct information given in **(i) to (vi)**. Each concept in (i) to (vi) can be used only once.

(9)

Based on the information contained in working paper A, dealing with **payroll and personnel**:

1.4 **Describe eight (8) internal controls** that management should design and implement to ensure that only valid new employees are added to the masterfile and only valid changes are made to the **employee masterfile**.

(11)

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**REQUIRED (continued)**

**Marks**

- 1.5** List four (4) input controls with an example of each, which can be implemented to ensure that the details of the new employees are entered accurately. (6)
- 1.6** Based on the information contained in working paper A dealing with the timekeeping in payroll and personnel:  
  
Explain four (4) weaknesses in Freshline's wage system. Limit your answer to the timekeeping function. (6)

**QUESTION 2**

**50 marks**

**Internal control**

The risk committee of Freshline requested management to design appropriate internal controls. They explained that there are five components of internal control. The following internal controls relate to two of the five components, namely control activities and control environment which were implemented by the company.

- a) Management promotes sound policies regarding human resources (policies).
- b) Any employee who is found guilty of theft is dismissed immediately.
- c) Physical entry to the data centre is controlled through closed circuit TVs at the entrances.
- d) Regular inventory counts are conducted and any differences between the items on the inventory listing and the actual physical items are followed up and resolved.
- e) The company has a receiving supervisor, a despatch supervisor, and a stores controller who is responsible for the custody of inventory.

The characteristics that relate to the control environment or types of control activities are listed below:

- i) Human resources policies and practices
- ii) Access/custody and security controls
- iii) Integrity and ethical values
- iv) Segregation of duties
- v) Comparison and reconciliation

**Acquisition and payment cycle**

The following documents are used in the acquisition and payment cycle of Freshline:

- a) Requisition
- b) Purchase order form
- c) Purchase invoice
- d) Cheque requisition
- e) Creditors' statements
- f) Goods received note (GRN)

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### Revenue and receipt cycle

The following internal controls have been implemented to mitigate risks associated with the recording of sales.

1. Invoices are recorded in the sales journal in numerical sequence.
2. The numbers of any cancelled invoices are recorded in the sales journal and marked "cancelled".
3. Prior to recording the sales invoices in the sales journal, the amounts on the invoices are added to obtain a control total. This control total is then compared to the total in the sales journal after the individual invoices have been recorded (batch control system).
4. An independent staff member checks the sequence of the invoices recorded in the sales journal and follows up on any missing invoices.

### Inventory

Due to the high volumes of inventory of Freshline, the risk committee indicated that controls need to be implemented to mitigate the risks associated with the protection of inventory against theft and loss.

### REQUIRED

### Marks

- 2.1 With reference to the **internal control** information:
- 2.1.1 **Indicate** for **each** of the internal controls implemented in **(b) to (e)** whether it relates to the control environment or a control activity. (6)
- 2.1.2 **Indicate** the characteristic of control environment/type of control activity in **(ii) to (v)** which relate to each observation. Each characteristic/type can only be used once. (6)
- Present your answer in the following format:** (2)

Internal control	2.1.1 Control environment/ Control activity (1.5 x 4 = 6 marks)	2.1.2 Characteristic/ type (1.5 x 4 = 6 marks)
(a)	Control environment  <i>(No marks will be awarded for identifying this component.)</i>	(i)  <i>(No marks will be awarded for identifying this characteristic.)</i>

With reference to the **inventory** information:

- 2.2 **Describe** the difference between a general control and an application control. (2)
- 2.3 **Describe** the **internal controls** that can be implemented to **mitigate the risks** associated with the **protection** of inventory against theft and loss in the warehouse. (12)

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**REQUIRED (continued)**

**Marks**

**2.4** With reference to the **acquisition and payment cycle** information:

**Indicate** the **function** of the **acquisition and payments cycle** under which each of the documents listed in **a–f** is most likely to be used at Freshline Ltd.

**(9)**

**2.5** With reference to the **revenue and receipt cycle** information:

For **each internal control** implemented in the **recording of sales** function, **name** two possible risks that will be mitigated.

**(12)**

**Present your answer in the following format:**

**(1)**

<b>Internal control</b>	<b>Risk</b>
<b>1</b>	(Name two possible risks)
<b>2</b>	(Name two possible risks)
<b>3</b>	(Name two possible risks)
<b>4</b>	(Name two possible risks)