



COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND GOVERNANCE

NMAC 408: ADVANCED AUDITING AND PRACTICE

END OF SECOND SEMESTER EXAMINATION

APRIL 2022

LECTURER: DR DUMISANI RUMBIDZAI MUZIRA

DURATION: 3 HOURS

INSTRUCTIONS

You are required to answer questions as instructed

Answer **any four** questions

Start **each** question on a new page in your answer booklet

Credit will be awarded for logical, systematic and neat presentations

QUESTION ONE

You are a first-year trainee accountant at Andre Gauta Ephraim Incorporated (AGE), a medium-sized audit firm. You are one of six audit team members to audit the DanChrome Group.

In preparation for the audit of DanChrome Group, your audit senior presented you with the following information on the DanChrome Group:

DANCHROME GROUP BUSINESS BACKGROUND

DanChrome Ltd (DanChrome) was established in 1976 in South Africa. Its core business is the mining and smelting of chrome ore. Chrome ore is converted to ferrochrome through intense metallurgical processing. DanChrome is one of the largest integrated ferrochrome producers in the world with an annual capacity of one million tons. DanChrome produces three grades of ferrochrome, namely charge chrome, intermediate chrome and low carbon ferrochrome, each used in different areas of the stainless steel smelting process.

DanChrome's mining operations are situated in Meyerton. The head office is situated in the central business district of Johannesburg. The DanChrome Group employs a workforce of 16 300 employees.

In April 2015, AGE was awarded a tender to audit DanChrome and its newly acquired subsidiary company, SamCoal (Pty) Ltd (SamCoal) for the year ended 31 August 2015. The appointment of AGE will be evaluated annually at DanChrome's annual general meeting as stated in the revised memorandum of incorporation of the company. The appointment of AGE as the auditors of DanChrome was a direct result of the previous auditors filing a notice of resignation. The previous auditors resigned because they regarded themselves as not having adequate resources to service DanChrome due to the company's growth. When AGE contacted the previous auditors, they confirmed that they had enjoyed the long association with DanChrome and also stated that DanChrome has a good reputation in the industry.

DanChrome acquired a 55% shareholding in SamCoal on 11 September 2014. At the time, the year end for SamCoal was on 31 March. To ensure consistency in group reporting, the financial year end of SamCoal was changed to 31 August. The core business of SamCoal is the mining of coal. SamCoal has three coal-mining sites in various areas of Mpumalanga and a newly established mining site in Limpopo. Each coal mining site has accounting staff responsible for capturing financial data. The head office of SamCoal is situated in Middelburg.

During mid-March 2015, Denzil Phillips, the audit partner on the audit, was approached by Siphos Platinum Mines Ltd, an 80% shareholder of DanChrome, to negotiate the sale of its shares in DanChrome. The sale was completed successfully in May 2015. This resulted in the delisting of DanChrome from the JSE Ltd. The new shareholding of DanChrome is as follows:

Shareholders of DanChrome	Shareholding %
Steel South Africa (Pvt) Ltd	80
Directors and staff	15
Other	5

In May 2015, the DanChrome Group was affected by the South African Transport Union's strike that lasted for a month. Employees of DanChrome Group also went on a strike in July 2015 over salary increases. This strike lasted for two weeks. The DanChrome Group was not able to export ferrochrome and coal to overseas customers during this period. These customers represent 80% of the group's customer base. As a result, the group recorded a loss for the 2015 financial year, for the first time in years.

On 30 June 2015, the service contract of both the chief executive officer (CEO) and the managing director (MD) of DanChrome Group came to an end. The majority shareholders decided at a general meeting not to renew their contracts. Both the CEO and MD had been employed by DanChrome for more than 10 years. It has been reported in the business press that they are mainly to be credited for the financial success of DanChrome over the years. The search is on for two candidates with the required skills, knowledge and experience to fill the vacant positions. In the meantime, the financial director is acting as both the CEO and MD.

To ensure that the DanChrome Group is well managed, a significant part of the remuneration of directors is incentive based. The director's remuneration is determined by the audit committee.

A week before the DanChrome Group's financial year end, the audit partner became aware of the following article in the financial press:

SAMCOAL MINE ON CULTURAL HERITAGE SITE

The Department of Water Affairs and Forestry has raised concerns about the illegal mining operations performed by SamCoal on the cultural heritage site in the Limpopo province, near the Zimbabwean border. The site is home to more than 470 bird species, as well as more than 50 different species of endangered plant life. According to the Department, SamCoal has already destroyed five square kilometres of the indigenous forest in order for them to perform their mining activities. A spokesperson for the Department of Minerals and Energy stated that SamCoal owns the mining rights to a portion of land situated close to the site. The Department of Water Affairs and Forestry has filed a lawsuit against SamCoal for the damage it has caused to the cultural heritage site.

James Taylor, Limpopo

On 5 September 2015, the attorneys of the DanChrome Group indicated that the court was likely to rule in favour of the Department of Water Affairs and Forestry. The estimated cost set to restore the site amounts to approximately R10 000 000.

The acting CEO has informed AGE that the new holding company requires the audited financial statements of the DanChrome Group within two weeks after the year end. The shareholders require this information as soon as possible to determine if the group might need to be steered into a different direction.

Adapted from UNISA, 2017

REQUIRED:

With reference to the opening paragraph and the DanChrome Group business background information, discuss the pre – engagement matters to consider as per International Standard on Auditing (ISA) 210 and the concerns AGE would have prior to accepting the DanChrome Group as an audit client. **[25 marks]**

QUESTION TWO

- a) ISA 500 *Audit evidence* explains types of audit evidence that the auditor can obtain.

Required

State, and explain, four types of audit evidence that can be obtained by the auditor. **[8marks]**

- b) ISA 705 *Modifications to the opinion in the independent auditor's report* sets out the different types of modified opinions.

Required

- i) Explain three ways in which an auditor's opinion may be modified **[6 marks]**
- ii) What is the meaning of “true and fair” in auditing. **[1mark]**

- c) ISA 700 *Forming an opinion and reporting on financial statements* explains the form and content of external audit reports.

Required

Outline the main elements of the external audit report. **[10 marks]**

QUESTION THREE

Explain the appointment process, and removal process of an external auditor. **[25 marks]**

QUESTION FOUR

You have been asked by the senior in charge of the audit of Bee Manufacturing to describe certain aspects of the work you will carry out in auditing the company's wages system.

- Employees of Bee Manufacturing are paid based on hours worked and quantities produced.
- The hours worked are recorded on clock cards and the quantities produced are confirmed by the supervisor.

- Wages are paid in cash each Friday for the previous week's work.
- Appointment of employees is authorised by the managing director, and the personnel department maintains employees' records and their rates of pay.
- The cashier is separate from the wages department.

Previous years' audits have highlighted weaknesses in internal controls in the company's wages system. This has allowed an employee in the wages department to perpetrate a fraud by creating fictitious employees on the payroll and misappropriating the wages. Some of your audit tests have been designed to detect whether this fraud is still taking place. A 'starters and leavers' test is carried out to ensure that employees are not paid before they commence employment or after they have left.

a) State the principal controls you would expect to exist in a wages system and explain their purpose. **[10 marks]**

b) Assuming you decide not to attend the wages payout, suggest other techniques you can use to check the existence of employees. **[5 marks]**

c) Describe how you will carry out a starters and leavers test. **[5 marks]**

d) Describe the analytical review techniques you can use in auditing the wages system **[5marks]**

QUESTION FIVE

Explain how management can use the fraud diamond to manage fraud in an organisation. **[25 marks]**

END OF EXAMINATION