



University of Fort Hare
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**NKUHLU DEPARTMENT OF ACCOUNTING
GOVERNANCE & AUDITING 3
AUD300E**

**FINAL ASSESSMENT OPPORTUNITY
NOVEMBER 2019**

ASSESSORS: Mrs Tammy Ntisana / Mrs Felicia Mintoor
MODERATORS: Ms Nadia Janson (External)
Prof Lana Weldon (Internal)
TIME: 3 hours (plus 30 minutes reading time)
MARKS: 120
PAGES: 11 pages (including front page and required)

INSTRUCTIONS:

1. Answer **all** the questions.
2. Start each question on a new page.
3. Show all workings clearly – marks are allocated to workings.
4. Only answers in ink will be marked (including workings). Pages where pencil or tippex were used will not qualify for remarking.
5. Only silent, non-programmable calculators are allowed.
6. Calculate the time that you should spend on each question by multiplying the number of marks for each question by 1.5 to determine the time, in minutes, available for each question. Adhere to these time constraints in order to finish the paper in the given time.
7. Delete all open spaces on your answer sheets with pen. Pages on your answer sheets that contain open spaces will not be eligible for a remark.
8. Students that contravene the rules in the General Prospectus of the University of Fort Hare will be disciplined in accordance with said rules.

Question	Topics covered	Marks	Minutes
(a)	General controls	20	30
(b)-(c)	Corporate Governance	28	42
(d)	Pre-engagement activities	8	12
(e)-(f)	Inventory and production cycle	33	50
(g) (h) (i)	Evaluation and reporting	31	46
	TOTAL	120	180

QUESTION ONE

Background

Mr and Mrs Moon, married and both retired, decided to invest their retirement savings by starting a leather production company. The company imports the leather in rolls and then manufactures this into various products such as handbags, wallets, laptop bags, shoes, etc.

The company, Leather-4-Africa Ltd [hereafter Leather-4-Africa] was incorporated in 2015 and expanded so successfully that it was listed on the Johannesburg Stock Exchange (JSE) by 1 January 2019. Leather-4-Africa established its manufacturing plant in Boksburg outside of Johannesburg and distributes to retailers across South Africa. The company head office is situated in Pretoria.

The company has fully integrated computerised financial accounting and management reporting systems. The systems were developed in-house to accommodate a number of unique (and complex) features pertaining to the company's business model and financial reporting system. The controls around the development and implementation of the systems were sound. Most data processing takes place at the Information Technology centre at head office.

The following appendices/working papers have been provided:

Reference	Description
Appendix A	Governance structures
Appendix B	Memorandum
Appendix C	Email
Working paper G110	Understanding Leather-4-Africa inventory
Working paper P100	Schedule of Audit Differences
Working paper Y100	Draft Audit Report

APPENDIX A: GOVERNANCE STRUCTURES

The shareholding of Leather-4-Africa at year-end, 30 June 2019 is as follows:

Mr Moon	15%
Mrs Moon	15%
Mr Staples	10%
Various public individual holdings	60%

The board of directors of the company consist of the following individuals:

- Mr Sam Fortune (Non-executive Director)
- Mr Jaryd Frost (Chief Executive Officer)
- Mr Thando Nnadi (Financial Director)
- Mr Julius Staples (Chief Operations Director)
- Mrs Natalia Frost (Non-executive Director – wife to Mr Jaryd Frost); and
- Mr Lucius Ivy (Managing Director of Stars (Pty) Ltd, Leather-4-Africa's newly formed subsidiary)

Mr Sam Fortune also holds three additional directorships in JSE-listed companies. He is, furthermore, involved in several other businesses, which takes up much of his time. Due to his busy schedule Leather-4-Africa only held two board meetings during the current year.

Leather-4-Africa has the following sub-committees: namely the audit committee, remuneration committee, nominations committee and the strategy committee. The audit committee consists of Mr Sam Fortune who is a certified financial analyst (see below).

The remuneration committee consists of Mr Sam Fortune, Mr Jaryd Frost (chair of this committee), Mr Thando Nnadi and the other non-executive directors (as mentioned above). This committee meets once a year and makes recommendations regarding the remuneration packages of the executive directors.

The board has delegated the responsibility of making all strategic and financial decisions to the strategy committee, who meets once a month. The members of this committee are Mr Jaryd Frost, Mr Thando Nnadi and Mr Julius Staples.

Due to resignations on the audit committee, the company wishes to appoint three new members on the committee to join Mr Sam Fortune, the remaining member of the committee. The company will request the nominations committee to present the recommendations to the shareholders at the upcoming annual general meeting so that the audit committee members can be appointed at this meeting.

APPENDIX B: MEMORANDUM

Mr Moon obtained the help of Mr Expert to assist with the following matters regarding Leather-4-Africa during its first year of incorporation in 2015 before listing on the JSE:

Matter 1:

Before Mr and Mrs Moon could start the company in 2015, they needed to secure a contract with a Chinese company to import the leather required to manufacture the various products that they would want to sell.

Mr Expert advised Mr Moon that the only way to enter into a contract (verbally or in writing) before Leather-4-Africa is incorporated, is to sign the agreement in the name of a third (and already incorporated) company. After Leather-4-Africa has been incorporated, the company must, within six months, ratify and transfer the contract over to Leather-4-Africa by way of an ordinary shareholders resolution.

Matter 2:

To obtain his shareholding, a loan was provided to Mr Julius Staples (Chief Operations Director). Mr Moon approved the loan on behalf of Leather-4-Africa. Mr Staples verbally agreed to repay the loan when he has funds available. Mr Expert indicated that there is no issue to provide the loan to Mr Staples as set out above. The company's liabilities exceed the company's assets by R 15 000 at the time of the transaction.

The Memorandum of Incorporation requires that a credit check be performed on any person/entity who receives financial assistance from Leather-4-Africa. Mr Expert indicated that it is not necessary to perform a credit check on Mr Staples as he is employed by Leather-4-Africa. Any non-repayment can be recovered from his monthly salary.

APPENDIX C: EMAIL

You are an audit senior at Awesome Auditors Inc. a small audit firm situated in East London with one audit partner and six additional audit staff members. You are aware that Leather-4-Africa became a successful company very quickly as your father has a material BEE shareholding in Leather-4-Africa.

Recently your audit firm received the below email from Thando Nnadi, the financial director of Leather-4-Africa Ltd, requesting that the firm submit a tender proposal for the appointment as auditor of Leather-4-Africa Ltd.

If the tender is successful, the audit would be Awesome Auditors' largest and most computerised client. Most of the audit staff members at Awesome Auditors have little experience in "more complex" computerised audit environments but it will be a great learning opportunity for the audit team members.

Dear Partner

This email is an invitation to you to make a presentation to myself and the audit committee on the services you have to offer. I am the newly appointed financial director of Leather-4-Africa Ltd and I will be removing the existing audit firm as soon as I have appointed a firm to replace them.

I find the existing firm (which I am not going to provide any information on, it is irrelevant who they are!) like most auditors I might add, to be inefficient, too expensive and simply unwilling to do things my way. So that you don't waste our time, I have the following conditions you should consider before you make a presentation:

We do not expect you to conduct a comprehensive audit. The audit committee requires that the annual audit be conducted on a verification of year-end balances only basis. I am not interested in anything else as all the other "so called" audit procedures simply increase the audit fee.

I have allowed 10 working days for performing the audit procedures whereafter we need the audit report. Quote accordingly. If we appoint you, the audit committee will determine your audit fee.

If you wish to be considered, you have one week to respond to this email.

Thando Nnadi

Client: Leather-4-Africa Ltd	Year end: 30 June 2019	G110
Prepared By: A Trainee	Date: 18 July 2019	
Reviewed By:	Date:	
Subject: Understanding Leather-4-Africa inventory		

As noted in the background information, Leather-4-Africa imports the leather in rolls and then manufactures this into various products such as handbags, wallets, laptop bags, shoes, etc.

Products are manufactured based on orders received from customers. The company operates a job costing system where a batch of the same product manufactured is treated as a separate job and costs and other information is recorded on a numerically sequenced job card.

The cost per product is calculated using a standard costing system. The standard costs are estimated by the production manager on an annual basis and presented on a standard costing schedule. The standard costs are then input into the system at the beginning of the year,

The standard cost includes direct material, direct labour, direct and indirect overheads allocated based on machine hours. The standard costing variances are calculated and recorded in the general ledger. The company does not take orders close to year end and therefore there is no work in progress at year end.

Leather-4-Africa manufactures their signature goods to maintain a certain level of stock and over and above that level, they manufacture based on specific orders. During the year, the company received a large order of wallets from a customer who also wanted their company branding embossed on the outside of the wallets. Leather-4-Africa requested that the customer pay a deposit of 25% of the total cost before they commenced manufacturing. Once Leather-4-Africa had manufactured the wallets and added the branding, the customer indicated that they no longer wanted the wallets and Leather-4-Africa has not been able to recover any further costs from the customer. Since the wallets were specifically branded for the customer, it is unlikely that Leather-4-Africa would be able to sell the wallets to any other customer. As a result, Thando Nhadi raised a provision for obsolete inventory at year end. The provision is calculated based on the cost of the wallets less the amount of the deposit paid by the customer.

Client: Leather-4-Africa Ltd	Year end: 30 June 2019	P100
Prepared By: A Trainee	Date: 30 August 2019	
Reviewed By:	Date:	
Subject: Schedule of Audit Differences		

The following uncorrected audit differences have been identified:

	Notes	Assets	Liabilities	Profit
Unrecorded liability	N1		80 000	(80 000)
Loss due to theft	N2	600 000		(600 000)
Irrecoverable debtor	N3	350 000		(350 000)
Incorrect PAYE	N4		200 000	(200 000)
Total misstatement		950 000	280 000	(1 230 000)

NOTES:

N1: This relates to an invoice from Moonshine (Pty) Ltd for cleaning materials provided during June 2019. The invoice was received and recorded in July 2019.

N2: During June the head office was broken into and assets with a book value of R600 000 were stolen. Leather-4-Africa were insured and expected to be paid out for the loss. However, during August the insurance company notified Leather-4-Africa that they would not pay out as their investigation had shown that the office was not locked properly and the alarm had not been armed.

N3: During review of one of the debtor's files, namely Biz Retailers (Pty) Ltd, legal correspondence dated 20 August 2019 was found which detailed that the company had been placed into liquidation. On further enquiry, Biz Retailers' insolvency had been brought about by poor liquidity management over the years. The accounts receivable amount owing to Leather-4-Africa at 30 June 2019 was R350,000. The liquidation had taken the management of Leather-4-Africa by surprise and they had taken no further action.

N4: PAYE has been incorrectly calculated due to a system programming error. The error has resulted in an underpayment to SARS of R200 000.

Final materiality has been assessed as R400 000.

Client: Leather-4-Africa Ltd	Year end: 30 June 2019	Y100
Prepared By: A Trainee	Date: 30 August 2019	
Reviewed By:	Date:	
Subject: Draft Audit Report		

Auditors Report

To: Mr Thando Nnadi

Opinion

We have audited the financial statements of Leather-4-Africa Ltd set out on pages 5 to 62 which comprise the statement of financial position as at 31 December 2017, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the possible effects of the matter described in the basis for qualified opinion section of our audit report, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2017 and of its financial performance and its cash flows for the year then ended.

Basis for Qualified Opinion

The company's head office was broken into during the year under audit. Although the Company was insured the insurance has refused to pay out. The insurance company's investigation found that the office had not been properly locked, and the alarm had not been armed.

Responsibilities of the Directors for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they exceed R 400 000.

A further description of the auditor's responsibilities for the audit of the financial is located at www.AwesomeAuditors.co.za/Auditorsresponsibilities and this description forms part of our auditor's report.

Awesome Auditors Inc.

33 Tokai Avenue
East London

QUESTION ONE – REQUIRED		Marks	
		Sub-total	Total
(a)	Based on the information in the Background , discuss the general controls that Leather-4-Africa Ltd would have implemented to ensure that they maintained sound controls during the development and implementation of the computerised financial accounting system.	18	20
	<i>Communication skills: Clarity of expression</i>	2	
(b)	Based the information in Appendix A , discuss whether Leather-4-Africa would be able to make a statement in its annual report indicating full application of the recommended practices contained in the King IV Report of Corporate Governance. Exclude from your discussion any reference to the <u>nomination</u> and <u>audit committees</u> .	15	15
(c)	For each of the matters provided in Appendix B , discuss if the advice provided by Mr Expert is correct and discuss any non-compliance with the Companies Act 71 of 2008 with regard to the actions taken.	12	13
	<i>NOTE: You can assume that Mr Moon and Leather-4-Africa Ltd acted in accordance with the advice provided by Mr Expert.</i> <i>Communication skills: Logical argument</i>	1	
(d)	With reference to Appendix C , discuss the aspects your audit firm should consider before accepting the audit engagement.	8	8
(e)	With reference to working paper G110 , what audit procedures would the auditors perform in order to verify the following:		25
	(i) the accuracy and valuation of the pricing of the leather products manufactured by Leather-4-Africa;	13	
	(ii) the accuracy, valuation and completeness of the provision for obsolete stock?	12	
(f)	With reference to work paper G110 , what controls would Mr Thando Nnadi want to put in place to ensure that the input of the standard costs onto the system at the beginning of the year is valid, accurate and complete?	8	8
(g)	With reference to N3 on work paper P100 , discuss the effect that the subsequent event might have on the financial statements of Leather-4-Africa Ltd for the year ended 30 June 2019.	3	3
(h)	Based on the information in work paper P100 , evaluate each of the uncorrected misstatements and the effect of these matters on the audit opinion of Leather-4-Africa Limited for the year ended 30 June 2019.	9	10
	<i>Communication skills: Clarity of expression</i>	1	
(i)	Draft a memo to your audit trainee outlining the mistakes he has made in the draft audit report on work paper Y100 and explain what he should have done. For this section you may assume that the client is unwilling to make any changes to the financial statements.	16	18
	<i>Communication skills: Layout</i>	2	
TOTAL			120

Sources: Rhodes / University of Free State (adapted extracts)

* End of assessment *

This page is provided for you to make notes on during reading time. It is NOT to be handed in and it must therefore not form part of your final solution.