

## TOE412S EXAM PAPER 2011

### QUESTION 1

You are a first-year trainee accountant at Motholo & Terblanche Incorporated (Motholo & Terblanche) a medium-sized audit firm in South Africa. Motholo & Terblanche operates from its only office situated in Johannesburg. There have been talks among the directors of the firm to open an office in Bloemfontein and East London once the clientele of Motholo & Terblanche increases.

You are currently involved in the 31 July 2011 year-end audit of Billing4U Limited (Billing4U) and have been provided with the following information by your audit senior:

#### Understanding of the Entity

In September 2010, Motholo & Terblanche was appointed for a third term (a term is a five year period) as the statutory auditors of Billing4U. Billing4U was established in 1998 and it was listed on the AltX of the JSE in 2002. Billing4U deals exclusively with providing billing solutions to eight (8) metropolitan municipalities in South Africa. Billing4U bills the residents living in the relevant municipalities for services that include water, electricity and rates on behalf of the municipalities. Billing4U has provided this service to metropolitan municipalities since 2001, following the first municipal elections held in South Africa in December 2000.

Billing4U's policy is to evaluate the reappointment of the audit firm every five (5) years. The audit committee of Billing4U believes this is in accordance with the Companies Act 2008 and that this will ensure that the independence of the audit firm is not threatened. Motholo & Terblanche planned the following audit team members for the statutory audit and tax return preparation of Billing4U.

| Name                     | Position           | Experience                                                                                                                                                     |
|--------------------------|--------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Gareth Lewis CA (SA), RA | Audit partner      | <ul style="list-style-type: none"><li>Has been the audit partner of Billing4U since 2001</li></ul>                                                             |
| Unathi Cliff CA (SA)     | Audit manager      | <ul style="list-style-type: none"><li>Has been the audit manager of Billing4U since 2007</li><li>Assists Billing4U in the preparation of tax returns</li></ul> |
| John Naidoo              | Audit senior       | <ul style="list-style-type: none"><li>Has been part of the Billing4U audit since 2009</li><li>Assists Billing4U in the preparation of tax returns</li></ul>    |
| Thabo Chauke (You)       | First year trainee | <ul style="list-style-type: none"><li>Will be involved in the statutory audit of Billing4U and will assist in the preparation of tax returns</li></ul>         |

The number of audit team members planned for the audit of Billing4U has decreased in comparison to that of prior years. During the financial year Billing4U was able to gain control of three companies that are in the business of providing billing solutions to district and local municipalities. Billing4U is now your firm's largest audit client in terms of revenue. The companies that Billing4U acquired have a 31 July year-end. This resulted in Billing4U changing its year-end from 31 March to 31 July. The three companies are located in various parts of South Africa and for their 31 July 2011 financial year end, they will be audited by their respective audit firms. None of these companies is an audit client of Motholo & Terblanche.

During February 2011, Billing4U changed its software from Billfast X200 to Speedbill 9000 in order to streamline the accounts of the residents for the services provided by the municipalities.

[TURN OVER]

In March 2011 thousands of households in the City of Johannesburg were disconnected from the services provided by the municipality. According to media reports, there were numerous complaints from residents. These complaints included inaccurate and hugely inflated bills. Complaints in other metropolitan municipalities were also reported but they are said to be insignificant compared to the complaints about the City of Johannesburg. The residents of the City of Johannesburg marched in protest to the Mayor's office demanding that their municipal services be reconnected and for their bills to be corrected. The Mayor of the City of Johannesburg contacted the CEO of Billing4U, Julius Zille, to help deal with the residents' crisis. Julius Zille knew about these issues after he has received numerous complaints from residents following the implementation of the new billing software system. However, he informed the Mayor that there was no crisis regarding the billing of the residents, as he believed the number of complaints are immaterial to the total number of residents in the City of Johannesburg.

The Mayor independently investigated the matter and found that there are problems within the billing system of Billing4U. The Mayor decided to terminate the contract with Billing4U when it reaches the end of its term on 31 March 2012. The Mayor lodged a lawsuit against Billing4U for the inconvenience caused to the residents of the City of Johannesburg. The lawsuit is set to cost Billing4U R210 million, and the legal team is confident that the ruling will be in favour of the Mayor. Billing4U does not have insurance to cover such lawsuits. The revenue received by Billing4U from the City of Johannesburg is the largest compared to revenue received from other metropolitan municipalities.

Julius Zille has informed the audit partner that the audited consolidated financial statements for the year ended 31 July 2011 are required a week after year end to enable the group to apply for a loan to cover the lawsuit instituted by the Mayor.

The shareholding of Billing4U was as follows on 31 July 2011:

| <b>Shareholders</b>                  | <b>Percentage (%)</b> |
|--------------------------------------|-----------------------|
| Juristic persons                     | 32                    |
| Natural persons other than directors | 39                    |
| Non-executive directors              | 9                     |
| Executive directors                  | 20                    |

The directors of Billing4U receive share options annually driven by profits for the year.

The following are working papers on gathering audit evidence:

|                 |                                                                                                                        |
|-----------------|------------------------------------------------------------------------------------------------------------------------|
| <b>2600 – 1</b> | <b>Administrative fee income</b>                                                                                       |
| <b>2700 – 1</b> | <b>Information relating to the Speedbill 9000 system</b>                                                               |
| <b>2800 – 1</b> | <b>Extract from procedures followed by Billing4U Ltd relating to the purchase and implementation of Speedbill 9000</b> |
| <b>2900 – 1</b> | <b>Extract from information relevant to disputed bills</b>                                                             |

| <b>Entity name:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | <i>Billing4U Limited</i>                          | <b>Year-end:</b> | <i>31 July 2011</i> | <b>2600 – 1</b><br><b>Page 1 of 2</b> |                                                              |                                                   |              |     |                    |     |                    |     |                  |    |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------|------------------|---------------------|---------------------------------------|--------------------------------------------------------------|---------------------------------------------------|--------------|-----|--------------------|-----|--------------------|-----|------------------|----|
| <b>Prepared by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | <i>J Naidoo</i>                                   | <b>Date:</b>     | <i>20 May 2011</i>  |                                       |                                                              |                                                   |              |     |                    |     |                    |     |                  |    |
| <b>Reviewed by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | <i>U Cliff</i>                                    |                  |                     |                                       |                                                              |                                                   |              |     |                    |     |                    |     |                  |    |
| <b>Audit section:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | <b>Administrative fee income</b>                  |                  |                     |                                       |                                                              |                                                   |              |     |                    |     |                    |     |                  |    |
| <ul style="list-style-type: none"> <li>• A standard contract, setting out the terms, conditions, fee structure, etc is entered into with the municipalities for the billing of the residents.</li> <li>• Both the administrative fee income and the penalties structures were approved by management and were included in one of Billing4U's policy documents.</li> <li>• The billing to the various residents by Billing4U on behalf of the municipalities is based on a monthly data file received by the latest on the 20<sup>th</sup> of each month.</li> <li>• This data file from the municipalities contains each resident's unique account number as well as the movement in meter readings that have to be billed.</li> <li>• An invoice is prepared at the end of each month for each municipality and contains the administrative fee, a penalty deduction (if necessary), VAT and the net administrative fee amount, all calculated in accordance with the standard contract.</li> <li>• Administrative fee income is charged according to the number of residents that appear on the data files received from the respective municipalities. The standard contract with the municipalities contain the following administrative fee structure:</li> </ul> |                                                   |                  |                     |                                       |                                                              |                                                   |              |     |                    |     |                    |     |                  |    |
| <table border="1"> <thead> <tr> <th><b>Number of municipality residents billed for the month</b></th> <th><b>Fee per resident per month (VAT Exclusive)</b></th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">1 to 100 000</td> <td style="text-align: center;">R20</td> </tr> <tr> <td style="text-align: center;">100 001 to 250 000</td> <td style="text-align: center;">R15</td> </tr> <tr> <td style="text-align: center;">250 001 to 500 000</td> <td style="text-align: center;">R10</td> </tr> <tr> <td style="text-align: center;">500 001 and more</td> <td style="text-align: center;">R5</td> </tr> </tbody> </table>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                                                   |                  |                     |                                       | <b>Number of municipality residents billed for the month</b> | <b>Fee per resident per month (VAT Exclusive)</b> | 1 to 100 000 | R20 | 100 001 to 250 000 | R15 | 250 001 to 500 000 | R10 | 500 001 and more | R5 |
| <b>Number of municipality residents billed for the month</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | <b>Fee per resident per month (VAT Exclusive)</b> |                  |                     |                                       |                                                              |                                                   |              |     |                    |     |                    |     |                  |    |
| 1 to 100 000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | R20                                               |                  |                     |                                       |                                                              |                                                   |              |     |                    |     |                    |     |                  |    |
| 100 001 to 250 000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | R15                                               |                  |                     |                                       |                                                              |                                                   |              |     |                    |     |                    |     |                  |    |
| 250 001 to 500 000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | R10                                               |                  |                     |                                       |                                                              |                                                   |              |     |                    |     |                    |     |                  |    |
| 500 001 and more                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | R5                                                |                  |                     |                                       |                                                              |                                                   |              |     |                    |     |                    |     |                  |    |

|                       |                                         |                  |                     |                                       |
|-----------------------|-----------------------------------------|------------------|---------------------|---------------------------------------|
| <b>Entity name:</b>   | <i>Billing4U Limited</i>                | <b>Year-end:</b> | <i>31 July 2011</i> | <b>2600 – 1</b><br><b>Page 2 of 2</b> |
| <b>Prepared by:</b>   | <i>J Naidoo</i>                         | <b>Date:</b>     | <i>20 May 2011</i>  |                                       |
| <b>Reviewed by:</b>   | <i>U Cliff</i>                          |                  |                     |                                       |
| <b>Audit section:</b> | <b><i>Administrative fee income</i></b> |                  |                     |                                       |

- There is also a penalty clause incorporated into the standard contract, which results in a reduction of Billing4U's administrative fee income for complaints relating to incorrect billing. The total number of all billing complaints received by Billing4U in a month that was due to their own fault and not due to an error on the data file they received from a municipality is used to calculate the penalty based on the following sliding scale:

| Percentage reduction in administrative fees (penalty) | Number of complaints relating to incorrect billing |
|-------------------------------------------------------|----------------------------------------------------|
| 1%                                                    | 500 to 10 000                                      |
| 3%                                                    | 10 001 to 50 000                                   |
| 5%                                                    | 50 001 and more                                    |

- The penalty percentage is multiplied with both the administrative fee that was raised in the previous month (to which the complaint relates) as well as the valid number of complaints received from residents. Therefore a backdated provision will be raised for any disputes that will be lodged relating to the July 2011 administrative fees, as the details will only be available in August 2011.
- During the conversion process from the Billfast X200 system to the Speedbill 9000 system, a power outage occurred when master files of the City of Johannesburg were transferred. This resulted in an estimated 98 000 valid complaints from residents.
- The number of valid complaints is derived from a list that is drawn from the "Disputes" module of the new Speedbill 9000 system.

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| <b>Entity name:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | <i>Billing4U Limited</i>                                        | <b>Year-end:</b> | <i>31 July 2011</i> | <b>2700 – 1</b> |
| <b>Prepared by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | <i>J Naidoo</i>                                                 | <b>Date:</b>     | <i>20 May 2011</i>  |                 |
| <b>Reviewed by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | <i>U Cliff</i>                                                  |                  |                     |                 |
| <b>Audit section:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | <b><i>Information relating to the Speedbill 9000 system</i></b> |                  |                     |                 |
| <ul style="list-style-type: none"> <li>• The Speedbill 9000 system was purchased on 10 December 2010 at an amount of €3 000 000 from an international supplier in Germany.</li> <li>• Billing4U decided to take out a forward exchange contract (FEC) on the same day to cover it against major fluctuations in the exchange rate as there were rumours in the market that a weakening of the rand could be expected at the beginning of 2011. The invoice was only payable in 2011 after the Speedbill 9000 system had been implemented and was fully operational.</li> <li>• Costs directly attributable to the Speedbill 9000 systems (e.g. the feasibility study) were incurred by Billing4U and amounted to R250 000.</li> <li>• Training was provided to the personnel of Billing4U by Mr Johnson, the Information Technology manager (IT-manager), to operate the system effectively and the cost thereof amounted to a further R500 000.</li> <li>• After discussions with the international supplier and based on a feasibility study, it was concluded that the Speedbill 9000 system can be used without problems for a period of four years. Thereafter Billing4U needs to consider updating the system for it to continue operating effectively. However, management decided to write the Speedbill 9000 system off over a period of six years.</li> <li>• As this system was bought in the current year, management did not deem it necessary to do an impairment test on this system.</li> </ul> |                                                                 |                  |                     |                 |

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|-----------------------|-------------------------------------------------------------------------------------------------------------------------------|------------------|-------------------------|---------------------------------------|
| <b>Entity name:</b>   | <i>Billing4U Limited</i>                                                                                                      | <b>Year-end:</b> | <i>31 July 2011</i>     | <b>2800 – 1</b><br><b>Page 1 of 3</b> |
| <b>Prepared by:</b>   | <i>J Naidoo</i>                                                                                                               | <b>Date:</b>     | <i>14 February 2011</i> |                                       |
| <b>Reviewed by:</b>   | <i>U Cliff</i>                                                                                                                |                  |                         |                                       |
| <b>Audit section:</b> | <b><i>Extract from procedures followed by Billing4U Ltd relating to the purchase and implementation of Speedbill 9000</i></b> |                  |                         |                                       |

#### **Decision and approval to purchase the Speedbill 9000 system**

- During August 2010 the Information Technology (IT) director, Mrs Rosa, sent out a questionnaire to the staff members who would be performing billing functions to obtain an understanding of their specific needs and requirements in terms of the new billing system.
- Only Mr Johnson, the Information Technology (IT) manager, replied to this questionnaire. As he is mainly responsible for the effective functioning of the new system, Mrs Rosa decided that Mr Johnson spoke on behalf of all the staff members and she decided not to waste any more time on further queries regarding this matter.
- Mrs Rosa conducted an extensive feasibility study in September 2010. She did some market research and discussed the following matters with the international supplier of the Speedbill 9000 system:
  - all the specifications and requirements of this new billing system versus those of other billing systems (locally and abroad) on the market;
  - all relevant costs associated with this new system (purchase costs as well as implementation and maintenance costs);
  - whether there would be new updated versions of the Speedbill 9000 system in the future, as this is a standard package; and
  - whether the international supplier has a good reputation locally and abroad.
- The international supplier of the Speedbill 9000 system has several branches and offices abroad. However, the South African branch closed down in 2009.
- No problems were identified during the feasibility study conducted by Mrs Rosa.
- Mrs Rosa contacted one company abroad currently using the Speedbill 9000 system. The company indicated that it did not experience any problems, although this company did not provide billing services to municipalities with a customer base of more than 250 residents. Mrs Rosa was of the opinion that if it worked for a customer base of 250 residents, it would work for a customer base of 1,2 million residents as in the case of the City of Johannesburg.
- After a detailed cost – benefit analysis conducted by Mrs Rosa and the financial manager, Mr Kriel, it was decided that the Speedbill 9000 system would be purchased from the international supplier. The purchase was authorised by management as well as the steering committee appointed by management to run the Speedbill 9000 project.

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| <b>Entity name:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | <i>Billing4U Limited</i>                                                                                                      | <b>Year-end:</b> | <i>31 July 2011</i>     | <b>2800 – 1</b><br><b>Page 2 of 3</b> |
| <b>Prepared by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | <i>J Naidoo</i>                                                                                                               | <b>Date:</b>     | <i>14 February 2011</i> |                                       |
| <b>Reviewed by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | <i>U Cliff</i>                                                                                                                |                  |                         |                                       |
| <b>Audit section:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | <b><i>Extract from procedures followed by Billing4U Ltd relating to the purchase and implementation of Speedbill 9000</i></b> |                  |                         |                                       |
| <b>Conversion from the Billfast X200 system to the Speedbill 9000 system</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |                                                                                                                               |                  |                         |                                       |
| <ul style="list-style-type: none"> <li>• Mrs Rosa was assigned to the conversion process by the steering committee and management. She was appointed as the only member of the “conversion project team”. She was mainly responsible for: <ul style="list-style-type: none"> <li>– deciding on an appropriate conversion method;</li> <li>– setting deadline dates and cut-off points;</li> <li>– setting time schedules for specific stages of the project;</li> <li>– allocating specific tasks to appropriate staff members;</li> <li>– giving clear guidance and support to these staff members as well as time schedules for completion of these tasks;</li> <li>– regularly monitoring the progress of the process;</li> <li>– identifying possible problems in the process; and</li> <li>– reporting to the steering committee at regular intervals.</li> </ul> </li> <li>• Mr Johnson was allocated to the training of staff members on the Speedbill 9000 system, as he trained himself in the use of the new system. Due to time constraints, he had brief discussions with the management of each department. He advised management that task descriptions would not have to be changed as each person would still be responsible for the same functions in general.</li> <li>• As part of the preparation for conversion, Mrs Rosa allocated the tedious task of preparing standing data files for the Speedbill 9000 system as well as the task of balancing files on the existing Billfast X200 system to Mr Kriel. She explained that in her opinion Mr Kriel was the financial manager and therefore would know much about making things balance.</li> <li>• After Mr Kriel had performed the above preparation tasks, the data transfer was authorised by management and the steering committee. Supervisors (senior management) were appointed to oversee the conversion. The external auditors, Motholo &amp; Terblanche, also attended the conversion.</li> <li>• A power outage was experienced during the conversion process.</li> </ul> |                                                                                                                               |                  |                         |                                       |

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| <b>Entity name:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | <i>Billing4U Limited</i>                                                                                                      | <b>Year-end:</b> | <i>31 July 2011</i>     | <b>2800 – 1</b><br><b>Page 3 of 3</b> |
| <b>Prepared by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | <i>J Naidoo</i>                                                                                                               | <b>Date:</b>     | <i>14 February 2011</i> |                                       |
| <b>Reviewed by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | <i>U Cliff</i>                                                                                                                |                  |                         |                                       |
| <b>Audit section:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | <b><i>Extract from procedures followed by Billing4U Ltd relating to the purchase and implementation of Speedbill 9000</i></b> |                  |                         |                                       |
| <b>Testing and post-implementation review of the Speedbill 9000 system</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                                                                                                                               |                  |                         |                                       |
| <ul style="list-style-type: none"> <li>• It was decided that the system would not be tested after the conversion and that the first month of actual billing to residents would be the test run of the Speedbill 9000 system.</li> <li>• All Speedbill 9000 system flowcharts, system descriptions, operating manuals, etc. either were drawn up or were updated.</li> <li>• Back-ups were made of the new system and they were kept off-site.</li> <li>• A post-implementation review was scheduled for January 2012.</li> </ul> |                                                                                                                               |                  |                         |                                       |

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| <b>Entity name:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | <i>Billing4U Limited</i>                                          | <b>Year-end:</b> | <i>31 July 2011</i> | <b>2900 – 1</b><br><b>Page 1 of 2</b> |
| <b>Prepared by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | <i>J Naidoo</i>                                                   | <b>Date:</b>     | <i>4 May 2011</i>   |                                       |
| <b>Reviewed by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | <i>U Cliff</i>                                                    |                  |                     |                                       |
| <b>Audit section:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | <b><i>Extract from information relevant to disputed bills</i></b> |                  |                     |                                       |
| <b>Background information</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |                                                                   |                  |                     |                                       |
| <ul style="list-style-type: none"> <li>• Billing4U deals with all residents' bill disputes, queries and complaints on behalf of its municipalities on a monthly basis. A separate module on the Speedbill 9000 system called "Disputes" is used specifically for this purpose. On average, approximately 1 500 disputes are received in aggregate for all the municipalities on a monthly basis.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                                                                   |                  |                     |                                       |
| <b>Disputes by City of Johannesburg residents</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |                                                                   |                  |                     |                                       |
| <ul style="list-style-type: none"> <li>• In the month following the implementation of the Speedbill 9000 system, thousands of disputes on bills were received from the City of Johannesburg residents. It was agreed by the City of Johannesburg and Billing4U that Billing4U would conduct a formal investigation, as the number of disputes were far in excess of the average number of monthly disputes.</li> <li>• After a full investigation by Billing4U, the following matter was identified as the main cause for the disputes: <ul style="list-style-type: none"> <li>– During the conversion process from the Billfast X200 system to the Speedbill 9000 billing system, a power outage occurred.</li> <li>– The power outage took place during the transfer of data files for the City of Johannesburg from the old to the new billing system.</li> <li>– As the generator had not been used in several months, it did not function on the day of the power outage.</li> <li>– A comparison between the files on the Billfast X200 system and the files on the Speedbill 9000 system for the City of Johannesburg was made as part of the investigation. It was estimated that data on approximately 98 000 residents of the City of Johannesburg were lost, incorrectly transferred or duplicated.</li> </ul> </li> </ul> |                                                                   |                  |                     |                                       |
| <b>Lodging of formal disputes on bills</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                                                                   |                  |                     |                                       |
| <ul style="list-style-type: none"> <li>• The City of Johannesburg residents were given the option either to lodge a formal dispute personally at one of four Billing4U care centres in the Johannesburg area or to call the Billing4U call centre. Operating hours at the care centres and the call centre were from 08:00 to 18:00 from Monday to Saturday.</li> <li>• Billing4U employed temporary clerks at each of the four Billing4U care centres, as well as at the call centre to capture the formally lodged disputes on the "Disputes" module. All temporary clerks signed employment contracts what were valid for a period of two months.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                                                                   |                  |                     |                                       |

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                                                   |                  |                     |                                       |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------|------------------|---------------------|---------------------------------------|
| <b>Entity name:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | <i>Billing4U Limited</i>                                          | <b>Year-end:</b> | <i>31 July 2011</i> | <b>2900 – 1</b><br><b>Page 2 of 2</b> |
| <b>Prepared by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | <i>J Naidoo</i>                                                   | <b>Date:</b>     | <i>4 May 2011</i>   |                                       |
| <b>Reviewed by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | <i>U Cliff</i>                                                    |                  |                     |                                       |
| <b>Audit section:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | <b><i>Extract from information relevant to disputed bills</i></b> |                  |                     |                                       |
| <ul style="list-style-type: none"> <li>• Each clerk was allocated a personal computer on which he/she captured the resident's unique account number, the nature of the dispute, etc. directly onto the computer via a keyboard. The date is an auto field.</li> <li>• After capturing the resident's unique account number, the "Disputes" module automatically retrieves the resident's details from the Speedbill 9000 master file and displays these on the screen. The system does not allow the clerks to delete or edit resident's master file details.</li> <li>• A reference number, allocated by the "Disputes" module, is given to a resident on receipt of a formal dispute. Reference numbers are allocated sequentially. These numbers are used by Billing4U to track the progress on the specific dispute. The following criteria have to be met in order to receive a reference number: <ul style="list-style-type: none"> <li>– The resident has to be a customer of one of the eight metropolitan municipalities.</li> <li>– The resident has to lodge a formal dispute within 30 days of the invoice date.</li> </ul> </li> <li>• The "Disputes" module only allowed the following types of disputes to be captured: <ul style="list-style-type: none"> <li>– incorrect stand and physical addresses;</li> <li>– excessive billing amounts;</li> <li>– deeds transfers not correctly updated on the Speedbill 9000 system;</li> <li>– incorrect estimated meter readings;</li> <li>– bills not received;</li> <li>– receiving duplicate bills;</li> <li>– incorrect detail given on bills; and</li> <li>– services unduly disconnected.</li> </ul> </li> </ul> |                                                                   |                  |                     |                                       |

**REQUIRED**

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | <b>Marks</b>   |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|
| 1. With regards to the <b>Understanding of the Entity</b> information:<br>(a) Discuss the factors that Motholo & Terblanche should have considered prior to accepting the reappointment as statutory auditors of Billing4U.<br>(b) Describe the risk of material misstatement, at the overall financial statement level, in the financial statements of Billing4U and at the group level for the year ended 31 July 2011.                                                                                                       | 13<br>13       |
| 2. With regards to <b>working paper 2600-1</b> and <b>working paper 2700-1</b><br>(a) Discuss the risk of material misstatement at the assertion level for net administrative fee income and for the recognition of the Speedbill 9000 system.<br>(b) Formulate the substantive audit procedures that you would perform for the year ended 31 July 2011 to audit:<br>(i) the net administrative fee income ( <b>working paper 2600-1</b> )<br>(ii) the recognition of the Speedbill 9000 system ( <b>working paper 2700-1</b> ) | 11<br>13<br>12 |
| 3. With regards to <b>working paper 2800-1</b> , describe the weaknesses in the procedures followed by Billing4U which relate to the purchase of Speedbill 9000, as well as the conversion, testing and post-implementation review thereof.                                                                                                                                                                                                                                                                                     | 25             |
| 4. With regards to <b>working paper 2900-1</b> , describe any additional computerised (programmed) application controls that you would expect to see in order to ensure the:<br>(i) occurrence and authorisation; and<br>(ii) completeness of the lodged disputes by the temporary clerks.                                                                                                                                                                                                                                      | 11<br>2        |
| <b>Total</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | <b>100</b>     |

**QUESTION 1 – SUGGESTED SOLUTION:**

- (a) (i) **Factors that Motholo & Terblanche should have considered prior to accepting the reappointment as statutory auditors of Billing4U Limited**

1. **Independence**

- 1.1 The audit partner (Gareth Lewis) has been the partner in charge of the audit for a period of **more than 10 years**, which creates a **familiarity threat** to independence. (2)
- 1.2 Gareth Lewis is in **contravention of the Companies Act** by being the audit partner of Billing4U Ltd for a **period of more than five years**. (1)
- 1.3 The **safeguard** that Motholo & Terblanche can apply is to **rotate the audit partner**. (1)
- 1.4 Billing4U Ltd is the **largest client** of Motholo & Terblanche **in terms of the revenue** generated. This would **create a self-interest** threat to independence. (2)
- 1.5 The rest of the **audit team members** (excluding the audit partner) will be involved in assisting Billing4U in the **preparation of tax returns**. (1)

- 1.6 In terms of the CPC 290.183 the preparation of tax returns **does not create a threat** to independence if **management takes responsibility for the returns, including any significant judgements made.** (1)

**2. Client investigation and business risk**

- 2.1 The **integrity of management is questionable** as the CEO, Julius Zille intentionally **provided the mayor with inaccurate information.** (1)
- 2.2 The **business risk is increased due to non-adherence to King III** which indicates a possible lack of integrity. King III state that it is **not good practice for non-executive directors to receive share options** as this could impair their independence. (1)
- 2.3 This is further demonstrated by the fact that the **audit committee is not complying** with the **Companies Act**, as the **re-appointment of auditors needs to be evaluated annually and not every 5 years.** (1)

**3. Skills, competence and resources**

- 3.1 Motholo & Terblanche does **not appear to have adequate staff members** to perform the audit of Billing4U. Only **4 members** are planned for the audit client that has **8 metropolitan municipalities** as clients (1)
- 3.2 There is a **tight audit deadline**, the audit report is required a week after year end, 31 July 2011, more audit team members will be required on the audit. (1)
- 3.3 Consider the **need for an IT expert** in the audit of the conversion from Billfast X200 to Speedbill 9000. (1)
- 3.4 Motholo & Terblanche have been auditing Billing4U for a reasonable amount of time. Skills and competence does not appear to be a concern in this regard. (1)

**4. Engagement letter**

- 4.1 The statutory engagement letter should be signed and will highlight the following: the **responsibility of the auditor to report a reportable irregularity** if it exists as well as **management's overall responsibility for the tax returns.** (2)

**5. Other matters**

- 5.1 Billing4U might be experiencing **going concern problems** and may **not be able to settle the audit fee.** However, Billing4U has enjoyed **long association** with Motholo & Terblanche and **recoverability of audit fees does not appear to have been a problem** in the past. (2)
- 5.2 The fact that the auditors have to **rely on the work performed by other auditors** should be taken into account, as Billing4U acquired 3 companies during the year. (2)
- 5.3 Additional reliance by a **3<sup>rd</sup> party as Billing4U** is going to apply for a loan based on the financial statements. (2)

5.4 Consideration should be taken into account with regards to the client's reputation due to the fact that they are being sued by the Mayor. (1)

Available 25  
Maximum 13

(a) (ii) **Risk of material misstatement at the overall financial statement level of Billing4U and at the group level**

| Risk indicator                                                                                                                      | Description of risk                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|-------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1. Billing4U Ltd is listed on AltX of the JSE.                                                                                      | <ul style="list-style-type: none"> <li>The AFS may be materially misstated, in order for Billing4U to meet the AltX listing requirements. (1)</li> <li>The AFS may be materially misstated in order to meet the shareholders expectation. (1)</li> </ul>                                                                                                                                                                                                                                                                          |
| 2. CEO, Julius Zille deliberately provided the mayor with incorrect information.                                                    | <ul style="list-style-type: none"> <li>The AFS may be materially misstated as the control environment might be compromised by the lack of integrity of the CEO/ management. (1)</li> </ul>                                                                                                                                                                                                                                                                                                                                        |
| 3. Directors receive share options driven by the profit for the year and directors have a significant share holding in the company. | <ul style="list-style-type: none"> <li>The AFS may be materially misstated by overstating revenue/ income and understating expenses, manipulation of profits, to increase the directors' benefits. (1)</li> </ul>                                                                                                                                                                                                                                                                                                                 |
| 4. Change in the financial year-end                                                                                                 | <ul style="list-style-type: none"> <li>The AFS may be materially misstated, as the items in the financial statements might not be properly accounted for in the correct period. (1)</li> <li>The AFS may be materially misstated as the change in year-end might not be done in compliance with the Companies Act requirements. (1)</li> </ul>                                                                                                                                                                                    |
| 5. Going concern                                                                                                                    | <p>The financial statement may be inappropriately presented on the going concern basis due to: (1)</p> <ul style="list-style-type: none"> <li>Loss of major client resulting in loss of revenue (City of Johannesburg). (1)</li> <li>Not having enough cash to settle the lawsuit of R210 million. (1)</li> <li>Going concern problems may give management the opportunity to manipulate the financial statements to show a favourable position. (1)</li> </ul> <p style="text-align: right;">Max (4)</p>                         |
| 6. Loan depends on the audited financial statements.                                                                                | <ul style="list-style-type: none"> <li>The AFS may be materially misstated, as the assets/ revenue might be overstated and liabilities/expenses understated in order to obtain the loan (fraudulent financial reporting). (1)</li> </ul>                                                                                                                                                                                                                                                                                          |
| 7. Billing4U operates with-in a group.                                                                                              | <ul style="list-style-type: none"> <li>The AFS may be materially misstated, as the related party/ inter group relationships and transactions might not be properly accounted and disclosed in Billing4U's financial statements. (1)</li> <li>The AFS may be materially misstated as this is the first year consolidated financial statements will be prepared. (1)</li> <li>The AFS may be materially misstated as the controls might not be operating consistently throughout all the companies within the group. (1)</li> </ul> |

| Risk indicator                                                                                                 | Description of risk                                                                                                                                                                                                                                        |
|----------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 8. Billing4U acquired three entities during the year.                                                          | <ul style="list-style-type: none"> <li>The AFS might be materially misstated as the acquisition of the three entities might not be accounted for in terms of IFRS3. (1)</li> </ul>                                                                         |
| 9. Consolidations required.                                                                                    | <ul style="list-style-type: none"> <li>There is a risk that the inter-group party transactions might not be eliminated on consolidation. (1)</li> <li>Inconsistent accounting policies may be used by the different companies in the group. (1)</li> </ul> |
| 10. Reliance on the component auditors.                                                                        | <ul style="list-style-type: none"> <li>There is a risk that the components auditor might not possess the required independence, skills and expertise to audit the component resulting in material misstatements in the group AFS. (1)</li> </ul>           |
| 11. Financial statements are required a week after year-end and the decrease in the members of the audit team. | <ul style="list-style-type: none"> <li>The tight audit timeframe on the audit team creates an <i>opportunity for fraudulent reporting by management</i> on the financial statements. (1)</li> </ul>                                                        |

Presentation: language and logic (1)  
Available 19  
Maximum 13

## PART b

### (i) Risk at the assertion level

#### **Net administrative fee income**

- There is a risk that administrative fee **income of the next period might be accounted for in the current period** to inflate profits due to the fact that management have share options based on profits and there is going concern issues. (Occurrence, cut-off). (1)
- There is a risk that **municipalities might be charged incorrect rates**, as the rates are driven by the number of residents billed per month and vary per month and various files are received from different municipalities (Occurrence, Accuracy, Completeness). (1)
- There is a risk that all the **complaints and resulting penalties are not taken into account** for calculation of the net administration fee (Completeness). (1)
- There is a risk that the **VAT subtracted not on the net fee income** (excluding the penalty charged) **but full fee income** (inclusive of the penalty charged). (Accuracy). (1)
- The administrative fee income could be calculated using the **incorrect penalty percentage (1) / original fee (1) / number of residents (1)** (Accuracy). Max (3)
- The **provision for the July penalties may be incorrectly calculated** due to the many problems that occurred during the year. (Accuracy). (1)
- The **provision for the July penalties may not be included** in the net fee income (cut-off). (1)
- There is a risk that the **net administrative fee** accounted for in the general ledger might be **inclusive of VAT and penalties charged**. (Accuracy) (1)

**Speedbill 9000**

1. *There is a risk that the **costs may not be properly treated.*** (1)
  - 1.1 **Costs capitalised** to the intangible assets are **not qualifying costs** (e.g. training costs). (Accuracy) (1)
  - 1.2 The costs **qualifying to be capitalised** (e.g. feasibility study costs) **might not be capitalised** (Existence, Completeness). (1)
2. There is a risk that the **foreign invoice** with regards to the purchase of Speedbill 9000 might not be **translated at the correct exchange rate** when the risks and rewards pass to Billing4U (Valuation, Accuracy). (1)
3. *There is a risk that the translation of the **FEC asset or liability** might **not be properly calculated.*** (Accuracy) (1)
4. There is a risk that **FEC gains or losses** might be **incorrectly accounted** for in the cost of the Speedbill 9000 (Valuation, Accuracy). (1)
5. There is a risk that the Speedbill 9000 might be **amortised** over the **incorrect useful life** (Valuation). (1)
6. There is a risk that the **intangible asset is not assessed for impairment** as required by IAS 36, as management did not deem it necessary to do an impairment test especially in light of the complaints received which might be software related (Valuation). (1)

Presentation: language and logic (1)  
 Available 19  
 Maximum 11

**(ii) General procedures for net administrative fee income and the intangible asset (Speedbill 9000)**

- Consider the effectiveness of the internal control environment before commencing with the substantive procedures. (1)
- **Agree the balances** of the net administrative fee income and the intangible asset from the **trial balance** to the **lead schedule, general ledger and the AFS.** (1)
- **Recalculate** the general ledger account of the **net administrative fee** and the **intangible asset.** (1)
- Obtain a signed **management representation letter** from management including a reference to occurrence and accuracy, for **administrative fee income** and valuation of the **Speedbill 9000 system.** (1)
- **Inspect** the **financial statements** and compare the policy with regards to revenue and intangible asset from **current year** to **prior year** to confirm that the **accounting policy is applied consistently.** (1)

**(ii) (a) Administrative fee income**

- Obtain the list of contracts with municipalities from management and agree the list to actual contracts. (completeness) (1)

- With regards to the contracts confirm the following:
  - the **date and duration** of the contract;
  - **terms and conditions**, etc;
  - the **parties** involved in the transaction; and
  - that the **document** was **signed by both parties**.

Max (1)
- With regards to the **fee structure**, agree to the **policy documents** and the **minutes of management (directors) meeting**. (1)
- Inspect the **minutes of the managers (directors’) meetings** to confirm the following:
  - that **all** new and renewed **contracts** with the municipalities have been **approved** by management; (1)
  - the **policy** that relates to the **administrative fee income** and the **penalties** for all the **municipalities has been approved**. (1)
- Inspect the **changes to the policy** and agree the **changes to the minutes of the managers (directors) meeting**. (1)
- Inspect the gross **administrative fee income general ledger account** to confirm that there are not **more than 16 transactions** (the financial year increased by 4 moths) per municipality depending on when the contracts were concluded. (1)
- Inspect the **general ledger account of the administrative fee** for the year ended 31 July to confirm that the **August transactions are not included**. (1)
- Use **generalised audit software/CAATs** to **calculate** the **number of residents** on the **monthly data files** per individual municipalities. (1)
  - **Agree** these numbers to the **number of residents used in the preparation of the invoice to the monthly data file received from the municipalities**. (1)
  - **Agree** the details of the **invoice, i.e. number of residents billed and rate used** to the **policy document**. (1)
- Select a sample of **entries in the gross administrative fee income journal** (or detailed general ledger) and follow them through to the **invoices**. (1)
- In selecting the sample **include the invoice** for the City of Johannesburg for February 2011 when the **power outage happened**. (1)
- **Recalculate these invoices** to ensure that the calculations of administrative fees, penalties and VAT were accurate (casting and extensions). (1)
- Use CAATs to generate a printout from the **“Disputes” module** of all the municipalities where residents have lodged a dispute. (1)
- Agree the **number of disputes** on the **generated printout** to the number of disputes on the **monthly invoice** of municipalities. (1)
- Inspect the generated printout to confirm that the disputes for February 2011 are specifically included. (1)
- Agree the **administrative fee used in the penalty** calculation to the administration fee **charged on the prior month’s invoice**. (1)

- Agree the **penalty percentage** used in the calculation to the **policy document**.(1)
- **Recalculate** the **penalty that relates** to the July 2011 disputes and compare it to the provision that has been raised to ensure that it is accurate. (1)
- **Recalculate** the **provision of the penalty** estimate for August 2011 and confirm that it has been properly allocated to the July 2011 administration fee income. (1)
- **Recalculate** the **net amount** to confirm that it is exclusive of the Vat and penalty. (1)
- Compare monthly **administrative fee income for the current year** to the **prior year** taking into account any expected increases in penalties due to the City of Johannesburg crisis and follow up on any major deviations. (1)
- Inspect the **financial statements** that the administrative fee was disclosed according to the **requirements of IAS18**. (1)

(ii) (b) **Speedbill 9000 system**

- Obtain the **purchase contract** and inspect it for the following: (1)
    - the **effective date**;
    - the **amount** of the transaction ( 3 million Euros); and
    - that it has been **signed by both parties**.
- } Max (1)
- Inspect the **minutes of the directors meeting** to confirm that the transaction to purchased Speedbill 9000 system was approved. (1)
  - Inspect the **minutes of the directors meetings** to determine the **date** on which the **conversion** took place from the Billfast X200 to the Speedbill 9000 system, as this is the date on which the new system is operational, which should be used in the calculation of the amortisation of the intangible asset. (1)
  - Inspect the fixed asset register to confirm that the intangible asset has been properly accounted for. (1)
  - **Recalculate** the **value that should be in the general ledger/fixed asset register** using the spot rate on the day the software was purchased to account.(1)
  - **Agree** the **spot rates** used to the **financial institutions**. (1)
  - Obtain the **FEC contract** and inspect it for the following: (1)
    - The FEC rates;
    - terms and conditions and
    - parties to the contract
- Max (1)
- Recalculate the hedge effectiveness as per the Accounting Standards. (1)
  - **Recalculate** the **FEC asset or liability** during the period the hedge is effective.(1)
  - Through inspection of the **general ledger account of Speedbill 9000** confirm that the **FEC asset or liability has been appropriately (transferred) accounted** for in the **intangible asset account**. (1)

- Inspect the **general ledger account of the intangible asset** and agree the cost in relation to the feasibility study to the **invoice / bank statement**. (1)
- Inspect the general ledger account for the intangible asset and confirm that the training cost were not capitalised. (1)
- Obtain a **copy of the feasibility study** and inspect that it indicates the **period** for which the software will be operational as **four years**. (1)
- Through inquiry of management consider the **reasonableness of the amortisation** period as well as the **assumptions and methods** used by management in deciding to write the intangible asset off over a period of 6 years instead of 4 years. (1)
- Obtain the advice from **an IT expert** on the ability of the software to operate effectively for a period over 4 years. (1)
- **Discuss** the **IT expert** finding with **management**. (1)
- **Recalculate the amortisation** using the appropriate useful life. (1)
- If applicable, take the **difference on the amortisation** to the **schedule of misstatements**. (1)
- With regards to the expert:
  - evaluate the **competence, capabilities and objectivity** of the expert;
  - obtain an **understanding of the work of the expert**; and
  - evaluate the **appropriateness of the expert's work as audit evidence**.
- Obtain evidence through discussion with the **IT expert** if there are any **indications** for the intangible asset (software) to be **impaired**. (1)
- **Request management** to perform the **impairment evaluation**, as it is a requirement in terms of IAS 38 to do it every year. If not, consider the impact of management's decision not to do the impairment test in the current year. (1)
- **Inspect the financial statements** to confirm that the intangible asset was disclosed according to the **requirements of IAS 38**. (1)

Presentation: Proper formulation of audit procedures (1)

Available 53

Maximum 25

**PART C**

**Weaknesses in the procedures followed by Billing4U Ltd, which relate to the purchase, conversion, testing and post-implementation of Speedbill 9000.**

| Information from the scenario to which the weakness relates<br>(DOES NOT COUNT MARKS)                                                                                                                                                                                                                                                                                                                                                                           | Weaknesses                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Decision and approval to purchase the Speedbill 9000 system</b>                                                                                                                                                                                                                                                                                                                                                                                              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| <ul style="list-style-type: none"> <li>Mrs Rosa sent out a questionnaire to the staff members who would be performing billing functions on the new system to obtain an understanding of their specific needs and requirements in terms of this new billing system.</li> </ul>                                                                                                                                                                                   | <ul style="list-style-type: none"> <li>Mrs Rosa only sent out the questionnaire to staff members who would be performing billing functions on the new system and therefore did not take the needs and requirements of the following parties into account: (1)               <ul style="list-style-type: none"> <li>the IT staff members of Billing4U;</li> <li>the internal auditors of Billing4U; or</li> <li>the external auditors, Motholo &amp; Terblanche, Max (2)</li> </ul> </li> <li>A questionnaire might not be sufficient to determine all user needs and requirements relating to the new system e.g. input, procedures, calculations, output, reports, audit trails, etc. Have all of these issues been dealt with in the questionnaire? (1)</li> </ul> |
| <ul style="list-style-type: none"> <li>Only Mr Johnson, the Information Technology (IT) manager replied to the questionnaire in terms of specific needs and requirements with regards to the new system. As he is mainly responsible for the effective functioning of the new system, Mrs Rosa decided that Mr Johnson spoke on behalf of all the staff members and she decided not to waste any more time on further queries regarding this matter.</li> </ul> | <ul style="list-style-type: none"> <li>Mrs Rosa decided that Mr Johnson (the IT manager) spoke on behalf of all staff members and therefore did not take the needs and requirements of any users who would be performing the actual billing functions on the Speedbill 9000 system into account. (1)</li> <li>Management of each user department did not authorise or approve the final specifications/needs/requirements of the Speedbill 9000 system. (1)</li> </ul>                                                                                                                                                                                                                                                                                               |
| <ul style="list-style-type: none"> <li>No problems were identified during the feasibility study conducted by Mrs Rosa.</li> <li>The international supplier of the Speedbill 9000 system has several branches and offices abroad. The South African branch closed down in 2009.</li> </ul>                                                                                                                                                                       | <ul style="list-style-type: none"> <li>No alternative suppliers of similar systems were considered. (1)</li> <li>Mrs Rosa did not identify any issues from the matters investigated in the feasibility study, but she neglected to raise the issue that the supplier does not have a branch in South Africa:               <ul style="list-style-type: none"> <li>this could have a serious impact on the assistance and support being offered by the supplier; or (1)</li> <li>it could indicate that the software is not appropriate for the South African market. (1)</li> </ul> </li> </ul>                                                                                                                                                                      |
| <ul style="list-style-type: none"> <li>Mrs Rosa discussed certain matters with the international Supplier of the Speedbill 9000 system.</li> </ul>                                                                                                                                                                                                                                                                                                              | <ul style="list-style-type: none"> <li>A system purchased abroad, might not cater for specific South African requirements (e.g. VAT and other specific tax requirements). (1)</li> <li>As it is a standard package, it might not be tailor-made for Billing4U's requirements and might not be adaptable for changes. (1)</li> <li>A supplier can't objectively evaluate itself. (1)</li> </ul>                                                                                                                                                                                                                                                                                                                                                                       |

| Information from the scenario to which the weakness relates<br>(DOES NOT COUNT MARKS)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Weaknesses                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>Mrs Rosa contacted one company abroad currently using the Speedbill 9000 system.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | <ul style="list-style-type: none"> <li>Mrs Rosa only contacted <b>one</b> company abroad that uses of the Speedbill 9000 system and based her conclusion that the system would work for Billing4U on only this company's experiences. (1)</li> <li>This company is abroad and therefore may not experience the same problems unique that are to a South African company. (1)</li> </ul>                                                                                                                                                                                                                                                                   |
| <ul style="list-style-type: none"> <li>The company abroad, which Mrs Rosa contacted, identified no problems although it does not provide billing services to municipalities with a customer base of more than 250 residents. Mrs Rosa is of the opinion that "if it works for a customer base of 250 residents, it will work for a customer base of 1,2 million residents".</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | <ul style="list-style-type: none"> <li>The company abroad using the Speedbill 9000 system only provides billing services to municipalities with a customer base of not more than 250 residents. This company is therefore not a good benchmark seeing that Billing4U's biggest client has a customer base of approximately 1,2 million residents. (1)</li> <li>The processing speed and storage functions of the Speedbill 9000 system, might not be sufficient to cater for 1,2 million residents. (1)</li> </ul>                                                                                                                                        |
| <ul style="list-style-type: none"> <li>The purchase was authorised by management as well as the steering committee appointed by management to run the Speedbill 9000 project.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | <ul style="list-style-type: none"> <li>Only management and the steering committee approved the purchase of the Speedbill 9000 system without the users, IT staff, internal auditors, etc. approving it after the results of the feasibility study and recommendations have been considered. (1)</li> <li>The board of directors did not authorise the purchase of the software, despite the system's major operational and financial impact. (Bonus)</li> </ul>                                                                                                                                                                                           |
| <ul style="list-style-type: none"> <li>Management and the steering committee assigned Mrs Rosa to the conversion process. She was appointed as the only member of the "conversion project team".</li> <li>She was mainly responsible for: <ul style="list-style-type: none"> <li>Deciding on an appropriate conversion method.</li> <li>Setting deadline dates and cut-off points.</li> <li>Setting time schedules for specific stages of the project.</li> <li>Allocating specific tasks to appropriate staff members.</li> <li>Giving clear guidance and support to these staff members as well as time schedules for completion of these tasks.</li> <li>Regularly monitoring the progress of the process.</li> <li>Identifying possible problems in the process.</li> <li>Reporting to the steering committee at regular intervals.</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>A project team (with appropriate IT and user staff members) was not formed by the steering committee as only Mrs Rosa was assigned to the conversion process (the only member of the "conversion project team"). (1)</li> <li>Mrs Rosa was solely responsible for all the tasks allocated to her by the steering committee and a lack of involvement/ownership by other people. She might not have: <ul style="list-style-type: none"> <li>The required knowledge or experience to perform all these tasks. (1)</li> <li>Sufficient time to perform the tasks to the required standard. (1)</li> </ul> </li> </ul> |

| Information from the scenario to which the weakness relates<br>(DOES NOT COUNT MARKS)                                                                                                                                                                                                                                                                                                                       | Weaknesses                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Conversion from the Billfast X200 system to the Speedbill 9000 system</b>                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| <ul style="list-style-type: none"> <li>As part of the preparation for conversion, Mrs Rosa allocated the tedious task of preparing standing data files on the Speedbill 9000 system as well as the task of balancing files on the Billfast X200 system to Mr Kriel. She explained that in her opinion "Mr Kriel is the financial manager and therefore knows a lot about making things balance".</li> </ul> | <ul style="list-style-type: none"> <li>The task of preparing standing data files on the Speedbill 9000 system as well as the task of balancing files on the Billfast X200 system was allocated to Mr Kriel, the financial manager. He probably does not have the required skills, knowledge or expertise to perform these technical IT functions. (1)</li> </ul>                                                                                                                                                                                                                              |
| <ul style="list-style-type: none"> <li>Mr Johnson was allocated to the training of staff members on the Speedbill 9000 system as he trained himself in the use of the new system.</li> </ul>                                                                                                                                                                                                                | <ul style="list-style-type: none"> <li>As Mr Johnson trained himself in the use of the new system, he might not be capable of providing sufficient training on the Speedbill 9000 system (he did not receive proper training himself). (1)</li> <li>No formal programme was devised setting out the detail of all personnel to be trained, dates and times for the training etc. (1)</li> <li>User procedure manuals were not used for the training as only quick discussions were held. (1)</li> </ul>                                                                                       |
| <ul style="list-style-type: none"> <li>Due to time constraints, he had brief discussions with the management of each department.</li> </ul>                                                                                                                                                                                                                                                                 | <ul style="list-style-type: none"> <li>Brief discussions with management of each department are not adequate training as all staff members were not individually trained regarding their specific tasks and functions. (1)</li> <li>Time constraints indicate poor planning and/or monitoring of the process from purchase until final implementation. (1)</li> </ul>                                                                                                                                                                                                                         |
| <ul style="list-style-type: none"> <li>Mr Johnson advised management that job descriptions would not have to be changed as each person would still be responsible for the same tasks.</li> </ul>                                                                                                                                                                                                            | <ul style="list-style-type: none"> <li>Clearly defined and updated job descriptions were not used as part of the training exercise. (1)</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| <ul style="list-style-type: none"> <li>A power outage occurred during the conversion process.</li> </ul>                                                                                                                                                                                                                                                                                                    | <ul style="list-style-type: none"> <li>As a power outage occurred during the conversion process, the premises of Billing4U were clearly not adequately prepared in terms of disaster recovery procedures etc. (1)</li> <li>There were no data recovery procedures. (1)</li> </ul>                                                                                                                                                                                                                                                                                                             |
| <ul style="list-style-type: none"> <li>It was decided that the system would not be tested after the conversion and that the first month of actual billing to residents would be the test run of the Speedbill 9000 system.</li> </ul>                                                                                                                                                                       | <ul style="list-style-type: none"> <li>It seems as though the following controls over preparation and entry of data were not performed as the system was not tested: (1) <ul style="list-style-type: none"> <li>A comparison between the files on the Billfast X200 system and the files on the Speedbill 9000 system.</li> <li>All discrepancies identified investigated.</li> <li>Record counts, control totals or hash totals used in the reconciliation of the old to the new system.</li> <li>Exception reports on problems identified obtained and investigated.</li> </ul> </li> </ul> |

| Information from the scenario to which the weakness relates<br>(DOES NOT COUNT MARKS)                            | Weaknesses                                                                                                                                                                                                                                                                       |
|------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                                                                                                                  | <ul style="list-style-type: none"> <li>- User approval for data converted (in terms of each user department).</li> <li>- Obtaining direct confirmation from the municipalities of information reflecting on the new system.</li> </ul> <p style="text-align: right;">Max (4)</p> |
| <b>Testing and Post-implementation review</b>                                                                    |                                                                                                                                                                                                                                                                                  |
| <ul style="list-style-type: none"> <li>• Supervisors were appointed to oversee the conversion.</li> </ul>        | <ul style="list-style-type: none"> <li>• Insufficient (or ineffective) supervision took place, else the conversion error would have been detected. (1)</li> </ul>                                                                                                                |
| <ul style="list-style-type: none"> <li>• Back-ups were made of the new system.</li> </ul>                        | <ul style="list-style-type: none"> <li>• No back-ups were made of the old system prior to conversion. (1)</li> </ul>                                                                                                                                                             |
| <ul style="list-style-type: none"> <li>• A post-implementation review was scheduled for January 2012.</li> </ul> | <ul style="list-style-type: none"> <li>• The post-implementation review scheduled for January 2012 is probably too late as numerous problems might have been experienced by then.(1)</li> </ul>                                                                                  |
|                                                                                                                  | <ul style="list-style-type: none"> <li>• The compatibility of the new system for the new Billing4U subsidiaries was not considered. (Bonus)</li> </ul>                                                                                                                           |

Available 37  
Maximum 25

#### PART D

The computerised (programmed) application controls you would expect to see to ensure the following:

*(i and ii )The occurrence and authorisation (validity) as well as the completeness of the capturing of lodged complaints by the temporary clerks.*

| Information from the scenario to which the application control relates<br>(DOES NOT COUNT MARKS)                                                                                                                                                                                                                                                                                                                                                  | Computerised application control over input – occurrence and authorisation                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Occurrence and authorisation</b>                                                                                                                                                                                                                                                                                                                                                                                                               |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| <ul style="list-style-type: none"> <li>• Billing4U employed temporary clerks at each of the four care centres as well as at the call centre to capture the formally lodged disputes on the “Disputes” module.</li> <li>• Employment contracts valid for a period of 2 months were signed by all temporary clerks.</li> <li>• Operating hours at the care centres and the call centre were from 08:00 to 18:00 from Monday to Saturday.</li> </ul> | <p><b>Computerised access controls</b></p> <ul style="list-style-type: none"> <li>• Temporary access should be given to the temporary clerks, which should be valid for a period of 2 months (after this period it should be automatically disabled). (1)</li> <li>• A temporary user Identification (ID) number and password should be allocated to the clerks on only the Speedbill 9000 “Disputes” module. (1)</li> <li>• Restricted access in terms of user profiles/access tables at both “Disputes” programme level as well as Speedbill 9000 system level should be in place. A CRUD matrix (create, read only, update and/or delete) could be used for this purpose. (1)</li> <li>• The module should check that the chosen password conforms with best practices. (1)</li> </ul> |

| Information from the scenario to which the application control relates<br>(DOES NOT COUNT MARKS)                                                                                                                                                                                                                                                                                                        | Computerised application control over input – occurrence and authorisation                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>• The system does not allow the clerks to delete resident’s details derived from the master file.</li> </ul>                                                                                                                                                                                                                                                     | <ul style="list-style-type: none"> <li>• Clerks should only be allowed access to the system during operating hours from 08:00 to 18:00, Monday to Saturday. (1)</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| <ul style="list-style-type: none"> <li>• Each clerk was allocated a personal computer on which the clerk did capturing via a keyboard.</li> </ul>                                                                                                                                                                                                                                                       | <ul style="list-style-type: none"> <li>• The personal computer (PC) on which the clerk does the capturing should shut down when an access violation takes place (e.g. incorrect user ID or password is entered three times). (1)</li> <li>• The PC on which the clerk does the capturing should have a time-out facility after a certain period of inactivity (1)</li> <li>• The user ID, date, time and nature of the activity performed on the PC should be logged by the computer. (1)</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| <ul style="list-style-type: none"> <li>• The following criteria have to be met in order to receive a reference number: <ul style="list-style-type: none"> <li>– The resident has to be a customer of one of the eight metropolitan municipalities.</li> <li>– The resident has to lodge a formal dispute within 30 days of invoice date.</li> </ul> </li> </ul>                                         | <ul style="list-style-type: none"> <li>• The following checks should be performed by the computer: <ul style="list-style-type: none"> <li>– Limit check: e.g. that the complaint is lodged within 30 days of invoice date. (1)</li> <li>– Range check: e.g. the resident’s account number falls within the minimum and maximum ranges for a customer of one of the eight metropolitan municipalities. (1)</li> <li>– Verification check: e.g. the computer should verify that the resident lodging the complaint is indeed a customer of one of the eight metropolitan municipalities by verifying the resident’s account number to the Speedbill 9000 master file data. (1)</li> </ul> </li> <li>• The computer should give an error message if an error is noted during any of the above program checks. (1)</li> <li>• A message box should appear after entry of the resident’s account number instructing the clerk to verify the resident master file details before continuing, to ensure the correct resident is being dealt with. (1)</li> <li>• There should be an alternative method of obtaining the resident’s account number, e.g. through a look-up facility. (Bonus)</li> <li>• If another complaint already exists, that complaint should be opened, or an exception report of multiple claims per month should automatically be generated. (Bonus)</li> </ul> |
| <ul style="list-style-type: none"> <li>• The “Disputes” module only allowed the following types of disputes to be captured: <ul style="list-style-type: none"> <li>– Incorrect stand and physical addresses.</li> <li>– Excessive billing amounts.</li> <li>– Deeds transfers not correctly updated on the Speedbill 9000 system.</li> <li>– Incorrect estimated meter readings.</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>• A drop-down list should be available on the capturing screen for the clerk to choose from the various types of complaints. (1)</li> <li>• There should be standardised fields for the capturing of additional information, depending on the type of dispute selected. (Bonus)</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |

|                                                                                                                                                                                                    |                                                                                   |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------|
| <b>Information from the scenario to which the application control relates<br/>(DOES NOT COUNT MARKS)</b>                                                                                           | <b>Computerised application control over input – occurrence and authorisation</b> |
| <ul style="list-style-type: none"> <li>– Bills not received.</li> <li>– Receiving duplicate bills.</li> <li>– Incorrect detail given on bills.</li> <li>– Services unduly disconnected.</li> </ul> |                                                                                   |

|           |           |
|-----------|-----------|
| Available | <u>14</u> |
| Maximum   | <u>11</u> |

|                                                                                                                                                                                                                                                        |                                                                                                                                                                                                                                                                                                                                                     |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Information from the scenario to which the application control relates<br/>(DOES NOT COUNT MARKS)</b>                                                                                                                                               | <b>Computerised application control over input – completeness</b>                                                                                                                                                                                                                                                                                   |
| <b>Completeness</b>                                                                                                                                                                                                                                    |                                                                                                                                                                                                                                                                                                                                                     |
| <ul style="list-style-type: none"> <li>• A reference number, allocated by the “Disputes” module, was given to a customer on receipt of the formal dispute. This number was used by Billing4U to track the progress on the specific dispute.</li> </ul> | <ul style="list-style-type: none"> <li>• The “Disputes” module should follow up on the sequence of the reference numbers and report any missing numbers (possibly through an exception report). (1)</li> </ul>                                                                                                                                      |
| <ul style="list-style-type: none"> <li>• Each clerk was allocated a personal computer on which the clerk captured the resident number, the date of lodging the dispute, the nature of the dispute etc, directly via a keyboard.</li> </ul>             | <ul style="list-style-type: none"> <li>• Field presence checks (missing data checks) should be in place to ensure that all critical input fields (mandatory fields) are present e.g. the resident number and the drop-down box for the nature of the dispute should be present and completed before a reference number is allocated. (1)</li> </ul> |

|                              |            |
|------------------------------|------------|
| Available                    | <u>2</u>   |
| Maximum                      | <u>2</u>   |
| Presentation: layout (table) |            |
| - Part c                     | (1)        |
| - Part d                     | <u>(1)</u> |
|                              | <u>2</u>   |

**QUESTION 2**

You are the audit senior employed by SuperAuditors Inc (“SuperAuditors”), a large firm of registered Auditors with offices throughout the world. You have been assigned to the 2011 audit of South African Petroleum Ltd (“SAP”), a company listed on the JSE Limited. SAP was incorporated in 1992 and has a 30 April year-end.

At one of your weekly progress meetings the engagement partner informed the audit team that the final materiality for the 2011 audit is R80 million and that the reporting deadline is 15 August 2011.

The following working papers are available:

| <b>WORKING PAPER</b>                                   | <b>Reference number</b> |
|--------------------------------------------------------|-------------------------|
| Understanding the entity and its environment           | JW 400                  |
| Extract from minutes of board of directors’ meeting    | JW 500                  |
| Decommissioning and restoration costs and oil spillage | R 600                   |
| Summary of unresolved findings                         | N 200                   |

|                       |                                                     |                   |               |                                   |
|-----------------------|-----------------------------------------------------|-------------------|---------------|-----------------------------------|
| <b>Company name:</b>  | SAP Ltd                                             | <b>Year- end:</b> | 30 April 2011 | WP ref<br><b>JW 400</b><br>Page 1 |
| <b>Prepared by:</b>   | JK                                                  | <b>Date:</b>      | 15 May 2011   |                                   |
| <b>Reviewed by:</b>   | WK                                                  | <b>Date:</b>      | 16 May 2011   |                                   |
| <b>Audit section:</b> | <b>Understanding the entity and its environment</b> |                   |               |                                   |

### Overview of operations

SAP is an oil and gas exploration company incorporated in South Africa with exploration licences for countries in Africa such as Kenya, Ethiopia, Somalia, Nigeria, etc. Since its incorporation in 1992, SAP has invested R12 billion in Africa and has grown into an African energy group.

SAP has an authorised ordinary share capital of 4 million ordinary shares.

Share capital balance: R32 million.

The 3,2 million issued ordinary shares are held as follows:

|                                                                                                                   |                  |
|-------------------------------------------------------------------------------------------------------------------|------------------|
| Shellgen Ltd, a company listed on the JSE, which is involved in the manufacturing of hydraulic drilling machines. | 1 120 000 shares |
| Aogen (Pty) Ltd, a privately owned company that specialises in the distribution of fuels and lubricants.          | 1 120 000 shares |
| Various private shareholders.                                                                                     | 480 000 shares   |
| Employees of SAP through a share participation scheme.                                                            | 480 000 shares   |

### Explosion on an oil rig in the Niger Delta

On 25 February 2011, there was an explosion on a SAP oil rig in the Niger Delta causing 4.9 million barrels of oil to gush into the Niger Delta, wreaking havoc on the region's environment and economy. Another 5,6 million barrels of oil were contaminated with the debris that was caused by the explosion. On 15 March 2011 the World Wildlife Fund (WWF) instituted a legal claim against SAP, suing them for R100 million. The market reacted extremely negatively to all of this and the share price plummeted from R236.85 per share on 25 February 2011 to R 146.67 per share on 20 April 2011 (the day before the meeting of the Board of Directors).

You raised the matter with the chairman of the board and her response was as follows "The oil spill is the largest ever man-made environmental disaster and is an accident that should never have happened, but if we truly learn from this accident I see no reason to stop the drilling and not to continue business as usual".

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                                     |                   |               |                                   |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------|-------------------|---------------|-----------------------------------|
| <b>Company name:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | SAP Ltd                                             | <b>Year- end:</b> | 30 April 2011 | WP ref<br><b>JW 400</b><br>Page 2 |
| <b>Prepared by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | JK                                                  | <b>Date:</b>      | 15 May 2011   |                                   |
| <b>Reviewed by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | WK                                                  | <b>Date:</b>      | 16 May 2011   |                                   |
| <b>Audit section:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | <b>Understanding the entity and its environment</b> |                   |               |                                   |
| <p><b>Governance and management structure</b></p> <p><b>Directors of the board</b><br/>         Mrs Beyleveld (Chief executive officer)<br/>         Mrs Terblanche (Financial director)<br/>         Mr Smith (Operations director)<br/>         Mrs Kriel (Independent non-executive director) (Chairman)<br/>         Mr Barnard (Independent non-executive director)<br/>         Dr H Thoothe (Independent non-executive director)<br/>         Mrs A Lacy (Independent non-executive director)</p> <p><b>Risk and Audit Committees</b><br/>         Mrs Kriel<br/>         Mr Barnard<br/>         Dr H Thoothe (Chairman)</p> <p>All members of the above two board committees are Chartered Accountants (SA). Mrs Kriel and Mr Barnard are specialists in the field of International Financial Reporting Standards. Dr Thoothe is a recently retired professor from the University of South Africa. She worked in the department of Auditing for almost 20 years and is still regarded as one of the top experts in the field of corporate governance and statutory matters.</p> |                                                     |                   |               |                                   |

|                       |                                                            |                   |               |                                   |
|-----------------------|------------------------------------------------------------|-------------------|---------------|-----------------------------------|
| <b>Company name:</b>  | SAP Ltd                                                    | <b>Year- end:</b> | 30 April 2011 | WP ref<br><b>JW 500</b><br>Page 1 |
| <b>Prepared by:</b>   | JK                                                         | <b>Date:</b>      | 15 May 2011   |                                   |
| <b>Reviewed by:</b>   | WK                                                         | <b>Date:</b>      | 16 May 2011   |                                   |
| <b>Audit section:</b> | <b>Extract from minutes of board of directors' meeting</b> |                   |               |                                   |

**Minutes of the meeting of the Board of Directors held on Thursday, 21 April 2011, at 10:00 in the Platinum Boardroom, Midrand Office Estate, Midrand.**

***Members present***

Mrs Beyleveld (Chief executive officer)  
 Mrs Terblanche (Financial director)  
 Mr Smith (Operations director)  
 Mrs Kriel (Independent non-executive director) (Chairman)  
 Mr Barnard (Independent non-executive director)  
 Dr H Thoothe (Independent non-executive director)  
 Mrs A Lacy (Independent non-executive director)

***On invitation***

Mr F Motholo (Chief audit executive)

***Welcome***

The chairman welcomed everyone present to the third and hopefully the last meeting of the year.

***Approval of Minutes held on 3 March 2011***

The chairman confirmed that all members of the board have received the minutes of the second board meeting for the financial year held on 3 March 2011 as prepared and circulated by her during the previous week. After making a few editorial corrections, the minutes were approved and signed.

***Feedback from Risk Committee***

Dr Thoothe gave feedback on the risk committee's responsibility towards the governance of risk within SAP. She said that a thorough risk identification process was undertaken and that Mr Barnard assessed the overall level of risk tolerance as low. She reported that the following key risks were identified:

- High staff turnover due to lack of training and poor staff management.
- Monthly debtors' reconciliations not reviewed timeously.
- No fraud risk plan in place to consider fraud exposure and prevention.

Dr Thoothe had nothing further to report on the risks identified. Mrs Beyleveld thanked Dr Thoothe for the good work that she and her team did and said that the board will simply take note of these risks. Mrs Beyleveld added that she was quite worried about the risks identified as they could have a major impact on the business. She asked Dr Thoothe to keep this information confidential between the board and the risk committee for now and not to disclose it to the employees and shareholders as yet.

|                       |                                                            |                   |               |                                   |
|-----------------------|------------------------------------------------------------|-------------------|---------------|-----------------------------------|
| <b>Company name:</b>  | SAP Ltd                                                    | <b>Year- end:</b> | 30 April 2011 | WP ref<br><b>JW 500</b><br>Page 2 |
| <b>Prepared by:</b>   | JK                                                         | <b>Date:</b>      | 15 May 2011   |                                   |
| <b>Reviewed by:</b>   | WK                                                         | <b>Date:</b>      | 16 May 2011   |                                   |
| <b>Audit section:</b> | <b>Extract from minutes of board of directors' meeting</b> |                   |               |                                   |

***Feedback from Internal Audit***

The head of the internal audit function, Mr Motholo, reported that all existing procedures and processes were assessed and were found to comply with the internal audit charter as approved by the board.

***Resolution to be passed: Transaction with Shellgen Ltd ("Shellgen")***

The Chairman referred the board to the detailed information provided on the proposed resolution included in the notice for this meeting.

Mrs Terblanche gave feedback on the negotiations that took place with the management of Shellgen during the last few weeks. The management of Shellgen approached SAP directly after the explosion took place, indicating that they are in discussions with the owners and management of Aogen (Pty) Ltd ("Aogen") to buy out a 16% stake in Aogen's shareholding in SAP at R160.65 per share. It was stated that Aogen has already indicated that they are willing to take part in this transaction as Aogen is extremely concerned about its investment in SAP as a result of the recent events and is in the process of revising its investment portfolios. Mrs Terblanche commented that management was very concerned about this matter and explained to the members of the board that this transaction could result in a hostile takeover by Shellgen.

SAP's management immediately entered into discussions with Shellgen and Aogen. An agreement was proposed whereby SAP buys back all its shares held by Shellgen at R175.56 a share. The management of Shellgen agreed to these terms and confirmed that they are willing to sell their stake in SAP.

Mrs Terblanche therefore proposed that the board pass a resolution agreeing to the following terms:

The 1 120 000 ordinary shares of Shellgen will be bought back at a price of R175.56 per share. The transaction will be financed using the company's cash reserves. SAP will acquire 768 000 of the ordinary shares. Andren (Pty) Ltd ("Andren"), a subsidiary of SAP, will acquire 352 000 share, which will be classified as "treasury shares".

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                                                            |                   |               |                                   |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------|-------------------|---------------|-----------------------------------|
| <b>Company name:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | SAP Ltd                                                    | <b>Year- end:</b> | 30 April 2011 | WP ref<br><b>JW 500</b><br>Page 3 |
| <b>Prepared by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | JK                                                         | <b>Date:</b>      | 15 May 2011   |                                   |
| <b>Reviewed by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | WK                                                         | <b>Date:</b>      | 16 May 2011   |                                   |
| <b>Audit section:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | <b>Extract from minutes of board of directors' meeting</b> |                   |               |                                   |
| <p>The directors of Andren are extremely glad that they will now be able to have a say in the resolutions adopted by SAP's shareholders.</p> <p>Mrs Terblanche advised the board that it is not necessary to evaluate the impact of this transaction on the liquidity and solvency of the company as the company's corporate finance team performed a detailed analysis in preparation of the failed "Bioclear-transaction". The board was referred to the resolution passed at the board meeting held on 13 October 2010.</p> <p>Andren approached SAP to sign a guarantee in respect of the loan of R15 million from Nedtec Ltd which will be used to finance the transaction. Mrs Terblanche indicated that the necessary processes were followed with the company's treasury and legal departments which approved the guarantee and that the board is required to include this in the resolution to be passed.</p> <p>All the members of the board present voted in favour of the resolution to be passed based on the terms mentioned above.</p> |                                                            |                   |               |                                   |

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                                                               |                   |               |                                  |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------|-------------------|---------------|----------------------------------|
| <b>Company name:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | SAP Ltd                                                       | <b>Year- end:</b> | 30 April 2011 | WP ref<br><b>R 600</b><br>Page 1 |
| <b>Prepared by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | J Gunter                                                      | <b>Date:</b>      | 4 July 2011   |                                  |
| <b>Reviewed by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | R von Willich                                                 | <b>Date:</b>      | 8 July 2011   |                                  |
| <b>Audit section:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | <b>Decommissioning and restoration costs and oil spillage</b> |                   |               |                                  |
| <b>Decommissioning and restoration cost</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |                                                               |                   |               |                                  |
| <ul style="list-style-type: none"> <li>• SAP erected an oil rig in the Niger Delta during 2005 and 2006 and completed it on 30 April 2006.</li> <li>• The local authorities approved the erection of the oil rig, provided the entity removed it after a period of 10 years and restored the environment to its original condition.</li> <li>• On 1 May 2006, the company estimated that the decommissioning and restoration costs 10 years hence would amount to R200 million at future prices. This will include the dismantling of the oil rig and restoration of the environment.</li> <li>• Assume a fair discount rate of 5% before taxation.</li> <li>• SAP uses the cost model to account for the oil rig.</li> <li>• The decommissioning and restoration costs were re-assessed by management on 1 May 2010 and are estimated at R250 million.</li> <li>• Management employed an expert to assist with this estimate.</li> </ul> |                                                               |                   |               |                                  |
| <b>Oil spillage</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                                                               |                   |               |                                  |
| <ul style="list-style-type: none"> <li>• On 25 February 2011, a major oil spillage caused much damage to the environment, around the rig. It also contaminated the water of an island that is reserved as a breeding area for the penguin population. As a result many penguins died and many had to be rescued by a nature conservation group. These penguins are in the process of recovery. The World Wildlife Fund (WWF) took legal action against the company and sued SAP for R100 million.</li> <li>• The court case was well on its way at year end (70% completed). The legal advisor indicated at year-end that there was a high probability (85%) that SAP would be liable to settle the legal claim of R100 million with the WWF as well as any legal costs that had been incurred.</li> </ul>                                                                                                                                |                                                               |                   |               |                                  |

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |                                                               |                   |               |                                  |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------|-------------------|---------------|----------------------------------|
| <b>Company name:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | SAP Ltd                                                       | <b>Year- end:</b> | 30 April 2011 | WP ref<br><b>R 600</b><br>Page 2 |
| <b>Prepared by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | J Gunter                                                      | <b>Date:</b>      | 4 July 2011   |                                  |
| <b>Reviewed by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | R von Willich                                                 | <b>Date:</b>      | 8 July 2011   |                                  |
| <b>Audit section:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | <b>Decommissioning and restoration costs and oil spillage</b> |                   |               |                                  |
| <ul style="list-style-type: none"> <li>• However management did not provide for or disclose the claim pertaining to the damages caused by the oil spillage at year-end, as they were of the opinion that they did not have any obligation until the court case was settled. They also indicated that they would not make any adjustments or disclosures relating to the oil spill in the current year's financial statements.</li> <li>• The court case was finalised on 30 June 2011 and SAP was found to be liable for all damages pertaining to the oil spill.</li> </ul> |                                                               |                   |               |                                  |

|                       |                                       |                   |               |                                  |
|-----------------------|---------------------------------------|-------------------|---------------|----------------------------------|
| <b>Company name:</b>  | SAP Ltd                               | <b>Year- end:</b> | 30 April 2011 | WP ref<br><b>N 200</b><br>Page 1 |
| <b>Prepared by:</b>   | MA                                    | <b>Date:</b>      | 20 July 2011  |                                  |
| <b>Reviewed by:</b>   | TM                                    | <b>Date:</b>      | 25 July 2011  |                                  |
| <b>Audit section:</b> | <b>Summary of unresolved findings</b> |                   |               |                                  |

The following matters were not resolved with SAP's management at the conclusion of the audit:

**Going concern:**

Based on the review of audit evidence gathered, the audit partner indicated that significant uncertainty exists regarding the company's ability to continue as a going concern. As a result management were consulted; they indicated that they have not performed the assessment of going concern and they are not willing to perform the assessment. According to management SAP is a going concern. The audit partner decided that the audit team should perform the assessment of going concern, but management refused to provide the audit team with:

- the cash flow forecast that they had prepared;
- written representation regarding the company's ability to continue as a going concern; and
- information prepared by the corporate finance team regarding the identified risks that may have a major impact on the business.

**Property, plant and equipment:**

The company purchased two electric motors to replace those destroyed during the fire explosion. The remaining motors were still in working condition. The electric motors are used in oil pumps that assist with the extraction of the oil. The pumps have a useful life of 10 years and the electric motors have a useful life of five years. While performing audit procedures on asset purchases, the third-year audit trainee discovered that these electric motors were delivered and installed during the 2011 financial year. The audit trainee held discussions with the asset manager who indicated that the electric motors were not being used and had not been depreciated, as approval from the board of directors was still awaited. Electric motors will be depreciated at 10% per annum on the straight line basis in the future. Total depreciation disclosed in the statement of comprehensive income was R186 million. Based on your calculation, the amount disclosed should be R228 million.

The company has adopted the cost model.

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |                                       |                   |               |                                  |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------|-------------------|---------------|----------------------------------|
| <b>Company name:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | SAP Ltd                               | <b>Year- end:</b> | 30 April 2011 | WP ref<br><b>N 200</b><br>Page 2 |
| <b>Prepared by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | MA                                    | <b>Date:</b>      | 20 July 2011  |                                  |
| <b>Reviewed by:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | TM                                    | <b>Date:</b>      | 25 July 2011  |                                  |
| <b>Audit section:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | <b>Summary of unresolved findings</b> |                   |               |                                  |
| <p><b><i>Inventory:</i></b></p> <p>The company did not account for goods in transit from suppliers, to the value of R180 million, at the end of the current financial year. Super Auditors identified a similar misstatement of R70 million, during the 2010 audit. The previous year's misstatement was considered not material and was carried forward to the current financial year. SAP purchases all of its inventory on credit.</p> <p><b><i>Laws and regulations:</i></b></p> <p>Based on audit procedures performed, it was discovered that SAP did not have a company secretary during the year. Management indicated that they did not see the need for a company secretary.</p> <p>Discussions relating to these findings were held with management and they were not willing to disclose this in the financial statements or directors' report.</p> <p><b><i>Prior year misstatements:</i></b></p> <p>The unadjusted misstatements relating to the prior period financial statements included:</p> <ul style="list-style-type: none"> <li>• inventory in transit worth R70 million not being recognised; and</li> <li>• an under accrual of R46 million of expenses.</li> </ul> |                                       |                   |               |                                  |

**REQUIRED**

|                                                                                                                                                                                                                                                                                                                                                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | Marks         |                                          |                                   |                    |                                   |                                       |     |  |       |  |  |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|------------------------------------------|-----------------------------------|--------------------|-----------------------------------|---------------------------------------|-----|--|-------|--|--|
| (a)                                                                                                                                                                                                                                                                                                                                                         | Identify and discuss any corporate governance and Companies Act (Act 71 of 2008) concerns that you may have based on the information provided. Limit your answer to the information provided in Working Papers <b>JW 400</b> and <b>JW 500</b> .                                                                                                                                                                                                                                                    | 31            |                                          |                                   |                    |                                   |                                       |     |  |       |  |  |
| (b)                                                                                                                                                                                                                                                                                                                                                         | Describe the impact that the contaminated oil barrels will have on your audit procedures to deal with the risks at assertion level for inventory.                                                                                                                                                                                                                                                                                                                                                   | 5             |                                          |                                   |                    |                                   |                                       |     |  |       |  |  |
| (c)                                                                                                                                                                                                                                                                                                                                                         | With reference to working paper <b>R600</b> , do the following:<br>(i) Provide the journal entries to make provision for the <b>change</b> in the decommissioning and restoration costs. Show all your calculations.<br>(ii) Critically discuss management's treatment of the claim for environmental damages pertaining to the oil spill.<br>(iii) Formulate the audit procedures that you would perform on the reassessed decommissioning and restoration costs for the year ended 30 April 2011. | 6<br>7<br>20  |                                          |                                   |                    |                                   |                                       |     |  |       |  |  |
| (d)                                                                                                                                                                                                                                                                                                                                                         | With reference to working paper <b>N200</b> , do the following:<br>(i) Discuss, giving reasons, whether or not the misstatements of the current year which resulted from the unresolved findings are individually material. (13)<br>(ii) Aggregate the individual misstatements and conclude whether that will result in the financial statements being materially misstated. Present your answer in the format of a schedule of unadjusted misstatements, as follows: (9)                          | 31            |                                          |                                   |                    |                                   |                                       |     |  |       |  |  |
| <table border="1"> <thead> <tr> <th>Description</th> <th>Statement of comprehensive income<br/>R'm</th> <th>Assets<br/>R'm</th> <th>Liabilities<br/>R'm</th> <th>Retained earnings (Equity)<br/>R'm</th> </tr> </thead> <tbody> <tr> <td>Example: Interest expense understated</td> <td>xxx</td> <td></td> <td>(xxx)</td> <td></td> </tr> </tbody> </table> |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | Description   | Statement of comprehensive income<br>R'm | Assets<br>R'm                     | Liabilities<br>R'm | Retained earnings (Equity)<br>R'm | Example: Interest expense understated | xxx |  | (xxx) |  |  |
| Description                                                                                                                                                                                                                                                                                                                                                 | Statement of comprehensive income<br>R'm                                                                                                                                                                                                                                                                                                                                                                                                                                                            | Assets<br>R'm | Liabilities<br>R'm                       | Retained earnings (Equity)<br>R'm |                    |                                   |                                       |     |  |       |  |  |
| Example: Interest expense understated                                                                                                                                                                                                                                                                                                                       | xxx                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |               | (xxx)                                    |                                   |                    |                                   |                                       |     |  |       |  |  |
| (iii)                                                                                                                                                                                                                                                                                                                                                       | Discuss the possible impact of each of the findings on the audit opinion and draw a conclusion about the opinion to be expressed in the audit report.                                                                                                                                                                                                                                                                                                                                               |               |                                          |                                   |                    |                                   |                                       |     |  |       |  |  |
| <b>Total</b>                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | <b>100</b>    |                                          |                                   |                    |                                   |                                       |     |  |       |  |  |

**QUESTION 2 – SUGGESTED SOLUTION****PART (a)****Corporate governance: King III requirements**

1. The statement by the chairman of the board that the company can “continue with business as usual” despite the recent oil spill is a concern in terms of King III. (1)
  - 1.1 King requires that the board should ensure that the company is and is seen to be responsible corporate citizen (principle 1.2). (1)
  - 1.2 King also requires that the board provide effective leadership based on an ethical foundation that implies that they should not compromise the natural environment (principle 1.1.4). (1)
2. This is the third and hopefully the last Board meeting for the year. (1)  
King III requires that the board should **meet at least four times per year** (principle 2.1.2). (1)

3. There is no evidence that **Remuneration and Nomination committees** exist (principle 2.23.6). (2)
4. Mrs Kriel, the chairman of the board is also a member of the audit committee. (1)
- 4.1 The chairman of the board should not be the chairman or member of the audit committee (principle 3.2.3). (1)
5. The **chairman prepared and circulated the minutes** of the previous board meeting. (1)
- The **company's secretary** should ensure that the **preparation and circulation of minutes** of board meetings (principle 2.21.12) are done properly. (1)
6. It seems as if the **chairman is fulfilling the role of the company's secretary**.
- 6.1 The board should be **assisted by a competent suitably qualified and experienced company secretary** (principle 2.21). (1)
- 6.2 The **Companies Act** (71 of 2008), section 86 makes it **mandatory for a company to appoint a company secretary**. (1)
7. The **Audit and Risk committees consist of the same directors**. (1)
- 7.1 The risk committee should include **both executive and non-executive directors** (principle 4.3.2.2) as members. (1)
- 7.2 **No members of senior management or from the operational side** of the company form part of the risk committee (principle 4.3.2.2) (1)
8. King III states that the members of the risk committee should comprise people with **adequate risk management skills and experience** to equip the committee to fulfil its duties (principle 4.3. par 20). (1)
- 8.1 It is unlikely that the three directors that are **accounting experts** will have **enough knowledge regarding risk management**. (1)
9. **Mr Barnard assessed the risk tolerance level** as low. (1)
- According to King III the **board should determine the levels of risk tolerance** (principle 4.2). (1)
- The risk committee **can assist the board to discharge its responsibilities**, but the risk tolerance level should not have been determined by one individual. (1)
10. **Only three key risks were identified, despite numerous other key risks** for example, environmental risks, claims instituted against the company. This raises questions on the **effectiveness of the identification process**. (1)
- The fact that there is **no fraud risk plan** is a concern as fraud is always considered to be a key risk. (1)
11. The **risk committee is not only responsible for identifying the risk**. (1)
- 11.1 The risk committee must **review the risk management progress and maturity of the company**, the **effectiveness of risk management activities**, the **key risks facing the company and the responses to address these risks** (principle 4.3 par 16). (1)

12. The fact that the **board are simply taking note of the risks** is not in line with King III. (1)
- 12.1 The risks should be documented in a **risk management policy and plan** (principle 4.1.5). (1)
- 12.2 The risk management plan should include the company's **definition of risk and risk management, the risk management objectives, the risk approach and philosophy**, as well as the **various responsibilities and ownership for risk** within the company (principle 4.1 par 6-7). (1)
13. The fact that the CEO asked the board and risk committee to **keep the information confidential** is not in line with the King III. (1)
- 13.1 The board should ensure that there are **processes in place enabling complete, timely, relevant, accurate and accessible risk disclosure to stakeholders** (principle 4.10). (1)
- 13.2 The risk management policy should be **widely distributed** throughout the company (principle 4.1.7). (1)
14. Internal audit is following a **compliance based approach as opposed to a risk based approach** as prescribed by King III. (1)
- 14.1 Internal audit should be an **objective provider of assurance** that considers: (principle 7.2.3)
- the risk that may **prevent or slow down the realisation of strategic goals**;
  - whether **controls are in place and functioning effectively** to mitigate these; and
  - the **opportunity that will promote the realisation of strategic goals** that are identified, assessed and effectively managed by the company's management team. (Max 2)
15. The head of Internal Audit is reporting to the Board which is not in line with King. (1)
- 15.1 The CAE should report functionally to the **chairman of the audit committee** (principle 7.4.4). (1)

#### Companies Act:

- **Buyback of shares:**

**Section 48** of the Companies Act No. 71 of 2008 is applicable as the **company and a subsidiary of the company are repurchasing the company's own shares**. (1)

The company may acquire its own shares if the decision to do so **satisfies the requirements of section 46**. (1)

A **liquidity and solvency test should** be performed. [Section 46(1) (b)] (1)

The **liquidity and solvency test** performed before the previous resolution is **not valid** as the company is required to satisfy the liquidity and solvency tests **immediately after the distribution** [Section 46(1) (b)]. (1)

Given the recent events pertaining to the explosion, there is a **possibility that the company will not meet the requirements of the liquidity and solvency tests immediately after the transaction** as per section 46(1)(b). (1)

An evaluation of the company's liquidity and solvency position should therefore be performed **before passing the resolution on the share buyback.** (1)

The company's subsidiaries **acquired more than 10% of the company shares**, which is **not permitted by section 48(2)(b)(ii).** (1)

**No voting rights are attached to the share acquired by Andren** as per section 48(2)(b)(ii) and therefore they will have **no say in the resolution adopted by SAP's shareholders.** (1)

The transaction does not meet the requirements of section 48 and 46 and therefore the **directors are liable** to the extent set out in section 77(3)(e). (1)

- **Financial assistance to subscribe for securities:**

The guarantee of a loan **falls within the definition of "financial assistance"** as prescribed by section 44(2) and therefore section 44 of the Companies Act is applicable. (1)

There is no indication that the company's Memorandum of Incorporation prohibited the board of directors to authorise the company to provide financial assistance. [Section 44(2)] (1)

A **special resolution of the shareholders** is required per section 44(3)(a)(ii). (1)

Therefore the **board resolution is not valid** for the financial assistance provided to the subsidiary. (1)

The Board did not perform the liquidity and solvency tests as required by section 44(3)(b)(i). The **liquidity and solvency test performed before the "Bioclear" transaction is not valid** as the company should meet the requirements of liquidity and solvency **immediately after providing the financial assistance.** (2)

The **decision made by the Board is void** as per section 44(5) as a result of the non-compliance with this section. (1)

The **directors are liable** in terms of sections 44(4) and 46(6) to the extent set out in section 77(3)(e)(iv). (1)

The directors are liable because:

- They were **present in the meeting when the resolution was passed.** (1)
- They **failed to vote against the resolution** despite knowing that the provision of financial assistance was inconsistent with this section. (1)

- **Directors' dealings:**

The statement by the chairman of the Board that the company can "continue with business as usual" despite the recent events, is a concern in terms of the following Companies Act requirements: (1)

**Section 22 of the Companies Act:** The substantial legal claim against the company cast significant doubt on the entity's ability to continue as a going concern which could imply that the company is trading under insolvent circumstances and the directors are therefore guilty of reckless trading. (1)

**Section 76 of the Companies Act:** Given the information above, it would also seem that the directors are not dealing in the best interest of the company and may be held liable in terms of section 76. (1)

Presentation: (logic and layout) 1  
Available 59  
Maximum 31

**PART (b)**

- Involve an expert in the valuation of the contaminated oil barrels. (1)
- Involve more experienced staff members with the audit of inventory. (1)
- The auditor should be more sceptical when auditing the valuation of inventory. (1)
- Assess the risk as high for inventory. (1)
- Consider using a lower materiality figure to address the risk. (1)
- **Extend substantive procedures/increase sample size (1)** on the valuation of inventory **at year-end (1)**. (2)
- *Incorporate an element of unpredictability in testing.* (1)
- Special attention should be given to identifying the contaminated oil barrels with the inventory count at year-end. (1)

Available 9  
Maximum 5

**PART (c)**

**(i) Accounting treatment (journals) with referencing to IAS 16/IAS37/IFRIC1**

|                                                            |             |                 |
|------------------------------------------------------------|-------------|-----------------|
| Dr Oil rig (1)                                             | R37 310 770 |                 |
| Cr Provision for decommissioning and restoration costs (1) |             | R37 310 770 (1) |

|                                                            |            |                |
|------------------------------------------------------------|------------|----------------|
| Dr Finance charges (P/L)(1)                                | R1 865 539 |                |
| Cr Provision for decommissioning and restoration costs (1) |            | R1 865 539 (1) |

FV = R50 million

i = 5%

n=6

Comp PV = R37 310 770 (2)

Finance charges R37 310 770 x 5% = R1 865 539 (1)

**Presentation: logic and layout of journal entries (1)**

Available 10  
Maximum 6

**(ii) Discussion of management's treatment of the claim for environmental damages pertaining to the oil spill**

- When considering the scenario, one has to determine if a provision should be raised for the environmental damage caused by the oil spillage or whether it should be disclosed as a contingent liability. (1)
- As per IAS 37 a provision is defined as a liability of which the amount or the timing is uncertain, and should only be recognised when: (1)
  - the entity has a present legal or constructive obligation to forfeit economic benefits because of events in the past
    - **the oil spillage happened on 25 February 2011 which is a past event** (1)
    - and it is more likely than not that there is an obligation in terms of the claim;** (1)
  - it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation
    - **the legal advisor indicated that there was a high probability (85%) that SAP would be liable to pay the R100 million to the WWF for the oil spill damages;** and (1)
  - a reliable estimate of the obligation can be made
    - **a claim of R100 million was instituted against SAP and there was an 85% probability that SAP would have to pay the claim as well as any other legal costs that were incurred.** (1)
- A contingent liability is:
  - a possible obligation that arises from **past events** and whose existence will only be confirmed by the occurrence or non-occurrence of **one or more uncertain future events not wholly within the control of the entity** (1)
    - **the oil spillage happened on 25 February 2011, which is a past event.** (1)
    - The court case was only settled after year-end, but there was already an indication (85% probability) at year-end that SAP would have to pay the WWF claim of R100 million.** (1)
- Based on the above, a provision should be raised for the R100 million/*liability must be disclosed/AFS should be adjusted.* (1)

|           |           |
|-----------|-----------|
| Available | <u>10</u> |
| Maximum   | <u>7</u>  |

**(iii) Audit procedures on the re-assessed decommissioning and restoration costs**

- *Agree opening balances to the prior year's audited financial statements.* (1)
- Obtain a signed management representation letter from management, in which all assertions regarding the decommissioning and restoration costs are referred to. (1)
- Obtain management's working paper (*schedule*) that relates to the decommissioning and restoration costs. (1)
- *Cast and cross cast the decommissioning and restoration costs working paper to ensure it is mathematically accurate.* (1)

- Inspect the minutes of the directors' meetings for the reasons for the re-assessment of the decommissioning and restoration costs *and impairment* as well as the approval thereof. (1)
- Have discussions with management regarding the decision to re-assess the provision for the decommissioning and restoration costs *for background and additional information*. (1)
- Agree the estimated decommissioning and restoration costs to the average costs of similar estimates in the industry/provision for similar companies. (1)
- As SAP is in business for 19 years, they should have removed and restored a previous location, therefore:
  - *Compare* the estimated decommissioning and restoration costs to the actual *assumptions and methods* of previous decommission and restoration projects, taking into account the time value of money. (1)
- Obtain an understanding of the data (*information and reasons*) on which the change in the estimate was based including (ISA540 par 8(c) and A24 to A38):
  - *Since* management have used an expert, consider the following (ISA540 par 8(c), ISA 500 par 8 and A37 to A48 *or* ISA 620). (1)
    - evaluate the **competence**, capabilities and **objectivity** of the expert by having discussions with the expert (1), gain knowledge of the expert's qualifications (1), and if he/she is a member of a professional body (1) and also discuss with management if the expert has any interests and relationships that might create any threats (1); 4 possible marks **max (2)**
    - obtain an understanding of the work of the expert including: **(max 3)**
      - an understanding of the relevant field of expertise;
      - whether any professional or other standards, and regulatory or legal requirements apply; (*environmental related*)
      - what assumptions and methods the management expert is using;
      - the nature of internal and external data or information the expert uses; and
      - if employed by the entity, enquire of management and members of management the most appropriate way to obtain the necessary understanding.
    - evaluate the appropriateness of the expert's work as audit evidence: **(max 2)**
      - the relevance and reasonableness of the expert's findings or conclusions, their consistency with other audit evidence and whether they have been appropriately reflected in the financial statements;
      - if his/her work involves the use of significant assumptions and methods and the relevance and reasonableness of those assumptions and methods; and
      - if his/her work involves significant use of source data and the relevance, completeness and accuracy of that source data.
      - *recalculate the workings of the expert/obtain working papers from the expert*

- *Consider whether a second expert needs to be appointed by the auditors (1), we then need to obtain the approval from management/any discussion pertaining to the independence of auditor's expert. (1)* (2)
- *Compare assumptions and methods to previous years to determine if it is consistently applied (reasonability)* (1)
- **Recalculate** the effect of the **re-assessment of the decommissioning and restoration costs (R50m)** to confirm the **accuracy** of it. (1)
- **Recalculate** the impact of the **re-assessment of the decommissioning and restoration costs on the finance charges** for the current year. (1)
- Inspect the working paper to ensure that a pre-tax discount rate (5%) was used. (1)
- *Inspect the journal entries and agree to it information on the working paper (1) and follow through to the general ledger.(1)* (2)
- Inspect correspondence from the local authorities which states that the company is indeed liable to remove the oil rig and for the restoration of the environment after a period of 10 years in order to confirm that the remaining period is equal to six years on 1 May 2010. (1)
- *Discuss with management or expert if there were any changes to communication from the local authorities (see point above).* (1)
- Discuss the recoverability of the oil rig with management to determine if the new carrying amount will still be fully recoverable. If there is any indication that this is not the case, management will have to conduct an impairment test. We as the auditors will have to obtain that working paper and do the following procedures: (1)
  - *Reassess the fair value and costs to sell used by management or obtain opinion from expert regarding these values.* (1)
  - Recalculate the fair value less costs to sell, value in use and then the recoverable amount (greater of fair value less costs to sell and value in use) to be in accordance with IAS 36. (1)
  - Use the recalculated information (*carrying amount exceeds recoverable amount*) above to determine if there is any impairment loss that has to account for. (1)
  - *Inspect the journal entries and agree to it information on the working paper and follow through to the general ledger.*
- Agree the balance of the decommissioning and restoration costs in the general ledger accounts to the trial balance and the annual financial statements to ensure that they coincide. (1)
- Inspect the financial statements to ensure that that:
  - the decommissioning and restoration costs and *impairments* were disclosed in accordance with IAS16, IAS36, IAS37 and IFRIC1; and (1)
  - the accounting policies are appropriate and consistent with these of prior years.(1)

**Presentation: Proper formulation of audit procedures (1)**

Available 34  
Maximum 20

**PART (d)****(i) Non-compliance with IFRS****Going concern**

The misstatement is not material in amount (quantitative). (1)

The misstatement is material in nature because: (1)

- the company might have used an incorrect basis to prepare the financial statements; and (1)
- necessary disclosures regarding going concern might not have been made. (1)

**Property, plant and equipment (PPE)**

The company has adopted the cost model; therefore the assets have to be depreciated. (1)

As per IAS16 paragraph 55, the electric motors should be depreciated when they are **available for use**.

In this case, they are **installed** (1)

**and are therefore available for use** in the current financial year. (1)

These motors have a different useful life from the pump (i.e. 5 years), therefore they should be depreciated separately from the pump. (1)

The misstatement (of R42m) is not individually material in amount, as it is less than the materiality figure. (1)

However the misstatement is material in nature because it constitutes non-compliance with IFRS (IAS16) **OR**

*The non-compliance with IFRS (IAS16) is not material in nature.* (1)

**Inventory**

The amount of inventory (R180m) not accounted for at the end of the current year is individually material (exceeds R80m). (1)

However this is not material in nature, as it is a timing issue. (1)

**Non-compliance with laws and regulations**

This non-adherence to *King III and Companies Act* is *not* material in nature, although: (1)

- The company is listed on the JSE Limited (JSE) and the JSE regulations require the company to comply with King III. Non-adherence to King III therefore constitutes non-compliance with JSE regulations. (1)

In terms of Section 86 of the Companies Act, a public company must appoint a company secretary, *but it does not affect the fair presentation of the financial statements*. (1)

The non-compliance cannot be quantified, and therefore we cannot assess whether it is material in amount or not. (1)

**Presentation (logic and layout)** **(1)**  
Available 17  
Maximum 13

**(ii) Schedule of misstatement:**

| Description                               | Statement of comprehensive income<br>R'm | Assets<br>R'm | Liabilities<br>R'm | Retained earnings (Equity)<br>R'm |     |
|-------------------------------------------|------------------------------------------|---------------|--------------------|-----------------------------------|-----|
| Prior year misstatement                   | (46)                                     |               |                    | 46                                | (2) |
| Inventory not accounted for (understated) |                                          | 180           | (180)              |                                   | (2) |
| Depreciation charge understated           | 42                                       | (42)          |                    |                                   | (2) |
| <b>Aggregate</b>                          | <b>(4)</b>                               | <b>138</b>    | <b>(180)</b>       | 46                                | (1) |

For not including any prior year misstatement relating to inventory. (1)

**Conclusion**

In aggregate, the misstatements relating to the statement of comprehensive income are not material, as they are less than the materiality figure of R80 million. (1)

The aggregate misstatements relating to assets (R138) and liabilities (R180m) are material.

(2)  
**Presentation (table and use of dr/cr) (1)**

Available 12  
Maximum 9

**(iii) Impact on audit opinion/report****1. Going concern**

The misstatement is material and pervasive because the basis for accounting is fundamental to the fair presentation of the financial statements as a whole. (1)

This is a limitation of scope, as management refused to provide relevant information to perform the going concern assessment. (1)

**OR**

*This is a disagreement with management as the auditors had sufficient evidence that there was significant uncertainty the company's ability to continue as a going concern.*

As a result, the auditors would disclaim an opinion (disclaimer of opinion). (1)

**OR**

*As a result the auditors would issue an adverse opinion.*

**2. Property, plant and equipment**

This constitutes a disagreement with management, as it is an incorrect application of IAS 16. (1)

The misstatement is material but not pervasive, as it confined to specifics elements of the financial statements. (1)

**OR**

*The misstatement is not material or pervasive*

This could result in a qualified (“except for”) audit opinion, if not adjusted. (1)

**OR**

*This could result in an unqualified audit opinion.*

**3. Inventory**

Based on conclusion in part (d(i)).

The misstatement is material but not pervasive, as it is limited to one issue. (1)

This constitutes a disagreement with management, as it is an incorrect application of IAS 2. (1)

This could result in a qualified (“except for”) audit opinion, if not adjusted. (1)

**4. Non-compliance with laws and regulations**

Non-compliance with laws and regulations will not affect the audit opinion, as this does not affect the fair presentation of the financial statements. (1)

However it will affect the audit report and this matter will be discussed in the “Report on other legal and Regulatory requirements”. (1)

**Overall comment**

If none of the adjustments are made, the auditors would issue a disclaimer of opinion, as the financial statements will be materially misstated and the impact would be pervasive due to a limitation of scope.

**OR**

*If an adverse opinion was issued due to the going concern problem, an overall adverse opinion will be issued.*

|           |     |
|-----------|-----|
| Available | (1) |
| Maximum   | 9   |