

Question	Response by managing director
1. Are the positions of chief executive officer and chairperson of the board held by different people?	<i>Not applicable. We do not consider it necessary to have a "chairperson of the board". Directors meetings are controlled by me.</i>
2. Number of directors	
2.1 executive directors?	<i>There are five executive directors.</i>
2.2 non-executive directors?	<i>There are two non-executive directors.</i>
2.3 independent non-executive directors?	<i>None. We don't consider that there is such a thing as an independent non-executive director. If you are a director you must be totally committed to the company, you can't be "independent."</i>
3. Are board committees appointed by the directors?	<i>No. I appoint all committees to assist the Board.</i>
3.1 audit committee?	<i>No, not necessary as we have an efficient internal audit department which reports regularly to me.</i>
3.2 remuneration committee?	<i>Yes, a three man committee consisting of myself, the director of Human Resources and one of the non-executive directors.</i>
3.3 other committees (specify)?	<i>No other standing committees considered necessary. If we need a committee for a specific task I appoint it and chair it.</i>
4. To what extent does the board embrace reporting in the triple context concept?"	<i>This company is about making profits for our shareholders. We believe in reporting our profits and not all the other soft issues.</i>
5. Does the company have a Code of Ethics in place?	<i>No. Employees know the rules here. Transgressions are dealt with by a properly constituted disciplinary process which answers to me.</i>

#### YOU ARE REQUIRED TO:

- explain the concept of proportionality with reference to the King IV Report. (5)
- comment on the extent of Milano (Pty) Ltd's compliance with the recommendations of King IV. Consider each of the responses by Claude Messi to the questions posed. (19)

2.9 (28 marks 34 minutes)

The list of senior executives and officers of Bevington (Pty) Ltd, a large manufacturer of children's clothing, is as follows:

- |                     |   |  |
|---------------------|---|--|
| 1. Virat Amla       | - | Chairman and non-executive director.         |
| 2. Frans Klewsner   | - | Deputy chairman and chief executive officer. |
| 3. Noddy Nkwe       | - | Financial director B.Com.                    |
| 4. Mary Smith**     | - | Human resources director B.A.                |
| 5. Marshall Gibbs** | - | Production director. B.Sc.                   |

- |                     |   |   |
|---------------------|---|---|
| 6. Mills Ndou***    | - | Marketing director (formally a CA(SA) before moving into marketing).                          |
| 7. Eric Hougaard    | - | Non-executive director (former production manager at Bevington (Pty) Ltd).                    |
| 8. Victor Botha*    | - | Company secretary. C.I.S.   |
| 9. Ashley Willemse* | - | Chief Audit Executive. CA(SA).  |
| 10. Russell Brent   | - | Independent non-executive director (practicing chartered accountant and registered auditor).  |
| 11. Serena Court    | - | Independent non-executive director and fashion editor of a national magazine. B.A. (journal). |
| 12. Bongi Zulu      | - | Independent non-executive director and chairwoman of her own toy company Playme (Pty) Ltd.    |
| 13. Chris Eubank    | - | Independent non-executive director and retired businessman.                                   |
- \* Victor Botha and Ashley Willemse are not directors.  
\*\* These directors have a limited understanding of integrated reporting and related processes and controls.  
\*\*\* Mills Ndou has a sound knowledge of integrated reporting and related processes and controls as he has maintained his interest therein.

The board considers sound corporate governance to be important and wishes to follow the recommendations of King IV. In view of this, it has decided to appoint an audit committee as the company is required to have its AFS externally audited by virtue of its public interest score.

#### YOU ARE REQUIRED TO:

- identify the factors the board should consider to determine the appropriate number of members of the board. (4)
- comment on the composition of the Board of Bevington (Pty) Ltd in terms of the recommendations of King IV. (8)
- indicate in terms of the recommendations of King IV giving a brief reason, whether each of the above
  - is eligible for **appointment** to the audit committee
  - should normally attend meetings of the audit committee. (10)
- indicate who you would recommend be appointed to the audit committee, assuming that it will consist of three members. Justify your choice. (6)

2.10

(40 marks 48 minutes)

You are the auditor of EePio (Pty) Ltd, a large chemical manufacturer. Due mainly to the size of the workforce and its turnover, the company has a public interest score of nearly 1200. Evan Cadel, the chief executive of the company, has called you to a meeting to clarify certain issues relating to corporate governance.

7. The chairman of the board authorised a payment of R500 000 to a government official to ensure that a tender which Brix Ltd had submitted for a government project was accepted. (4)

8. The manager and staff of the external audit team had on a number of occasions experienced a significant lack of co-operation with the production manager and his staff on matters pertaining to the audit, e.g. asset verification, valuation of work in progress. (3)

9. It has come to the attention of the board that the engagement partner of Brix Ltd's external audit team has invested heavily in the same long term project in Dubai as Max Priest. (4)

**YOU ARE REQUIRED** to discuss fully whether any of the above matters should be referred to the audit committee for their consideration, and whether any of the decisions taken should have been referred to the audit committee before being taken.

## 2.23

(20 marks 24 minutes)

JayB Ltd is a listed manufacturing company. Due to resignations from the audit committee, the company wishes to appoint three new members to join the only remaining member from the previous committee. The remaining member is Robbie Wessels, an independent non-executive director of JayB Ltd and a certified financial analyst. The procedure which the company will follow will be to request the nominations committee to present its recommendations to the shareholders as to who the shareholders should elect to the audit committee at the upcoming annual general meeting.

The nominations committee has called for the names of individuals to be submitted to it for consideration for appointment to the audit committee. The following names have been put forward:

1. Gambhir Gull - Company secretary of JayB Ltd.
2. Rod Dodger - Professor of corporate law at Unisa and not connected to JayB Ltd in any way.
3. Karl Zeiss - Chairman and non-executive director of JayB Ltd.
4. Terry Ticker - Senior partner of Ticktock Inc, JayB Ltd's auditors. He is not the designated auditor, but does advise the company on taxation.
5. Aaron Khumalo - CA(SA), senior manager of JayB Ltd's BB - BEE function.
6. Klark Gayble - CA(SA) an independent non-executive director of JayB Ltd.
7. Theuns Jordaan - Production director of MayB (Pty) Ltd, a subsidiary of JayB Ltd.
8. Jennifer Jacobs - An industrial psychologist who has no connection with the JayB group, but is well known in business circles.
9. Rod Grind - CA(SA) and former chairman of JayB Ltd who retired four years ago. He holds 4% of the shares in JayB Ltd and his company Rodds (Pty) Ltd supplies JayB Ltd with

certain manufacturing materials. Although he resigned his chairmanship he still holds a position of non-executive director of JayB Ltd.

**YOU ARE REQUIRED** to indicate whether each of the above is eligible for appointment to the audit committee of JayB Ltd if the company is to comply with the highest standards of corporate governance. Fully justify your decisions.

## 2.24

(22 marks 26 minutes)

Trellis Ltd, a public company has never appointed an audit committee. The company has seven directors one of which is a non-executive director. As Harry Hart, the managing director says "we have had the same audit firm for 30 years and the relationship has worked well, they do lots of work for the company besides the audit, we pay them well, and they are an integral part of the business. I can see absolutely no reason to have an audit committee to check up on our auditors. In any event, I will just appoint myself as chairman of the audit committee, or I will get the shareholders to include a clause in the company's Memorandum of Incorporation which states that we don't require an audit committee."

**YOU ARE REQUIRED** TO:

- a) comment on Harry Hart's attitude to audit committees and his intended action regarding the audit committee to be appointed. (10)
- b) explain to him the consequences for Trellis Ltd of the sections in the Companies Act 2008 relating to audit committees. (12)

7. The information system and related business processes relevant to financial reporting, consist of the procedures and records established by the entity to:
- Initiate, record, process and report transactions,
  - .....
  - .....
  - .....
8. Control activities are closely linked to the information system and are implemented to ensure that transactions which are processed:
- Have occurred,
  - are processed accurately,
  - .....
  - .....
9. Besides being described by type of control activity or as general or application controls, controls can also be described in terms of their overall objective. Listed in the order in which they occur, these controls can be described as:
- Preventive controls,
  - .....
  - .....
10. Approval/authorisation, as well as comparison and reconciliation are common control activities found in medium/large companies (and of course in many smaller companies). Further common control activities are:
- Segregation of duties,
  - performance reviews,
  - .....
  - .....

**YOU ARE REQUIRED TO** complete each of the above statements by providing **two** additional, relevant pieces of information, e.g. objectives, limitations of internal control, components, risk categories, etc., as indicated in each statement. To illustrate ..... to complete Statement 1, 2 more **objectives** must be added, and to complete Statement 2, 2 further **limitations of internal control** must be added.

#### 4.17 (32 marks 38 minutes)

In terms of ISA 315 (Revised) – Identifying and assessing the risks of material misstatement through understanding the entity and its environment, internal control has five components, one of which is the entity's risk assessment process. The suggestion here is that to adequately control the business, the directors (management) should assess the risks which the business faces, from minor risks to major risks and respond to the risks by putting internal control procedures/policies/activities in place. In this manner the entire internal control system will be developed.

#### YOU ARE REQUIRED TO:

- define business risk. (2)

- list the other four components of internal control (other than the entity's risk assessment process). (2)
- briefly explain the term control environment. (3)
- discuss whether the external auditor is directly interested in all the business risks which are identified by the company's risk assessment process. (3)
- describe briefly the elements which make up that part of a company's information system which is relevant to a company's financial reporting system. (6)
- state, using four key words in your answer, the objective which management aims to achieve in an accounting (financial reporting) system by implementing application control procedures. (2)
- discuss each of the following in relation to internal control:
  - strong control environment
  - sound personnel practices
  - appropriate and comprehensive segregation of duties
  - isolation of responsibilities
  - comprehensive access control
  - good document design
  - regular and frequent comparison and reconciliation. (14)

#### 4.18 Put 103 (12 marks 15 minutes)

UK2010 (Pty) Ltd is a manufacturing company with a large labour force. Each of the procedures or actions listed below (1 to 10) relates to one (or more) of the components of internal control, as identified by ISA 315 (Revised), namely:

- control environment
  - risk assessment
  - information system (relevant to financial reporting)
  - control activities
  - monitoring of controls.
- UK2010 (Pty) Ltd engages an independent labour consultancy to conduct a review of the company's payroll activities on an annual basis. This includes a report to the directors on employee satisfaction, the company's adherence to fair labour practice, legality of employees, etc.
  - Access to hardcopy employee records is restricted to the human resource manager and her senior administration clerk.
  - When the factory administration clerk has batched the wage period's clockcards he takes control totals, including the total number of clock cards in the batch. When the data capture clerk in the payroll section receives the clock cards, he counts them before signing a batch control sheet to acknowledge receipt.



4. The foremen are responsible for checking and authorizing (signing each clock card) overtime hours entered on the clock card and calculated by the wage administration clerk.
5. Employees are paid by electronic funds transfer. To effect the transfer, two senior employees are required to enter their unique passwords. One password "approves" the transfer and the second password "releases" the payment. Before "approving" and "releasing", the senior employees must check the supporting documentation.
6. The paymaster (senior manager) carefully reviews the bi-weekly reconciliation of wages paid for the current wage period to the previous wage period.
7. The company subscribes to Labourwatch, a quarterly journal which contains important information about any current or pending strike action and other labour related threats to the industry.
8. Write access to the employee masterfile is restricted to the human resource manager's senior administration clerk.
9. All individuals who apply to work in the payroll section must pass a test of competency (set by the company's human resource department) on the payroll package used by the company before they can be considered for the position.
10. The company uses a well known payroll package, Payday, for processing the payroll.

**YOU ARE REQUIRED TO** indicate to which component(s) of internal control each action or procedure listed above (1 to 10) applies. Where you select control activity as the component, indicate the type of control activity you consider the action or procedure to be.

**4.19 (12 marks 14 minutes)**

Hysbak (Pty) Ltd is a large company which manufactures all kinds of lifting equipment e.g. elevators, hydraulic jacks. Each of the following procedures or conditions takes place or exists at the company:

1. Any employee who is found guilty of unauthorised use of company assets or theft, is dismissed immediately.
2. Expensive spares and components are kept in a secure area in the warehouse.
3. All employees working on accounting applications on the company's local area network are subject to user identification, password and user profile controls.
4. The buying clerks are required to sign all purchase orders (in the designated block) and before sending the order to the supplier, must have the order authorised by the chief buyer (who must also sign in the designated block).
5. Management adopt a management philosophy which places emphasis on leadership, sound judgement and ethical behaviour.

6. The production manager approves all overtime hours to be worked before they are worked.
  7. The company conducts regular inventory cycle counts. All differences between physical inventory and recorded inventory quantities are carefully followed up.
  8. All company cheques must be signed by two authorised signatories.
  9. The senior creditors clerk reconciles each creditors statement with the creditors account in the creditors ledger on a monthly basis. Selected reconciliations are re-performed by the financial accountant, before payment is made. All reconciliations re-performed are signed by the financial accountant.
  10. Receiving clerks are required to count goods received and must sign all GRNs they make out.
- Two of the components of internal control (in terms of ISA 315 (Revised)) are **control environment** and **control activities**. Five possible control activities are listed below (i) to (v):
- (i) segregation of duties
  - (ii) isolation of responsibilities
  - (iii) access/custody controls (physical controls)
  - (iv) authorisation and approval
  - (v) comparison and reconciliation

**YOU ARE REQUIRED TO** indicate for each of the above procedures/conditions (1 to 10) whether it relates to control environment or control activities. Where your answer is control activities indicate into which category (or categories) of activity it falls (i) to (v).

**4.20 (12 marks 25 minutes)**

In terms of ISA 315 (Revised), an important component of a company's internal control is its risk assessment process. This may be a highly structured documented process as might be found in a large listed company or a less formal process as might be found in a small to medium sized private company. Either way, a risk assessment process is of little value if the risks identified are not addressed. Many of the risks faced by a wide variety of companies are very similar and are addressed by the introduction of basic internal control activities. Business risks are assessed not only as regards the business as a whole e.g. the risk of foreign competition, but also at operational level within the various business cycles.

Britelites (Pty) Ltd, a medium sized retailer of decorations and light fittings has implemented the following control activities (amongst others) to address risks which they face in the various business cycles.

1. The purchase application software will not produce a purchase order unless the order is made out to a supplier listed on the approved supplier masterfile. (3)
2. To gain access to the warehouse, warehouse employees must place their thumb on a biometric reader. If the thumbprint is authorized, the turnstile is activated. (2)



**8.1** (22 marks 26 minutes)

The following documents are used in the revenue and receipts cycle of Backwoods (Pty) Ltd a wholesaler of camping equipment.

- |                   |                                |
|-------------------|--------------------------------|
| 1. delivery note  | 6. sales invoice               |
| 2. receipt        | 7. internal sales order        |
| 3. picking slip   | 8. deposit slip                |
| 4. customer order | 9. statement                   |
| 5. credit note    | 10. customer remittance advice |

**YOU ARE REQUIRED TO:**

- place the documents in the order in which they are most likely to occur. (5)
- explain the purpose of each of the documents listed. (12)
- give three reasons why Backwoods (Pty) Ltd numerically sequence their documents. (3)
- comment on whether the document numbers on the customer's documents used in the system are useful to Backwoods (Pty) Ltd. (2)

**8.2** (15 marks 18 minutes)

Greenbox (Pty) Ltd is a large wholesaler of garden equipment. The company's revenue and receipts cycle is well staffed and is divided into clearly defined functions, namely receiving of orders, warehousing (picking), dispatch, invoicing, recording of sales, mailroom and receipting/cashier. It also has a "goods returned" function which handles the return of goods by customers and a credit management section. The following control procedures take place in the day to day running of the company. (Note: these procedures are in random order.)

- Jonny Greenfingers follows up on trade references supplied by prospective customers seeking credit.
- Carl Camelon, checks the detail on all internal sales orders prepared by the six order clerks.
- Walter Weed, one of the warehouse clerks, makes out a back order note for an item which is ordered but is not "in stock".
- The gate controller counts the number of boxes on the company's delivery truck and agrees it to the delivery notes held by the driver.
- Themba Treetops compares the goods to be delivered, to the picking slip and delivery note as they are packed into boxes for delivery.
- Harriet Hedge phones all debtors who have exceeded their credit terms every 48 hours to establish when Greenbox (Pty) Ltd can expect payment.

7. When customers collect goods they have ordered, they sign a delivery note and retain a copy.

8. Benji Berry checks the sequence of the invoices entered in the sales journal to identify missing invoices.

9. Gustav Glass compares prices on the invoice to the official pricelist and reperforms the VAT calculation.

10. Petrus Prunus regularly reviews bank deposits from customers made by EFT.

11. Lolly Lupin makes out credit notes for defective goods which are sold and returned by customers. Before doing so she obtains the authority of Petrus Prunus to issue the credit note.

12. Daisy Dumisa goes through the "back orders" file on a weekly basis to ascertain the status of the backorder.

13. Petrus Prunus reviews the general journal frequently and follows up on any journal entries pertaining to debtors, such as bad debts written off.

14. Internal sales orders sent to the accounting department are filed in numerical sequence.

15. Themba Treetops goes through the days picking slips at the end of each day to confirm that they have all been acted upon.

**YOU ARE REQUIRED** to indicate the function under which each of the control procedures (1 – 15) is most likely to occur at Greenbox (Pty) Ltd.

8.3 (10 marks 12 minutes)

Intersales (Pty) Ltd is a large company which wholesales a range of household products to its customers in South Africa, Namibia, Zambia and Zimbabwe. It does not sell to the general public. The company has very good internal control which addresses and is based upon the generally accepted components of internal control, i.e.

- the control environment
- the risk assessment process
- the information system, relevant to financial reporting
- control activities
- monitoring of controls.

Each of the following pieces of information relates to the **revenue and receipts cycle**.

1. All incoming sales orders are directed to the telesales order clerks. A queuing system will direct the call to the next available clerk.

2. All journal entries for the write off of a debtor, are authorised by the credit controller and the senior financial accountant.

3. On the 25<sup>th</sup> of the month a statement is produced for each of the company's debtors and emailed to them.

4. The company has an effective defined programme for developing and promoting employees.

5. The credit controller, sales director and operations director meet once a month to discuss issues or problems which may have developed with the company's products, markets or customers, and how they should be addressed.

6. When pickers in the warehouse have picked all the goods on a picking slip, they sign the picking slip.

7. The company engages the services of Inside Africa Inc to provide a six monthly report on the political, economic and consumer trends in the countries in which they do business.

8. Over the years the company has developed a reputation for ethical and honest business practice. Any employee who doesn't comply with the company's ethical code is dismissed.

9. All debtors are required to pay their accounts by electronic funds transfer (cash or cheque payments are not accepted).

10. The financial director receives a month to month report on various ratios and statistics including debtors days outstanding, debtors who have gone bad, number of customer complaints, etc.

**YOU ARE REQUIRED** to identify the component of internal control to which each of the above relates.

8.4 (10 marks 12 minutes)

You are on the audit team of Spaceman (Pty) Ltd, a company which manufactures cupboards, storage boxes, metal baskets etc. The company's accounting systems are all computerised and located on a local area network. The following policies, procedures and practices are in place at the company:

1. Once Chester Kolbe, the credit controller, has investigated a potential client's creditworthiness, he signs the relevant credit application before taking it to the financial accountant for final authorisation.

2. Employees who work in the revenue and receipts cycle are sent regularly on training courses relating to their functions within the cycle, e.g. when software is updated.

3. When a debtor exceeds his/its payments terms the system automatically puts a "hold" on the debtors account which prevents the debtor from making any further purchases.

supervising counts of the company's cash floats. The head of internal audit believes that carrying out these counts enhances the control environment.

The main petty cash float is maintained by the chief cashier. There are, however, three other floats in operation. One is held by the secretary in the buying department, and is used to make small cash purchases. The second is kept by the raw materials storeman and is used for giving change when selling scrap materials, e.g. off cuts. Scrap is only sold to employees and only cash is accepted, no cheques, credit cards or EFTs are accepted for scrap sales. The third float is under the control of the sales director's secretary, and is used to refund occasional entertainment and travelling expenses incurred by the company's sales representatives from time to time. The approximate total amount of cash on hand at any one time is eight thousand rand, and the largest amount of cash (float and sales) is held by the raw material storeman.

All of the cash floats are maintained on an imprest basis.

**YOU ARE REQUIRED** to outline the steps to be taken/procedures to be followed by members of the internal audit staff when conducting cash counts at Big Boy Manufacturing Ltd.

- state whether you agree or disagree with the opinion of the head of internal audit that the cash counts enhance the control environment. Justify your answer. (3)
- explain the imprest method of maintaining cash floats. (4)
- comment on whether the counts should be conducted on a surprise basis. (2)
- describe two precautionary measures which should be taken by an internal auditor when conducting cash counts at Big Boy Manufacturing Ltd. (3)
- describe the controls which should be in place to ensure that all the cash sales of scrap raw materials is accounted for. (13)

#### **PART B (18 marks 22 minutes)**

You are in charge of the audit of "cash and bank" at Beachbreak (Pty) Ltd for the financial year-end February 2018. During the interim audit conducted during late December 2017, you had audited the bank reconciliation at 31 November and found it to be correct. All payments to trade creditors and all other payments over R20 000 made by Beachbreak (Pty) Ltd are carried out by electronic funds transfer. Amounts of R20 000 or less are paid by cheque. During March, as part of your normal year-end procedures, you are preparing to audit the bank reconciliation prepared by Otis Redding and presented below.

#### **Bank reconciliation at 28 February 2018 – Beachbreak (Pty) Ltd**

Balance as per cashbook R127 261.30

Add: outstanding cheques

49378	3 October 2017	4 446.35
52133	10 December 2017	15 210.65
52876	18 February 2018	9 316.00
53192	22 February 2018	943.89
53193	22 February 2018	47 209.11
		<u>77 126.00</u>

204 387.30	
Add: direct EFT deposit: Note 1	18 649.30
	<u>223 036.60</u>
Less: bank charges and fees for February 2018	163.00
Balance as per Bank Statement 28 February 2018	<u>222 873.60</u>

Note 1: This represents an electronic funds transfer credited in error by the bank, to Beachbreak (Pty) Ltd's account on the 17 February 2018.

**YOU ARE REQUIRED** to describe the audit procedures you would conduct on the bank reconciliation of Beachbreak (Pty) Ltd at 28 February 2018.

#### **8.9 (33 marks 40 minutes)**

You have been approached by John Stone, the owner of Stonebrix (Pty) Ltd, to advise on the design of an internal control system for revenue and receipts. Stonebrix (Pty) Ltd is a newly formed company which will sell bricks to building contractors. Sales will only be made to account holders on credit. John Stone has instructed you to design a manual system as he has not yet decided on whether to implement a fully integrated computer system or to outsource the accounting function. He has also requested that you make use of the personnel who are already employed by Stonebrix (Pty) Ltd, i.e. he does not wish to employ any more staff. He is quite prepared to have whatever documentation is necessary printed, and to incur any other reasonable expenditure for an efficient system to be put in place.

You have held discussions with John Stone about how the business operates and have noted the following:

- Stonebrix (Pty) Ltd purchases its bricks from the manufacturer and stores them on its property in a large brickyard. The company sells only popular types of bricks and thus holds only fifteen different types in its brickyard. Each of the types of brick is stored in its own section of the brickyard in symmetrical piles. Bricks are stacked on wooden pallets in piles of 500 and wrapped in industrial transparent plastic. This makes the counting of bricks on hand quick and simple. Bricks are counted every afternoon after the last delivery and the quantity entered on a preprinted "daily stock report" by Bridge Zuma.
- Building contractors either send a member of their staff (e.g. foreman or driver) to place an order or they phone or fax the order through. Orders are seldom sent through the post.
- Stonebrix (Pty) Ltd delivers the bricks to its customers. A delivery charge is built into the cost of the bricks regardless of the delivery destination. Due to the difficulty of transporting bricks, customers do not collect their orders.
- The staff of Stonebrix (Pty) Ltd consists of
  - John Stone – general manager (and owner)
  - Shannon Green – employed as the financial and administration manager
  - Preggs Naidoo – who has some credit management and general accounting skills
  - Bridge Zuma – the brickyard controller/administrator



- \* Marcia Oliver – general administration
- \* Petra Peterson – qualified bookkeeper
- \* Carmen Twitty – reception and secretarial

In addition the gate at the entry/exit point for the premises is manned by a security guard and there are two labourers who assist with loading etc in the brickyard. The company also employs three truck drivers.

**YOU ARE REQUIRED TO** describe the control procedures/activities which you consider should be implemented for the revenue and receipts cycle of Stonebrix (Pty) Ltd. Your recommendations should be set out under the following headings and should indicate the staff member who should carry out the procedures/activities you recommend.

1. Receiving customer orders. (10)
2. Sales authorization. (8)
3. Brickyard and dispatch. (7)
4. Invoicing. (8)

Note: You are **not** required to deal with functions other than 1 – 4 above, or with the control environment, risk assessment and monitoring components of the internal control process.

**8.10** (33 marks 39 minutes)

Ultratool (Pty) Ltd is a wholesaler of power tools, e.g. drills, compressors, etc. Your firm has been engaged to evaluate the company's internal control systems and you have been assigned to the revenue and receipts cycle. At a meeting with Ben Dekker the financial accountant, you noted the following:

1. All the company's systems are resident on a local area network. The company has a small IT department which is responsible for maintaining the network, improving systems and making programme changes etc.
2. The company sells only on credit to account holders.
3. Only hardcopy orders from customers are accepted; phone orders are not accepted. Customers do phone in to enquire about prices etc but are asked to post, fax or email their orders.
4. Xavier Frans, the order clerk is responsible for initiating the processing of orders. He accesses the "orders" module of the revenue application software and keys in the details of the order (taken from the customer order) to produce an internal sales order (ISO).
5. A two-part ISO is printed out. The top copy is sent to the warehouse administration clerk and the second copy is kept by Xavier Frans.
6. The warehouse administration clerk accesses the "create picking slip" module from his terminal and keys in all the information from the ISO.

Once he has keyed in the information he prints a two-part picking slip, the top copy is placed in a tray outside the warehouse office. The warehouse pickers remove the picking slips from the tray and select the goods ordered, initialing the picking slip against each item ordered as it is picked.

Ben Dekker is of the opinion that the application software is poorly designed and does not make satisfactory use of programmed controls. He informs you that the company is experiencing a number of problems in the cycle including:

- \* unauthorised changes being made to debtors credit limits on the debtors masterfile,
- \* inaccurate and incomplete internal sales orders and picking slips being created,
- \* customer orders which are not processed because an internal sales order is never created.

Ben Dekker has indicated that the company is quite prepared to make whatever changes to the software which are necessary to significantly reduce the problems in the cycle.

**YOU ARE REQUIRED TO:**

- a) Advise Ben Dekker on the internal controls which should be put in place to ensure that unauthorised amendments to the debtors masterfile cannot be made. (8)
- b) describe the control procedures (including program controls) which could be put in place at Ultratool (Pty) Ltd to reduce the creation of inaccurate and incomplete internal sales orders and picking slips. (10)
- c) describe the control procedures which should be put in place to ensure that an internal sales order is generated for all orders received from customers. (5)
- d) outline the programme change controls which should be complied with should Ultratool (Pty) Ltd decide to make changes to the revenue and receipts application software. (10)

**8.11** (35 marks 42 minutes)

You are the senior on the audit of Smartpart (Pty) Ltd, a company which wholesales a large range of motor vehicle accessories to garages, panel beating businesses and specialist accessory shops. The company sells only on credit to account holders.

Smartpart (Pty) Ltd has expanded quickly over the past few years and the accounting system and related internal controls are proving to be inadequate. You have therefore requested various members of the audit team to document the company's systems to enable you to evaluate them. One of your best trainees, Anton Goosen, has presented you with the following narrative pertaining to **certain functions** in the revenue and receipts cycle.

**Order receiving/sales authorisation**

No aspect of the order receiving function is computerized. Orders are received by phone, or mail. Customers sometimes place an order by phone and within two or three days send a written order to confirm the phone order. When a customer phones, the call is put through to

both copies of the invoice "FILLED" and hands one copy of the invoice to the customer with the goods. The customer then loads the goods onto his vehicle and leaves Tapp Tapp (Pty) Ltd's premises. The remaining copy of the invoice is filed in the despatch department.

6. If a contractor does not have an account, the salesman will select the "open new account" module of the accounts receivable software and, following the screen prompts, will enter the contractor's name, trading name, registration number (if applicable), address and bankers. The salesman will request the contractor's identity document and enter the identity number into the computer. Once this has been completed, the contractor is automatically allocated an account number and added to the debtor's masterfile. He can then make whatever purchases he requires.

#### YOU ARE REQUIRED TO:

- a) explain the internal control objectives of validity, accuracy and completeness in the context of sales in the revenue and receipts cycle. (3)
- b) explain the following assertions pertaining to the accounts receivable balance in the year-end financial statements of Tapp Tapp (Pty) Ltd: existence, accuracy, valuation and allocation, completeness and classification. (5)
- c) identify the two assertions pertaining to the audit of accounts receivable which, under normal circumstances, are likely to attract a greater risk of material misstatement. Give brief reasons. (4)
- d) identify and explain the weaknesses in internal control in the aspects of Tapp Tapp (Pty) Ltd's revenue and receipts cycle which are described in points 1 – 6 above. Do not concern yourself with backorders. (24)

8.13

(30 marks 36 minutes)

Quik Tyre (Pty) Ltd sells tyres to garages and fitment centres on credit. They accept phone orders only, as their main marketing strategy is quick delivery. Garth Galian, the financial accountant, has approached you for advice regarding the company's credit sales system (which was developed in-house some years ago), as a number of problems have been experienced lately in the "receiving of orders" section. This has resulted in customer dissatisfaction, excessive bad debts and numerous problems with invoices and delivery notes which are either incomplete or incorrect with regard to customer details.

Your observation and enquiry of Donny Lopez, the order clerk, revealed the following:

1. When a customer telephones, Donny Lopez asks for the customer's account number and enters it.
2. If the account number is accepted the customer's details then appear on the screen.
3. If any part of the customer's account is more than 60 days in arrear an "in arrear" field appears on the screen indicating the amount which is in arrears.

4. Whenever this "in arrear" field appears, a programme control prevents Donny Lopez from proceeding with taking the order. Occasionally a customer's account will be in arrear because a credit note has not been passed by Quik Tyre (Pty) Ltd. In these situations Donny Lopez will override the in arrears, take the order and later process a credit note.

5. On discussion with the customer about the amount in arrears, Donny Lopez may decide to override the "in arrear" control, depending on the information provided by the customer.
6. Every time the "in arrear" field is overridden the amendment (override), together with a brief reason for the override (which is keyed in by Donny Lopez) is logged by the computer.

Note: if a customer order is not to be accepted, Donny Lopez does not proceed with the order but refers the customer to Gene Kelly, the credit controller.

7. Should Donny Lopez or Gene Kelly wish to follow up on the log of overrides of the "in arrear" control, they may do so as they both have read/write access. No other accounting personnel have access to this file.
8. Once Donny Lopez has entered a valid customer account number (see 1 above) and if necessary, resolved any problems relating to amounts in arrear he can proceed with the order.
9. Using Quik Tyre (Pty) Ltd's product catalogue the customer informs Donny Lopez of the tyre code and a description of the tyres required. Donny Lopez keys these in and the telephone conversation is terminated.
10. The order details are written to a "daily order file" and a multi-part, sequenced internal sales order form/ picking slip is printed.
11. If a potential customer (one with no account number) wishes to place an order he is referred to Gene Kelly who emails a credit application form to the customer. This must be completed by the potential customer and emailed back to the customer.
12. Once this is returned, Gene Kelly confirms that the names of two credit references have been given, checks that all information requested on the form has been provided, and if satisfied, signs the credit application form, and prints out a hard copy.
13. The hardcopy is then passed to Donny Lopez who
  - \* accesses the masterfile amendment module of the revenue application,
  - \* adds the new customer to the debtors masterfile, and
  - \* phones the customer informing him of his account number.
14. Additions to the masterfile are written to a log. Logs are sequenced by the computer. Donny prints a copy of the log from time to time and files it away in case there is a query.

Note: the software has suitable programme and screen aid checks to enhance the accuracy and completeness of data keyed in.

**YOU ARE REQUIRED to identify and explain** the weaknesses in the "receiving / authorising of orders" procedures at Quik Tyre (Pty) Ltd as described above.

8.14

(34 marks 40 minutes)

**Dan Dare** the former sales manager of Velocity (Pty) Ltd, has recently been appointed as the credit manager at the company as part of his career development. The company's revenue and receipts cycle is computerised and resident on the company's local area network. Software is well designed and kept up to date. Being familiar with the policies and procedures relating to extending credit to new customers, following up on slow payers, etc., he has fitted into his new role quickly but is concerned about a few of the computer related aspects and has asked you to explain some of these. His first concern is control over the debtors masterfile and he has asked you what controls are in place to prevent an employee at Velocity (Pty) Ltd from invalidly deleting a debtors record of sale, a friend or family member, from the debtors masterfile.

**YOU ARE REQUIRED TO :**

- explain the principle of **defence in depth**. (2)
- explain to Dan Dare how invalid deletions of a debtors record from the debtors masterfile is prevented. (10)

**Dickie Jeeps** the owner/manager of Coolrinkz (Pty) Ltd, wishes to computerise his sales order function. His business, which manufactures and sells a range of soft drinks, has grown considerably and his existing system which is manual is not working effectively. He is finding more and more that sales are being made to his customers when they are over their credit limits, which in turn is negatively affecting his cashflow. He tells you that his customers phone in their orders to the sales order clerk and he wants to keep it this way, but he wants a system which allows him to authorise or reject a sale from a customer who is over his credit limit. He does not want to automatically deny the customer the sale as he feels that this is not good customer relations. Dickie Jeeps also understands that he will need to upgrade/computerise the rest of the revenue and receipts cycle (and integrate it with other cycles), train staff including the debtors clerks and sales order clerk, and is quite prepared to incur the expenditure. However for now he wants to get "sales ordering right as this is where it all starts".

**YOU ARE REQUIRED TO** describe to Dickie Jeeps, a sales ordering system which would meet his needs and ensure that only orders from approved customers are accepted and that they are entered into the system accurately and completely. Your answer should list the controls which should be put in place and you can assume that Dickie Jeeps understands computer terminology. Do not concern yourself with inventory availability. (22)

8.15

(24 marks 29 minutes)

**Jobfixers (Pty) Ltd**, a company which supplies a range of tools, has a fully integrated computerised accounting system resident on its local area network. The following activities/procedures take place at some point in the revenue and receipts cycle :

Sales orders (email, phone or fax) are entered into the system. Ben Bolt the sales order clerk, accesses the sales order module and completes an on-screen sales order. This process is subject to a range of application controls which ultimately result in the order which has been taken, being written to a **pending sales order file** or a **sales order file**. All pending sales orders must be approved by Clarence de Wet the credit controller, before the order can be accepted. Clarence de Wet performs this function on the system (i.e. not manually). Processing of sales orders is in real time.

At various times of the day Foster Grove the warehouse administration clerk, accesses the sales order file from his terminal in the warehouse. He selects the sales order he wants to have picked and prints out a copy of the sales order in the form of a picking slip. When Foster Grove selects a sales order for "picking", the system allocates (attaches) a status code to the sales order (on the system) which indicates that it has been selected for picking and is now at the picking slip stage. (The sales order selected is not transferred to a separate picking slip file). Once the tools have been picked, they are moved to the picking control area of the warehouse with the picking slip. At this point, one of the two picking control clerks, checks the tools picked against the picking slip to identify incorrect tools or incorrect quantities picked. The control clerk is then responsible for correcting and approving the picking slip on the system.

Once the picking control clerk has completed his duties, the tools and the hardcopy picking slip are transferred to the despatch area where Joe Hart the despatch controller, performs a final check of the goods before creating the invoice on the system. (Jobfixers (Pty) Ltd sends a copy of the invoice with the goods). Loyiso Gwala is in charge of the warehouse.

**YOU ARE REQUIRED TO :**

- give two reasons why a sales order might be placed on the pending sales order file. (2)
- explain how approval on the system by Clarence de Wet of pending sales orders, would be successfully carried out. (8)
- indicate what access privilege to the sales order file should be given to each of the individuals listed below. Explain your reason for selecting the access privilege you believe should be given:
  - Foster Grove, the warehouse administration clerk (2)
  - The picking control clerks (4)
  - The pickers (2)
  - Joe Hart, the despatch controller (3)
  - Loyiso Gwala, the warehouse manager (3)

8.16

(45 marks 54 minutes)

**Supplyline (Pty) Ltd** is a company which supplies a wide range of household goods to other companies, CCs and traders in the Eastern Cape region.

The company sells only on credit to approved account holders. The company generally has a satisfactory internal control system but changes in the method by which debtors pay their accounts, means that some changes are required. The major change is that debtors are paying by electronic funds transfer directly into the company's bank account. There are



4. Gordon Marks and Dave Gear, the chief buyer, evaluate the reliability of a supplier and the quality and price of the supplier's goods before the supplier is placed on the "approved supplier" list.
5. Copies of requisitions from the warehouse are filed numerically and cross-referenced to purchase orders.
6. The purchase invoices received from the supplier are matched to the corresponding goods received note, supplier delivery note etc.
7. A goods received note is made out and signed by the receiving clerk.
8. The general ledger account to which the purchase must be allocated in the purchase journal is entered on the purchase order.
9. The passwords of two senior officials are entered to authorise and release the payment of creditors by EFT.
10. Before he approves the schedule of creditors for payment, Ben Moses the accountant, carefully examines the supporting documentation for any changes to creditors banking details.

**YOU ARE REQUIRED TO:**

- a) identify the function in which each of the procedures/activities listed above will take place. (5)
- b) briefly explain the reason for the procedure/activity. (10)

10.3

(12 marks 14 minutes)

Consider each of the following policies/procedures/activities which relate to the acquisitions and payment cycle at Blackcharge (Pty) Ltd, a large industrial equipment supply company. (Note: policies/procedures/activities listed below are in no particular order. Consider each one separately.)

1. Each morning, after careful scrutiny of the inventory requisitions to be sent to the ordering department, the warehouse manager signs each requisition.
2. All Blackcharge (Pty) Ltd employees are required to attend a business ethics workshop annually.
3. Blackcharge (Pty) Ltd places orders with approved suppliers only. Each supplier has a supplier code, and if the ordering clerk does not enter a valid code when creating an order, she cannot proceed with preparing an order.
4. Senior and middle management within the acquisitions and payments cycle meet regularly with the company's risk committee to discuss operational supply risks in its industry.

5. Once the ordering clerk has processed the requisitions from the warehouse, the file of purchase orders must be approved by the senior buying officer. Write access to the approval function is restricted to the senior buyer.
6. Each year a systems analyst from Blackcharge (Pty) Ltd IT department meets with employees in the acquisitions and payments cycle to explore and suggest changes to the application software which could improve the efficiency and effectiveness of the cycle.
7. Any proposed changes arising out of (6) above, must be, inter alia, evaluated by Giles Jacobs the financial accountant, internal audit and the IT manager.
8. When an invoice is received by Blackcharge (Pty) Ltd, it is matched and cross checked to the corresponding order, supplier delivery note and goods received note.
9. Before any employee in the acquisitions and payment cycle can access the computer system, she must identify herself and authenticate herself.
10. When goods ordered are delivered by a supplier, the goods receiving clerk must enter Blackcharge (Pty) Ltd's order number (taken from the supplier's delivery note) onto the system. This will bring details of the order onto the screen in the form of a GRN.
11. To effect an EFT payment to a trade creditor, Silent Mthemba, the senior creditors manager, must authorise the payment file (on the system) and Giles Jacobs, the financial accountant, must release the payment.
12. Once a week a log of all purchase orders which have been outstanding for longer than 10 working days is printed and followed up by the ordering clerk.

**YOU ARE REQUIRED TO** indicate whether each of the above policies / procedures / activities is a general control or an application control.

10.4

(26 marks 32 minutes)

1. Describe the overall objectives of a company with regard to the acquisition of goods and the payment of the goods acquired. (3)
2. Provide two examples of how the misappropriation of company assets might be achieved in the acquisition and payments cycle. (3)
3. Distinguish between a "re-order level" and a "re-order quantity". (3)
4. Knightclubs (Pty) Ltd imports golf equipment. At the financial year end you selected a small number of foreign creditors as part of your accuracy, valuation and allocation testing. Describe the procedures you would carry out to verify that the foreign creditors' balances have been included at appropriate amounts. (4)
5. Omni (Pty) Ltd has a computerized ordering system but does not make use of all the facilities offered by the software. Currently the order clerk creates a batch of purchase orders (based on requisitions from the stores controller) on his computer. He prints out

Andy Hall makes out a preprinted two part (original plus copy) order form for all orders. The original order is either sent by post to the supplier, left with a supplier when Andy Hall visits the supplier or given to the supplier's sales representatives when they call on Footprint (Pty) Ltd, and the copy remains in the order book. Prices for branded shoes are set by the importer, but with other suppliers, prices are negotiated by Andy Hall.

### Receiving

When goods from suppliers are delivered to Footprint (Pty) Ltd, any one of the six warehouse assistants will receive the goods. To receive the goods, the warehouse assistant checks the number of boxes being delivered against the supplier delivery note, signs the delivery note and keeps a copy. Where the boxes delivered do not agree with the supplier delivery note, the difference is recorded on the delivery note and signed by both the warehouse assistant and the supplier's delivery personnel. The boxes are left in the receiving area until the warehouse assistants have time to move them into the warehouse where the goods are unpacked and stored. This usually occurs a day or two later.

**YOU ARE REQUIRED TO** recommend improvements to the ordering and receiving functions of the acquisitions and payments cycle at Footprint (Pty) Ltd, based on the information given above. For each recommendation you make, you are required to provide your reasons/justification for the recommendation. There may be more than one reason/justification for a single recommendation.

Note: Structure your answer under the following headings:

1. Ordering function (25)
2. Receiving function (15)

Although Footprint (Pty) Ltd's accounting records are kept on computer, the company does not wish to "computerize" the ordering or receiving functions. The company is prepared to incur reasonable expenditure arising from your recommendations including the cost of employing an order clerk if you make such a recommendation.

### 10.10 (25 marks 30 minutes)

Delmundo (Pty) Ltd is a small manufacturing company. The company's accounting functions are carried out by the accounting staff consisting of the accountant, Mary Roosevelt, and two clerical assistants, Stella Stirling and Dean Ramjan. The new owner of the business John de Marzo, is concerned about a number of the accounting systems and, not having a business background, has asked you to review and report on certain systems. However, his immediate concern is the control over the payment of creditors. To gather first hand knowledge of how the system currently works, John de Marzo himself compiled an accurate description of the system which he has given to you.

1. When an invoice is received from a supplier it is promptly written into the purchase journal by Stella Stirling and filed alphabetically by supplier name. When the suppliers' monthly statement arrives Stella Stirling agrees the invoices received to the statement. She also checks that any payments that were made to the supplier by Delmundo (Pty) Ltd are reflected on the statement.

2. If an invoice reflected on the statement has not been received, Stella Stirling highlights the invoice(s) and marks it "outstanding" on the statement. The full amount reflected on the statement is paid. When the outstanding invoice is received, it is filed with the statement to which it relates and the "outstanding" written on the statement is crossed out and dated, and the word "received" written next to it.

3. Using the statements Stella Stirling then makes a list of the names of all creditors and the amounts which they are to be paid. No other information or supporting documentation is provided with the list. The list is passed to Mary Roosevelt for payment.

4. To pay creditors, Mary Roosevelt accesses the electronic funds transfer facility on her computer and compiles a schedule of payments to be made by EFT to creditors. She obtains this information from the creditors list prepared by Stella Stirling. She carefully checks the details e.g. bank, branch code, account number of the creditor to be paid against the hard copy file which she keeps for all creditors. If there is a creditor on the list provided by Stella Stirling which is not on Mary Roosevelt's hard copy list, she phones the creditor to obtain the necessary bank details to enable her to make the payment. She updates her hard copy file. She then accesses Delmundo (Pty) Ltd's bank account via her terminal and updates the list of beneficiaries which can be paid by EFT. To add a beneficiary, Mary Roosevelt must enter her unique password.

Once she has completed the EFT payment schedule she asks Stella Stirling to carry out an on screen random check of the details entered before authorising and releasing the transfer. Mary Roosevelt is the only employee to have access to the EFT facility and EFTs can only be made from her terminal. Each payment on the creditors list for which an EFT has been made is cross referenced by date to the EFT schedule by Stella Stirling.

5. Stella Stirling passes the creditors list to Dean Ramjan as he is solely responsible for the cashbook i.e., writing it up, posting to the general ledger and subsidiary ledgers and reconciling it monthly.

**YOU ARE REQUIRED TO** identify the weaknesses in the payments system described above by John de Marzo. For each weakness you identify, explain briefly why you consider it to be a weakness.

**You are not required to make recommendations.**

### 10.11 (25 marks 30 minutes)

The acquisition and payments cycle provides plenty of opportunity for employees and management to misappropriate company assets. In addition to controlling the acquisition of goods, the cycle is designed to control the outflow of funds from the business, so any major breaches of control can have serious consequences. The following information relates to Shine (Pty) Ltd, a wholesaler of light fittings and other electrical equipment.

1. The two buying officers negotiate prices with suppliers and place orders. They also follow up on orders to ensure they are received.

and the person delivering the goods will sign both the copies of the delivery note to acknowledge the changes.

The boxes are placed in a secure area until the warehouse packers have time to move them into the warehouse, unpack them and place the toys on their respective shelves in the warehouse.

At 3pm each working day, one of the receiving clerks (they rotate this function on a weekly basis) accesses the "create goods received note" module. The screen comes up formatted as a goods received note which the receiving clerk then completes taking the information from the supplier delivery notes. Once the goods received notes have been completed, the quantities on the inventory masterfile are automatically updated and the date in the "pending order field" is deleted to convey that the order has been received. The receiving clerk prints out one copy of the goods received note which is attached to the supplier delivery note and is filed sequentially and retained in the receiving department. (The goods received notes remain on the system to be accessed and printed out by the creditors/accounting department where they are matched to the supplier invoice when it arrives.)

**YOU ARE REQUIRED TO identify and explain** the weaknesses in the internal controls over those functions of the acquisitions cycle at Toy-Toy (Pty) Ltd described above.

**10.13 (40 marks 48 minutes)**

You are a member of the team engaged on the audit of 2<sup>nd</sup> Part (Pty) Ltd which sells second hand motor spares and accessories. The company purchases its inventory from two sources, namely, scrap yards and manufacturers of car spares and accessories, who sell their production overruns and slightly damaged inventory items to 2<sup>nd</sup> Part (Pty) Ltd. You have been assigned to the year-end audit of the acquisitions and payments cycle and have ascertained, inter alia, the following information.

1. One of the major business risks faced by 2<sup>nd</sup> Part (Pty) Ltd is that the company may purchase parts and accessories which have been stolen from manufacturers, or which come from stolen or hijacked vehicles. To counter this, the company carries out a comprehensive investigation into their suppliers before conducting business with them. The company's accounting systems are fully computerised (they are run on a local area network (LAN) which links all departments/sections) and once a supplier has been approved, it is entered on the "approved supplier masterfile". The financial controller, Bernard Bunz, has emphasised the importance of dealing only with approved suppliers, and maintaining detailed supporting documentation for all purchases, due to the widespread dishonesty and criminal activity in the trade.

2. No inventory is purchased without an official printed order. Order forms are computer generated and cannot be created for a supplier not on the approved supplier masterfile. Orders are initiated on the strength of a signed requisition sent to the buying department by the warehouse manager.

Note: Suppliers, both scrap yards and manufacturers, regularly contact the warehouse manager to notify him of availability of second hand parts, overruns or damaged items. If the warehouse manager considers the item should be ordered, he negotiates the price (which he then enters, with other details, on the requisition. Controls over the ordering function, both manual and computerised, are sound.

3. All deliveries from suppliers are routed to a physically secure Deliveries Bay for the unloading and receiving of goods. The three receiving clerks make use of a single terminal in the bay which is linked to the LAN. As goods delivered are mostly second hand or slightly damaged, receiving clerks do not perform quality checks on deliveries. All deliveries are sent with a computer generated copy of the goods received note, to the "Quality Check and Reconditioning" section where all items purchased are put into saleable condition, e.g. cleaned, rubber seals etc replaced, tested and repackaged. From this section they are moved into the warehouse, where they are stored by part number, description etc. (Any items which are "damaged beyond repair" are returned to the supplier.)

4. Hard copy of all documentation is sent to, or printed out in, the accounting department where it is matched and filed temporarily to await the supplier's invoice. The necessary checks are carried out before the purchase journal is written up. The supporting documentation is then filed alphabetically by supplier.

At an interim audit conducted earlier in the year, you had extracted a sample of purchase transactions for detailed testing. Although these tests had proved satisfactory, you decided to extract a small sample of purchase transactions from the purchase journal for the month of April (financial year-end 30 April) on which to perform detailed procedures. One of the purchase transactions selected, and for which you obtained the supporting documentation, was:

Creditor : Crash 'n Smash (Pty) Ltd

Amount : R97 620.14

**YOU ARE REQUIRED TO:**

- discuss your audit firm's responsibilities in respect of the prevention and detection of fraudulent acts by 2<sup>nd</sup> Part (Pty) Ltd, (e.g. the purchase and sale of stolen goods). (5)
- explain why there is increased risk of unauthorised access to data and programmes in a networked environment (e.g. 2<sup>nd</sup> Part (Pty) Ltd's local area network). (3)
- state the controls which should be in place at 2<sup>nd</sup> Part (Pty) Ltd to ensure that additions to the "approved supplier masterfile" are valid, accurate and complete. (Do not concern yourself with controls or procedures to approve suppliers.) (10)
- discuss the manual and programmed (automated) application controls which you would expect to be in place for the receiving of deliveries from suppliers. (12)
- describe the substantive procedures you would carry out on the supporting documentation for the April purchase transaction with Crash 'n Smash (Pty) Ltd of R97 620.14 to obtain evidence in respect of the **occurrence, accuracy and cut-off** assertions relating to this purchase. (10)



## CHAPTER 11

## INVENTORY AND PRODUCTION CYCLE

### 11.1 (15 marks 18 minutes)

Toycos (Pty) Ltd manufactures unique toys in small batches and makes use of the following documentation:

- |                             |                                   |
|-----------------------------|-----------------------------------|
| * purchase order            | * supplier delivery note          |
| * picking slip              | * customer remittance advice      |
| * inventory adjustment form | * transfer to finished goods note |
| * sales invoice             | * clock cards                     |
| * production report         | * job cards                       |

All components used in the manufacturing process are received from suppliers at the central receiving bay and subsequently transferred to the components warehouse. Toys which have been manufactured are transferred from production to the finished goods warehouse. The company uses a "job cost" costing basis for accumulating costs and maintains computerized perpetual inventory records.

#### YOU ARE REQUIRED TO:

- identify from the list above, those documents which Toycos (Pty) Ltd would use in their **inventory and production cycle**, and briefly describe what each document is used for. (6)
- explain why a job costing system would be suitable for Toycos (Pty) Ltd. (2)
- indicate the cycle to which each of the documents you have not identified in (a) above, relates. (4)
- state the three broad objectives that a well designed, properly implemented internal control process for the inventory and production cycle will achieve. (3)

### 11.2 (24 marks 29 minutes)

**YOU ARE REQUIRED TO** consider each of the following statements independently and indicate whether it is **true** or **false** and to provide a brief justification for your answer.

- For many wholesale companies the fair presentation of the annual financial statements will be threatened if the company does not implement a strong accounting system and related control activities applicable to its inventory. (3)
- Because a company's inventory and production cycle has no **direct** interface with entities outside the company, the traditional components of internal control, e.g. control environment, the risk assessment process etc do not apply to the cycle. (6)
- When the directors wish to manipulate the financial statements to present a more favourable picture of the company's performance, an effective way to do so would be to manipulate the inventory balance at reporting date. (2)

**11.7** (32 marks 38 minutes)

You are the newly appointed financial manager of The Shoebox (Pty) Ltd, which operates a chain of 20 large retail shoe stores in and around Port Elizabeth, selling on a cash only basis. The stores are controlled from a central head office and all inventory is issued to the stores from a central warehouse. All inventory deliveries to stores are made by The Shoebox (Pty) Ltd's own delivery vans.

An analysis of the most recent branch accounts revealed that the average gross profit margin for the 20 stores was 51% but that five stores reported margins below 20%.

You approached the managers of the stores in question and the company internal auditor and they all ascribed the poor margins to weak internal control systems which enables theft in particular, to go undetected. Their explanation for this, with which you agreed, is that the internal control system has not kept up with the rapid growth of the company. You therefore decided to design internal controls to improve the control over branch inventories.

For a number of reasons, it is not feasible to computerise branch activities, although all processing at head office is computerised.

The stores are staffed by a branch manager, a cashier and between 2 and 5 sales assistants (depending on the size of the store). The company does not wish to change this. All the branches' inventory is kept either on display or in storerooms at the back of the shop. All inventory items are coded. A cash sales invoice, which indicates the item code and description, is made out for each pair of shoes sold. No inventory records are kept at the branches.

Due to the nature of the stores clientele, the company introduced a "down payment scheme". This enables a customer to purchase shoes over six months by making payments when they are able to. The selected shoes are put aside and only once the six payments have been made are the shoes handed over to the customer. Internal controls over this scheme are particularly poor.

**YOU ARE REQUIRED TO** design an internal control system for the control of inventory under the following headings:

1. Despatch from central warehouse to stores (12)
2. Receiving of goods by stores (5)
3. Physical control over inventory at stores (10)
4. The "down payment scheme". (5)

Detailed computer applications should not be considered.

**11.8** (35 marks 42 minutes)

You are on the audit of EagleEye (Pty) Ltd a company which manufactures security devices, e.g. burglar alarm units, surveillance cameras, etc.

Some months prior to the audit, the company appointed Simon Brown as the internal auditor of the company. He reports to Krishen Vather the financial manager. Prior to his

appointment as internal auditor, Simon Brown had been an administration clerk in the creditors section. However, due to a restructuring of the creditors section, his position had become redundant, and his options were either to leave the company or accept the newly created post of internal auditor. Although he has no formal training in auditing, Simon Brown is regarded as a competent and enthusiastic staff member who could develop into a satisfactory internal auditor.

It has also been decided that, as internal auditor, he could be used effectively if staff members in the accounting department are absent, on annual or sick leave, to carry out their responsibilities.

You had considered the possibility of relying on some of the work which Simon Brown had carried out relating to the inventory and production cycle and using him to assist with certain aspects of the year-end inventory audit, but decided at this stage it was not appropriate to do so.

In addition to your audit responsibilities, Krishen Vather has requested that you evaluate certain aspects of the production cycle and make recommendations for improvement where necessary. He believes that improvements are required and that the Board would be receptive to reasonable recommendations. He has provided you with the following narrative description:

**Systems description - production**

1. The company manufactures a standard range of products, each of which has its own product code.
2. Manufacture is carried out by ten technicians who each have their own workstation in the factory. The workstation consists of a bench and all the necessary equipment the technician requires to build and test the products.
3. The factory foreman, Frans Flinthoff, is in charge of the factory and reports to the production manager.
4. The sales department notifies the production manager of demands for the company's products on a weekly basis. (This procedure works well).
5. A large "production blackboard" is positioned at the entrance to the factory. This blackboard displays each workstation number and the name of the technician assigned to that workstation. Below these headings are columns to enter the date, product code and quantity of the product to be manufactured.
6. Each Monday morning the production manager assigns work to the technicians by updating the date, product code and quantity columns on the blackboard.
7. All of the technicians are trained to manufacture all of the company's products and have an assembly manual to which they can refer if necessary.
8. Components for manufacture are kept in a warehouse adjoining the factory. As technicians generally know what components are needed to manufacture each product (they can also refer to the assembly manual), they will personally select the components from the warehouse shelves as they require them.

9. Once the technician has constructed and thoroughly tested a batch of items, he loads them onto a trolley and takes them to the finished goods warehouse.

10. On arrival at the finished goods store he unloads the items in the receiving area and returns to his workstation.

11. Before the end of each working day a warehouse clerk who is responsible for keeping the components warehouse and finished goods warehouse clean and tidy, takes the items manufactured from the receiving area and places them on the allocated shelves in the warehouse. No perpetual inventory records are maintained.

**YOU ARE REQUIRED TO:**

- fully justify your decision not to rely on the work of Simon Brown, the internal auditor, on the audit of EagleEye (Pty) Ltd. (15)
- identify the weaknesses in those aspects of the production cycle described above, and for each weakness make suitable recommendations for improvement. (Do not concern yourself with the costing of manufactured items). (20)

**11.9** (22 marks 26 minutes)

You are the auditor in charge of the audit of Screens (Pty) Ltd, a company which rents out television sets. At the financial year-end 30 April 2018, the company's records revealed inventory of 14 000 television sets on hand, valued on average at R2 500 each, of which 12 321 were out on rental. Rental payments are received monthly and are identified in the cash book, and debtors ledger by name and the rental agreement number.

The trainee on the job, Elvis Adams, decided that he should perform tests on the existence assertion relating to television sets owned by Screens (Pty) Ltd. To achieve this he selected 12 (twelve) clients from the list of rental agreements on a random basis and drafted a confirmation letter to each of them requesting that they **positively confirm** the existence of the TV set they had rented. The results were as follows:

- 10 of the 12 confirmation letters were returned.
- Of the 10 returned 9 confirmed that the television set did exist.
- The tenth confirmation letter stated that the television set had been returned.

The workpaper presented by Elvis Adams revealed that his response had been as follows:

- for the two confirmations not returned, he had sent a second letter but had not received any reply. Follow up by fax and phone had also not provided any response.
- for the letter which revealed that the television set had been returned, he checked the rental agreement and established that it had expired.

The workpaper also revealed the following conclusion:  
"I am satisfied with the existence assertion for television sets owned by Screens (Pty) Ltd. Of the 12 positive confirmations sent out, in effect ten of the twelve confirmed the existence of the television set. This equates to an 83% positive response which is excellent for a circularisation. No further tests are necessary."

**YOU ARE REQUIRED TO:**

- explain fully why you would not be satisfied with the work performed by Elvis Adams. (12)
- indicate and explain what further tests should be carried out in respect of the existence assertion relating to the television sets assuming that time does not allow for a full statistically based positive circularisation to be carried out and that you regard the risk surrounding the existence assertion to be high. (10)

**11.10** (35 marks 41 minutes)

You are the manager on the audit of Firezone Ltd. The company is a wholesaler of numerous products related to domestic and industrial heating, fire extinguishers and other fire fighting chemicals and equipment. The company's year-end is 31 July. The senior on the audit was taken ill shortly before the financial year-end and you had no choice but to put a far less experienced trainee Ted Mitton, in charge of the audit.

Pertinent information about the company's inventory is as follows:

- Inventory is kept in a single warehouse in Durban.
- The warehouse is divided into six sections according to the type of goods stored e.g. domestic heaters, chemicals etc, and is neatly stacked.
- The majority of items are packaged in sealed boxes or cartons.
- Some of the chemicals have a limited shelf life. Where this is the case, the expiry date is stamped on the container.
- Firezone Ltd holds inventory on consignment from Bushblaze Inc, an Australian firefighting company.

You asked Ted Mitton to submit a report to you on his attendance at the year-end inventory count. The report contained the following information.

- The inventory count took place over two afternoons, from 1pm to 5pm on 30 and 31 July. This was to enable the company to receive and dispatch goods during the morning.
- The count was carried out by the six warehouse employees who usually pick the goods to fill orders. This worked well because they are familiar with the nature of the inventory and where everything is stored.
- The pickers decided amongst themselves which section of the warehouse to count. Maggie Motolo, the warehouse administration clerk, printed a list off the computerised perpetual inventory system (inventory sheet) of each item (description and quantity) in the section chosen by the picker. The numerically sequenced inventory sheets were



- (b) for each criticism you have raised in (a) above, state what should have been done by Don King and Henry Cooper (and his trainee) respectively. (24)

**11.12 (35 marks 42 minutes)**

You are the senior in charge of the audit of inventory at Flower Power (Pty) Ltd, a company which sells a wide range of gardening equipment e.g. spades, wheelbarrows, electric hedge cutters etc, to nurseries, garden shops and hypermarkets. The company's premises consist of a single, large warehouse/head office situated in Johannesburg.

The company's inventory records are computerised and a perpetual inventory is maintained.

Responsibility for inventory rests with Ruud van Bekkem, who is the warehouse manager. Sheik Mashaba, the inventory controller, reports to Ruud van Bekkem and is directly responsible for the custody of inventory. The company has, for the first time, appointed an internal auditor. He will join the company on 1 May 2018.

The company conducted a count of all inventory on hand at 31 March, the financial year-end. You and your team had attended. Prior to the count Ruud van Bekkem had informed you that, in his opinion, the theft of inventory by employees from the warehouse had increased. The inventory count proved Ruud van Bekkem's suspicions to be well founded and significant adjustments to the quantities of a number of inventory items in the inventory masterfile (perpetual inventory) had to be made. These adjustments were effected, as with other adjustments made during the year, in compliance with the company's sound controls over masterfile amendments.

After the inventory count, at a meeting held in early April, Ruud van Bekkem sought your advice on how the theft of inventory by employees, could be reduced. You recommended to him that, in addition to the physical controls he intended to install, the company should introduce inventory cycle counts. In your opinion the manner in which Flower Power (Pty) Ltd conducts its year-end inventory counts, e.g. two man teams, double counts etc, would be very suitable for cycle counts. Ruud van Bekkem was enthusiastic and has asked you to draft him a memorandum in which you identify and discuss the key issues in planning cycle counts, how discrepancies between actual quantities and recorded quantities are dealt with, and how cycle counts will reduce the theft of inventory by employees.

**YOU ARE REQUIRED TO:**

- state the effect, if any, which Ruud van Bekkem's suspicion that the theft of inventory had increased, would have had on your assessment of the risk of material misstatement in the inventory balance for the 31 March 2018 audit of inventory. Justify your answer. (3)
- explain the term "direction of testing" in the context of your attendance at Flower Power (Pty) Ltd's inventory count. Indicate in which direction you would have increased, if at all, the extent of your audit procedures. (3)
- identify the application controls which would be in place at Flower Power (Pty) Ltd for amendments to the inventory masterfile to be regarded as sound. (9)

- d) draft a memorandum on cycle counts to Ruud van Bekkem dealing with the matters he raised with you at the post inventory count meeting held in early April. (20)

**11.13 (35 marks 42 minutes)**

You are a member of the computer audit team of Imzy and Taheer, a firm of registered auditors. One of your firm's clients, Marbles (Pty) Ltd, a wholesaler of toys is intending to introduce a computerised accounting system which will result in the buying, warehousing, despatch, sales, payroll and accounting departments being linked on a local area network.

As part of an exercise to educate staff and gain their interest in the project all employees have been asked to communicate any concerns or problems which they might have about the introduction of the system. Generally their staff responded very positively with the exception of Marcus Welby, the warehouse manager. Marcus Welby who has been with Marbles (Pty) Ltd for many years is responsible for the receipt, custody (storage) and despatch of inventory. He has a large staff who report to him including five receiving clerks, six warehousemen and three despatch clerks.

Marcus Welby's submission concerning his problems with the proposed computerisation included the following:

"I am particularly concerned that the introduction of the computer will reduce the control I have over my department.

- I believe in good old fashioned books and paper which I can see and read, everything will now be "on the system". (3)
- With so many terminals about, linked to other departments there is going to be unauthorised access to the inventory records. (12)
- With five receiving clerks operating three terminals in the receiving department I won't be able to pinpoint responsibility. (3)
- Receiving clerks are bound to make numerous errors when using the terminals which will result in incorrect GRNs etc being printed and which will go undetected. (8)
- Amendments to my inventory ledger can now be made without my authority or even without me knowing about it. (4)
- I also fail to see how this computerisation will enhance the effectiveness of our physical inventory control which it is claimed will be the case." (5)

As you are very knowledgeable about the proposed system, you have been asked to discuss Marcus Welby's concerns with him.

**YOU ARE REQUIRED TO** respond to Marcus Welby's concerns explaining to him, inter alia, the controls which would be put in place which would address the concerns he has raised.

10. Reperformed the debenture calculation for interest paid during the year to debenture holders, and traced the amount from the cash book to the interest account in the general ledger.
11. Inspected the Memorandum of Incorporation for any conditions which may have affected the issue of shares carried out by the company during the year.
12. Confirmed by inspection of the dates on the supporting documentation, that the issue took place during the year under audit.
13. Inspected the title deeds for a vacant piece of land in an industrial park purchased during the year by Transit Ltd.
14. When conducting a physical inspection of equipment in the factory, selected a small sample of items and traced their asset numbers back to the fixed asset register.

**YOU ARE REQUIRED TO** identify the assertion(s) to which each of the procedures listed above (1 – 15) relates.

**12.7 (15 marks 18 minutes)**

You are the senior in charge of the audit of Baxters (Pty) Ltd a manufacturing company. The company also rents out its spare storage capacity from time to time. Whilst preparing to audit the finance and investment cycle for the financial year-end 31 March 2018 you asked a junior trainee to explain the assertions relating to the following account headings reflected in the draft financial statements.

Rental Income	R283 200
Liabilities: 10% Debentures	R4 000 000

His response was as follows:

**Rental Income:**

- Material:** Rental Income is large enough to be separately disclosed.
- Rights:** Baxters (Pty) Ltd owns the property which is being rented out and therefore has the right to charge rent.
- Completeness:** All spare capacity which becomes available, is rented out.
- Occurrence:** I don't know what this means but I think it is an assertion.

**10% Debentures**

- Material:** Again because the amount is so large it must be separately disclosed.
- Reperformance:** Interest on the debentures must be calculated at 10%.
- Validity:** The debentures are legal in terms of the company's Memorandum.

**Presentation:** The debentures have been correctly presented in terms of International Auditing Standards.

**YOU ARE REQUIRED TO** discuss your junior trainee's response!

**12.8**

**(40 marks 48 minutes)**

You have recently been appointed as the internal auditor of North Shore (Pty) Ltd, a large shipping company in Port Elizabeth. Your first assignment was to evaluate the company's accounting systems and related internal controls. The company is divided into five sections, each of which has its own section accountant who is responsible for producing monthly accounts and ensuring that sectional financial matters run smoothly. While reviewing the financial records of the warehousing section you were surprised to see that considerable capital expenditure had been incurred just before the financial year-end (30 June). You found that the same occurred in the other four sections of the company and on visiting the various sections (in July), you noticed a fair amount of equipment still in boxes and not in use. Deciding to follow this up, you approached Andy Bell the most senior sectional accountant, for an explanation of how the system for capital expenditure operated. He responded as follows:

1. Each sectional accountant is responsible for capital expenditure for his section.
2. A budget is prepared in the office of the financial director. Budgeting figures are calculated by increasing the prior year's budget by the average consumer price index for the year. Sectional accountants are notified as to what their section can spend on the purchase of capital items.
3. However, if sections do not spend their capital budget in any financial year, that section's budget is reduced for the following year. As you can see, we all try to avoid a cut in our budget by making sure we spend our budget before the end of the financial year.
4. If a staff member in the section requires equipment, for example in my warehouse section the foreman may decide he needs a new fork lift, he will email my assistant with the precise details of what is required as well as the name of a supplier. None of the equipment used by North Shore (Pty) Ltd is particularly complicated, so this method works fine.
5. My assistant will then complete a pre-printed, numerically sequenced, multi-copied order form (which I as sectional accountant will sign) and send the top copy to the supplier. The second copy of the order is sent with the supplier delivery note, to the central creditors department for payment. The third copy is left in the order book and used by the assistant to write up the new equipment in the assets register.
6. The supplier delivers the equipment to the section and my assistant signs the supplier delivery note after agreeing the items to the supplier delivery note. He retains a signed copy of the supplier delivery note which is sent to the creditors department as described in point 5 above.

**YOU ARE REQUIRED TO** identify and describe the weaknesses in the system of investing in capital equipment at North Shore (Pty) Ltd, based on the information given above **and** to recommend improvements to address the weaknesses you have identified.

Do not concern yourself with payments to creditors.

Lay your answer out on a double page as follows:

Weakness	Explanation
1. ....	1. ....
2. ....	2. ....

12.9

(37 marks 45 minutes)

You are a member of the team on the audit of The Office (Pty) Ltd, a company in the Eastern Cape which manufactures office equipment for export. You have been given responsibility for the audit of certain aspects of the finance and investment cycle for the financial year-end 31 July 2018. One of those aspects is the audit of long term loans made by The Office (Pty) Ltd. In August 2017 the company had decided as part of its social responsibility, to make loans available to local enterprises to develop their businesses. In terms of the scheme these enterprises supply The Office (Pty) Ltd with certain of its materials for manufacture. They will also continue to supply other businesses. The company had not made any loans prior to the introduction of the scheme.

Minutes of the Directors' Meeting held in August 2017 revealed the following:

- The maximum loan to any single enterprise would be R250 000.
- Loans would be repayable in full after 5 years.
- Interest of 5% per annum would be payable annually in arrears on the anniversary date (date the loan was made) of the loan.
- The loans would be unsecured.
- No loan may be made to any enterprise in which a director (or his family) of The Office (Pty) Ltd has a financial interest.

Your audit manager has requested you to perform a detailed audit of the new loan scheme. To assist you in your audit Lewis Figo, the financial accountant of The Office (Pty) Ltd presented you with the following schedule.

**Loans made to external entities at 31 July 2018**

Name	Date of Loan	Amount	Accrued interest
KC and Co	1 Sept 2017	R250 000	R11 458
Chairlegs CC	1 Sept 2017	125 000	5 728
Savuka Enterprises*	1 Sept 2017	50 000	-
Sithole & Co	1 Nov 2017	75 000	2 812
Ndungane Glass	1 Nov 2017	150 000	5 626

Eastcape Resins	1 Feb 2018	250 000	6 250
Paruk Paint	1 Feb 2018	50 000	1 250
Bisho Handles	1 Feb 2018	50 000	1 250
Jabula Projects	1 March 2018	250 000	5 208
Oakwoods	1 May 2018	75 000	937
Wuzawork	1 May 2018	250 000	3 125
Team Transport	1 May 2018	150 000	1 875
		1 725 000	45 519
		(50 000)	
		<b>R1 675 000</b>	<b>R45 519</b>

\* This enterprise went insolvent in February 2018. The liquidator notified The Office (Pty) Ltd that nothing would be recovered. Amount was written off in June 2018.

**YOU ARE REQUIRED TO:**

- explain the terms validity (authorization and occurrence), accuracy and completeness in the context of the investment cycle. (4)
- discuss the risk of material misstatement associated with the account heading "Loans made to external entities" as reflected in the financial statements of The Office (Pty) Ltd at 31 July 2018. (5)
- outline the internal control procedures you would expect to find in place at The Office (Pty) Ltd to ensure that all loans made in respect of this scheme are valid. (8)
- describe the substantive audit procedures you would carry out in respect of "Loans made to external entities" and "Accrued interest" at 31 July 2018. Do not concern yourself with related disclosures or the presentation assertion. (20)

**12.10** (23 marks 27 minutes)

Microjoy (Pty) Ltd manufactures household appliances.

Set out below are certain material matters which have been identified on the year-end audit 30 April 2018.

- The company provided a written unlimited guarantee to Oven (Pty) Ltd's bankers for the overdraft facilities of Oven (Pty) Ltd, a company with common shareholders to Microjoy (Pty) Ltd.
- A court action against the company in respect of compensation for loss of office of R2.5 million claimed by a former managing director, is in progress at 30 April 2018. Microjoy (Pty) Ltd's legal advisors are of the opinion that the claim cannot be satisfactorily defended but that the maximum compensation will be R1 million.
- The Board of Directors approved the expenditure of R18 million for new welding stations per the minutes of the board meeting of directors held on 30 April 2018. The technical director is currently at an international trade show attending an exhibition of

**Rights:** employees have the right to be paid in terms of their employment contracts.

**Obligation:** Diggers (Pty) Ltd have a legal obligation to pay wages and in the case of the current financial year that obligation is for R7 321 421.

**Validity:** all amounts included in the total of R7 321 421 are for work actually performed by employees during the year.

**YOU ARE REQUIRED TO** comment on your trainee's understanding of the assertions. Justify your answer.

**9.8 (34 marks 41 minutes)**

1. Deepdiggers Ltd, a mining company, has a large workforce of around 5000 workers, many of whom are migrant workers from rural regions and neighbouring countries. The company has a formal risk assessment process which includes a risk committee which meets twice a year to identify and assess risks faced by the company, and consider whether the risks are being appropriately responded to. The risks relating to human resources are always an item for discussion on the agenda.

**YOU ARE REQUIRED TO** describe briefly five risks which a company such as Deepdiggers Ltd might face relating to its workforce. (5)

2. Magoo (Pty) Ltd has a workforce of approximately one hundred hourly paid employees. Hours worked are recorded using a conventional clockcard and clocking device system, but the preparation of the payroll is computerised and wages are paid by EFT. Wages are paid every two weeks. At the conclusion of the wage period, the factory administration clerk Joel Jantjes, carries out various control procedures on the clockcards for the preceding two weeks, batches them, and takes them himself to Brandon August the wage clerk, for entry into the system.

**YOU ARE REQUIRED TO:**

- a) describe the control procedures which Joel Jantjes should carry out on the clockcards prior to batching them. (3)
- b) describe the batch controls which should be carried out on the clockcards up to the point they are accepted by Brandon August. (8)
3. Glassoon (Pty) Ltd, a manufacturer of glass containers, has recently been awarded a major contract which will require the company to employ approximately thirty new hourly paid factory workers. With recruiting procedures completed, the newly appointed personnel must be added to the employee masterfile. The company's payroll cycle is fully computerised.

**YOU ARE REQUIRED TO** describe the controls which should be carried out to ensure that only validly appointed new employees are added to the employees masterfile and that all details pertaining to the additions, are accurately and completely recorded. (12)

4. Hourly paid employees at Bingo (Pty) Ltd record their hours worked on clockcards. Each employee's hours are then entered onto the system by the wage clerk.

**YOU ARE REQUIRED TO** briefly describe six programme (automated) controls which will contribute to ensuring that hours are only entered by the wage clerk for valid employees, and that hours entered are accurate and complete. (6)

**9.9 (45 marks 54 minutes)**

You are a newly appointed internal auditor at Calpak (Pty) Ltd. The company is a manufacturer of backpacks and bags for sporting equipment. The company employs approximately 120 hourly paid semi-skilled workers, equally spread over the three sections, cutting, stitching and finishing. Each section has a section supervisor who reports to the factory foreman. The wage payroll system is currently completely manual but management now wish to computerize the system. As the first phase of this exercise you have been asked to evaluate the system so that the company will have a better understanding of what weaknesses the computerized system must address. Your initial enquiries have revealed the following:

1. Wages are paid every two weeks. The wage period runs from a Thursday morning to a Wednesday afternoon two weeks later. The work day commences at 7.30am and employees work a daily eight hour shift.
2. On arrival at their section, employees report to their section supervisor who records their presence by ticking the appropriate column on the **daily time sheet**. (See 7 below)
3. Work periods are controlled by a factory siren (hooter). Employees commence work when they hear the siren at 7.30am and end the days shift at 4.30pm, again when the siren sounds. The siren is also used to control tea and lunch breaks.
4. Workers are not required to sign themselves out at the end of the day, but if they continue to work after 4.30pm, they must notify their section supervisor. On reporting for work the following day they must inform their section supervisor of the number of hours overtime they worked the previous afternoon/evening. The section supervisor records this on the daily time sheet against the employee's name.
5. Three administration clerks from the accounting department are responsible for certain payroll functions. An administration clerk is allocated to each of the three sections i.e. cutting, stitching and finishing.
6. Each administration clerk maintains a ledger of all wage earners in the section for which he is responsible. The factory foreman is responsible for hiring and dismissing staff (as well as receiving notices of resignation). When a change must be made to the employee ledger, the foreman sends a completed, pre-printed, sequenced "Employee Engagement / Dismissal / Resignation Form" to the section administration clerk. This contains full details of the employee, e.g. date of engagement/dismissal, grade and pay scale. The clerk updates his ledger, and files the instruction from the foreman.

7. On Wednesday morning the administration clerks prepare the daily time sheets for their section for the following wage period. Daily time sheets are preprinted and sequenced (each section has its own unique sequence). The sheets consist of a column for the names of employees in the section, as well as a column for each day of the working week in which the section supervisor can tick off each employee's (daily) attendance and enter any overtime worked.
8. Before 7am on Thursday morning, the administration clerks take the daily time sheets (for the following wage period) to the supervisor of the section for which they are responsible, and collect the completed wage period's time sheets. The supervisor and the administration clerk sign the completed wage period's time sheets to acknowledge the transfer.
9. The administration clerks then prepare the wage period (see pt 1) payroll for their section. They calculate the normal hours worked (each "tick" represents 8 hours) and the overtime hours for each employee from the daily time sheets. The employees' hourly pay rate is obtained from the employee ledger and overtime is calculated at the rate of one and a half times the normal wage rate. Using the relevant schedules and tables, the administration clerks calculate PAYE, UIF and medical aid deductions and calculate the net wage payable to each employee as well as the total wages (and deductions) payable for their section. The payroll is preprinted, well designed and pages are numerically sequenced in a bound book.
10. Once the payrolls for the three sections have been prepared, they are sent to the factory accountant who re-performs the calculations on the payrolls, makes any corrections, and signs the payrolls to acknowledge his control procedures. He then prepares and signs cheques for the net wages and all deductions to be paid over e.g. PAYE. The cheques are sent to the financial accountant for a second signature and the payrolls are returned to the respective administration clerks. The factory accountant also prepares a coinage schedule.
11. On receipt of the payrolls the administration clerks prepare a pre-printed paycheck for each employee in their section by writing the details of the employee and the period's wages onto the paycheck.
12. On the Friday morning of a wage payout, Calpak (Pty) Ltd's security section takes the cheque and the coinage schedule to the bank. The cash is placed in three numbered bank bags (per the instructions from Calpak (Pty) Ltd), sealed, and delivered to the administration clerks by security. The three administration clerks make up the paypackets for their section according to the payroll.
13. At 3pm on a payout Friday, the administration clerks (accompanied by a security guard) distribute the paypackets from three pay points within the factory. Wage earners must present their staff identity card, and sign the payroll next to their names on receiving their wages. As there are only approximately 40 wage earners per section, the payout is completed without significant delay. (Note: do not concern yourself with unclaimed wages.)
14. During the course of the following week, the administration clerks update the employee ledger with details of each employee's wages and deductions.

# YOU ARE REQUIRED TO:

- a) identify and explain the weaknesses in the payroll cycle of Calpak (Pty) Ltd based on the information given above. Your explanation must convey why you believe that the weaknesses you have identified are weaknesses. (30)
- b) For each weakness, explain in general terms if, and how, a computerized wage system would address the weakness. (15)

## 9.10 (35 marks 42 minutes)

Your firm has recently been appointed as auditor of Folozifet (Pty) Ltd, which is situated in Empangeni. The company manufactures shoes and outdoor footwear. Because all of the company's footwear is handmade, manufacturing is labour intensive.

As part of conducting your risk assessment procedures you are in the process of evaluating the company's systems and have gathered the following information about the company's payroll and personnel cycle:

1. The cycle is computerised and the payroll software which the company uses, is reputable and well supported.
2. Staff involved in the payroll cycle are:  
Olga Olifant – human resource manager (she has two clerical assistants)  
Ben Buffel – the factory wage and administration clerk  
Louis Lyon and Tiger Singh – the wage clerks responsible for payroll preparation  
Ryno White – the wage department supervisor who has overall responsibility for the operation of the wage department.
3. Because of the threat of having cash on the premises, employee's wages are paid directly into their bank accounts every two weeks. Hence no wage payout takes place; all wage earners are provided with a payslip detailing the amounts paid into their bank accounts. These are handed to employees by the factory foreman, Jacques Jakkals, once the payroll has been authorised. On receiving their payslips, employees must sign a payslip distribution sheet to acknowledge having received their payslips.
4. Employee hours worked are recorded on clockcards (which are designed to record employees' work hours for two weeks). Every second Wednesday afternoon after the factory has closed, Ben Buffel collects the clockcards for the just completed wage period and, having carried out sound internal control procedures, delivers the cards to the wage clerks.
5. On Thursday mornings, Tiger Singh prepares the payroll. He accesses the relevant module of the wage application software which is resident on the local area network from his terminal, and keys in the necessary information from the clockcards.
6. As a result of a suitable range of programme controls and careful checking and review by Ryno White and Louis Lyon, a complete, accurate and valid payroll is produced.



7. In addition to the payroll, a reconciliation of the wages from one wage period to the next, is produced. This reconciliation identifies, inter alia, the changes in wage employee headcount from one wage period to the next, e.g.
- |   |     |
|---|-----|
| Number of employees at the end of wage period 1 | 154 |
| Less: Resignations/Dismissals                   | (6) |
| Add: Appointments                               | 8   |
| Number of employees at the end of wage period 2 | 156 |

All resignations/dismissals and appointments reflected on the period-to-period reconciliation are supported by authorised masterfile amendment forms. Your firm's approach to the audit of wages includes the selection of a very limited number of wage periods. The wage expense for these wage periods is audited in detail and then used as a basis for analytical procedures to be conducted on the wage expense for the year.

#### YOU ARE REQUIRED TO:

- describe the control activities, both manual and computerized (automated), which you would expect to find in place to ensure that the hours captured by Tiger Singh, are valid, accurate and complete. Your answer should commence with controls over the issue of clockcards at the start of the wage period (2 weeks) and end with the controls over keying in of the hours. Do not concern yourself with general controls. (25)
- describe the procedures you would conduct to satisfy yourself that employees included on the payroll for the wage periods selected for audit, are not fictitious (e.g. dummy workmen). (10)

#### 9.11 (40 marks 48 minutes)

Times (Pty) Ltd is a manufacturer of timing devices. In addition to a large salaried staff, the company employs about 100 skilled and semi-skilled wage earners. As part of the planning for the audit, you obtained the following information:

- The 100 employees are spread evenly over three sections.
- Each section is headed by a foreman. The foremen report to Reason Seconds, the factory manager.
- The three sections are located in a single factory building and to enter or leave the building, hourly paid employees must pass a clock card through a clocking machine to record their time of entry or exit and to activate the control gate. The clock is located at the control gate. There is only one point of entry/exit.
- The clocking procedure is observed by Ben Bigg the factory administration clerk who has a glass fronted office overlooking the clocking area.
- Employees work Monday to Friday and are required to "clock-in" by 7am and "clock-out" at 4pm. Any additional time worked is regarded as overtime. Overtime work is carefully planned and scheduled by the section foreman. Reason Seconds authorizes the schedule of overtime.

- Wages are paid every two weeks and the clockcards for each wage period are prepared in the human resources department and sent to Ben Bigg with a listing of each employee for whom there is a card. Ben Bigg agrees the cards to the list, signs the list and retains a copy.

- The wage period runs from Thursday morning until Wednesday afternoon two weeks later. Early on the Thursday morning Ben Bigg collects all the clock cards for the wage period just completed from the racks next to the clocking machine, and replaces them with the clockcards for the two week wage period commencing that morning.

- Once the previous period's cards have been collected, various batch controls and other procedures are carried out before the clockcards are taken to the wage office by Ben Bigg.

- The wage office is staffed by the paymaster, Jerome Jantjies, and his assistant, Preston Ngcobo. The wages are processed using application software developed and maintained by the company itself. Enhancements to the software are made from time to time by Times (Pty) Ltd's small information technology (IT) section to keep the application up to date with tax requirements and to provide management with better information for controlling wages, which is a major expense. The company runs all of its accounting applications on a local area network and the IT department is headed by Shakira Maharaj.

- Preston Ngcobo is responsible for preparing the payroll. Once he has received the clockcards, he selects the "enter hours worked" module and then captures the employee number, as well as the normal and overtime hours from each clockcard. Once he is satisfied that the hours captured are accurate and complete, he selects the "process payroll" option to effect the processing of the payroll. The software is well designed and includes a number of programme (automated) controls to provide valid, accurate and complete capture and processing of data.

#### YOU ARE REQUIRED TO:

- explain the internal control objectives of validity, accuracy and completeness in the context of the payroll cycle. (5)
- describe the batch controls and other procedures which should be in place from the time Ben Bigg collects the completed wage period's clockcards from the racks, to the time Preston Ngcobo accepts the clockcards from Ben Bigg. (12)
- identify and explain the controls which should be in place to prevent unauthorized access to the wage application and its various modules on Times (Pty) Ltd's local area network. (8)
- briefly explain the following programme control and give an example of how each control could be used to assist Preston Ngcobo in capturing valid, accurate and complete data
  - \* mandatory field check
  - \* verification check
  - \* limit check

(3x2) (6)

e) describe the internal controls which should be implemented over enhancements to the wage application software. (9)

**9.12 (30 marks 36 minutes)**

You are a member of the audit team of Gardenshake (Pty) Ltd, a company which manufactures wooden huts, dog kennels, etc. The manufacturing process is labour intensive and the company has a labour force of about 200 hourly paid staff. You have been assigned to the audit of the payroll cycle and your senior has asked you to evaluate the controls over certain functions in the cycle. You have obtained the following information.

1. The company has a human resources department which is responsible for all matters pertaining to labour. The department is, inter alia, responsible for maintaining the wage employee masterfile as well as hard copy records for each employee, e.g. employment contract, banking details, notification of grade changes, wage rate increases etc. Hiring, dismissal and resignations are dealt with by this department in conjunction with the factory manager.
2. Employees are divided into four sections, each of which manufactures a different product line. In addition to the hourly paid staff, the company employs (in the factory) a factory manager, four foremen who each control a section as well as two factory administration clerks who assist with costing and certain aspects of the wages.
3. Hours worked are controlled by a clocking system at the entry/exit points of the factory and employees are required to "clock" themselves into and out of their section by passing their clockcards through the clocking machine on entering or leaving the factory. Each section has its own clocking machine at the factory entrance. Employees work a 40 hour normal time week, i.e. 80 hrs per wage period. Overtime is worked as required.
4. At the conclusion of the wage period the clockcards are taken to the wage department which is located in the main administration offices for processing. Two wage clerks in this section are responsible for entering the hours worked off the clockcards and producing the payroll using a reliable software package. To enter hours the wage clerk accesses the prepare payroll module. The software will then bring up the first employee's record on the screen and once the hours have been entered and confirmed, automatically bring up the next employee's record.

5. Wages are paid every two weeks, by EFT directly into the employee's bank account.

**YOU ARE REQUIRED** to describe the application controls (both computerised and manual) which you would expect to find in the payroll cycle based on the information given above. You are **not** required to deal with controls subsequent to (after) the keying in of clockcard data by the wage clerks. Do not concern yourself with the entry of additional earnings and deductions.

**9.13 (40 marks 48 minutes)**

Hay Sixteen (Pty) Ltd is a wholesale distributor of agricultural products. Its accounting systems are computerised and are resident on a local area network. The following information pertains to the company's computerised salary system:

1. All employees at Hay Sixteen (Pty) Ltd are salary earners. There are no hourly paid employees.
2. The company has a staff of approximately 75 employees.
3. All personnel matters are the responsibility of the company's human resource section which is headed by Katherine Pearn and staffed by Ian Patty and Kim Robbins.
4. Derek Dark is the financial manager and he has overall responsibility for all accounting and financial matters.
5. All salaries are paid by electronic funds transfer on the last Friday of every month.
6. The employee masterfile is maintained by the human resource department along with all relevant supporting employee documentation.
7. EFT payments are made via the internet. The company's bank has loaded its software onto the company's system to facilitate the payment of salaries by EFT and the downloading of bank statements and other documentation as required. There is also an enquiry facility on the company's bank accounts.

**YOU ARE REQUIRED** to describe the application controls you would expect to find in place at Hay Sixteen (Pty) Ltd to ensure that salary payments are valid, accurate and complete.

**9.14 (37 marks 44 minutes)**

HippoHyde Lodge is a large resort situated in Mpumalanga. It consists of 100 accommodation units, reception area and offices, as well as various facilities for visitors to enjoy. The resort is entirely fenced for security purposes. Besides a number of salaried staff, the resort employs approximately 75 hourly paid personnel which includes housekeeping maids, cleaners and garden staff. The following information pertains to the (wage) payroll system.

1. The payroll system is computerised and the payroll application is resident on the lodge's local area network. The network is maintained by Frans Kruger the IT manager.
2. Hours worked by hourly paid personnel are recorded by a biometric scanner/timing device situated at the main gate to the resort. To gain access and record hours a worker must place his thumb on a scanner. The same procedure must be carried out at the end of the day when workers leave the resort. If the scanner identifies a valid thumbprint, the turnstile will be activated and the time of entry or exit will be recorded