Part (a)(i) Describe the tests of controls you would perform to evaluate the operating effectiveness of controls over the weekly wages payroll system

<table>
<thead>
<tr>
<th>Control area</th>
<th>Audit procedures to test operating effectiveness of the controls</th>
</tr>
</thead>
</table>
| Maintenance of employee master file | 1. For a sample of MAFs  
  - Inspect the MAFs for **signatures** of the **HR manager** AND the relevant **Section manager** as evidence that the check has been performed on a timely basis.  
  - Agree the information on MAF to **supporting documentation**.  
  - Agree the **amendments per MAF** to the **master file** to ensure it has been correctly updated.  
  1  
  
2. Inspect the **access profiles** of staff to confirm that only **authorised members of the HR department** have **access to the HR (master file) system**.  
  1  
  
3. **Amendment logs**  
  - Inspect a sample for **signature of the Finance Director** as evidence that the check has been performed (approval)  
  - Inspect the **sequential numbering** of the MAFs/run exception report for **missing numbers**, and follow up on missing numbers.  
  1  
  
4. Select **amendments as per master file** and agree to **MAF forms and logs** to confirm valid amendments.  
  1  
  
| Employee identification and recording of hours worked | 5. **Observe clocking-in-out procedure**  
  - Confirm that staff gain access to/leave the factory only after **scanning their thumb print** using the biometric scanning device (staff cannot leave after clocking in/without clocking out, only using own thumb, etc).  
  - Attempt to gain **access with unauthorized staff thumb print/leave without clocking out**.  
  - Confirm that **security staff** is present at the entry/exit points to monitor the clocking process.  
  - **Enquire of security staff** of process followed when someone attempts to gain access to/or leave the factory in an unauthorised manner.  
  - **Record detail for selected staff clocking in & out, as well as late arrivals/early departures** for follow up to Entry and Exit logs (point 7).  
  1  
  
6. **Verify that the correct thumb print is stored** for the correct employee (e.g. for a sample of employees, capture thumb prints and verify them against that recorded per Masterfile record)  
  1  
  
| Review of employee attendance | 7. **Entry and Exit logs**  
  - Enquire of **foreman of the process** followed to **review the logs** and to investigate unexplained activity noted.  
  - Inspect logs for **evidence of review** by foreman (signature/code, etc).  
  1  
  
| Approval of hours worked | 8. For a sample of the “total hours worked schedule” (normal & overtime)  
  - Inspect the schedule for **evidence of unusual hours worked**, e.g. normal hours > 40 hours, high overtime, etc and validate accuracy thereof.  
  - For **overtime work inspect the job card** for the **signature of the factory foremen** as evidence that the overtime hours have been pre-authorised.  
  - Trace **hours worked** for a sample of employees on the schedule to system-generated **attendance reports** to confirm the accuracy of hours worked.  
  - Inspect the **schedules for the signatures of the factory foremen** as evidence of performing the checks and approving the schedule.  
  - **Enquire of the foreman** what process is followed to review the schedule and confirm the accuracy thereof.  
  1  
  
Total 76
9. Confirm from the **computer software provider** that they are satisfied with the **process** by which the **payroll system** calculates the **hours worked** per employee and **prepare the data** for generating the **payslips** (direct confirmation from them/inspection of reports, upgrades, versions etc).

10. For a sample of selected payrolls (re-perform using CAATS, etc):
   - Agree the **HOURS worked** by employee per payroll to:
     - the hours for the employee per “**total hours worked schedule**”; and
     - the hours as calculated with reference to the **Entry and Exit time logs/biometric data**.
   - Verify hourly **RATES** per employee to the rates per **employee master file/employment records**.
   - Agree **ALLOWANCES AND BENEFITS** for a selection of employees to employee master file records/supporting documentation.
   - **Recalculate wage amounts** and agree to **payslip**.
   - For **ADDITIONAL AMOUNTS PAID** to employees (overtime/benefits/allowances), inspect the **Total hours worked schedule** and supporting documentation for the signatures of the factory foremen as evidence that such amounts have been approved.
   - Confirm the **TOTAL NUMBER OF EMPLOYEES** per the payroll report to the total number of employees actually employed by the company.
   - Run **EXCEPTION reports and follow up exceptions** (excessive overtime, negative hours, calculation errors, duplicate names etc. (mark for valid exception reports)
   - Confirm that **both payroll clerks have “approved the payroll”** as evidence of checking the accuracy and completeness thereof (**approve option stamp**).

11. Inspect **access profiles** of staff to confirm that:
    - only authorised payroll staff have access to the payroll system;
    - the second payroll clerk has **read-only access** to the payroll system.

12. Confirm, by **enquiry of the payroll clerks**, the **process that is used** to finalise the payroll report.

13. Inspect selected **payroll and supporting documentation schedules** for the signature of the payroll administrator as evidence of procedures and controls performed.

14. Inspect the **access profiles** of staff to confirm that the payroll administrator **does not have write access** to the payroll file.

15. Confirm through **enquiry of the wages clerk**, the **process that is used where changes need to be made to the payroll**.

16. Confirm that **two independent people signed off as authorisation of the payroll** (payroll clerk and payroll administrator) through enquiry and inspection of the “**approve option**” on the payroll.

17. Inspect a sample of **logs of changes** made to the payroll for the **signature of the Finance Director** as evidence that such changes have been reviewed and approved.

18. For selected payrolls inspect the **journal entries** to record the weekly payroll expenses in the general ledger accounts.

19. Other valid tests of controls: .................................................................
    .................................................................
Part (a)(ii) Describe the substantive analytical procedures that XYZ would perform to test the payroll expense for weekly wages

Procedures will include the following:

1. Comparisons

   Wage expense:
   - Month-to-month/week to week for current year
   - To prior-year figures
   - To budgets and forecasts
   - Cost centres

   Deductions paid to third parties – month to month

   Average wages per employee per month/prior year/budget

2. Develop an expectation to compare payroll expense against, for example the increase in number of employees from 80 to 300

3. Follow up on fluctuations with management, arising from comparisons above.

4. Ratio and trend analysis (maximum 2) E.g.:
   - Wages as a percentage of total expenses
   - Wages as a percentage of total sales
   - Wages as a percentage of production costs
   - Wages in relation to output / production

Available: 10 Maximum for part (a)(ii) 7

Part (b) Discuss and conclude whether you are permitted to prepare the journal entries to process the weekly wage expenses and related balances for the month of December 2015 as requested by the Financial Director, with reference to:

Part (b) (i) the Companies Act, 2008 (Act 71 of 2008), as amended

1. Section 90 (2) prohibiting the auditor to perform accounting or bookkeeping work, or be responsible for maintaining accounting records for the client, will only apply if it is a statutory audit.

   As Ambition (Pty) Ltd is a private company, it will not require an audit, unless the Public Interest Score (PIS) is more than 350, or the audit requirement is contained in the MOI.

2. Ambition’s PIS is greater than 350 and the audit disqualifications will need to be considered.

   Turnover > R300 million = 300 points, 300 employees = 300 point (motivation), thus PIS>350.

3. Section 90(2) of the Companies Act provides that an auditor cannot do the following:

   (ii) Be an employee or consultant of the company who was or has been engaged for more than one year in the maintenance of any of the company’s financial records or the preparation of any of its financial statements.

   Application: As the audit team is recommending journal entries to the client and has not been engaged for more than one year in maintenance of any of the company’s financial records, this is a once-off event.

   (iv) Be a person who, alone or with a partner or employees, habitually or regularly performs the duties of accountant or bookkeeper, or performs related secretarial work, for the company.

   Application: The audit team is not providing the service of preparing the journals on a regular or habitual basis.

4. Conclusion: The audit team is permitted to prepare the journal entries for the December weekly wage payroll since the prohibitions stated in s90(2) of the Companies Act have not been contravened.
### Part (b) (ii) the SAICA Code of Professional Conduct.

1. The preparation of the journal entries will need to be assessed against the independence/conflict of interest requirements contained in section 290 of the SAICA Code.  

2. The auditor should determine whether Ambition is a public interest entity, as different requirements of the CPC would apply depending on the outcome.

3. Ambition is **NOT a public interest entity** as it is not listed or required to be audit as under same requirements for listed entities (paragraph 290.25).  
   - accordingly **the auditor may provide** accounting services, provided the threats to independence are considered and proper safeguards applied.

4. Threats: the preparing of journal entries would create a **self-review threat** when the auditor audits the journals (section 290.164).  
   - The threat **would be significant** as the auditor would audit these amounts that would be significant to the financial statements (more than 300 employees) (**motivation**).

5. **Safeguards:** Safeguards that the auditor could apply to reduce the threat are (section 290.168):  
   - **arrange for such services to be performed by an individual who is not a member of the audit team;** or  
   - if such services are performed by a member of the audit team, to have a **partner or senior staff member** who is not a member of the audit team, to review the work.  
   - ensuring such services are only provided for a **short period of time** and not on an recurring basis;  
   - discussing the situation with those charged with governance to ensure they are aware of the treats and safeguards.

6. **Conclusion:** If the necessary safeguards are applied, my firm will be permitted to provide the services.

**Available 20 Total for part (b) Maximum 15**

**Communication skills – clarity of expression**  

Maximum 16

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### Part (c) Discuss the responsibilities of XYZ to communicate deficiencies in internal controls as a result of identifying that the warehouse supervisor had not authorised an employee’s overtime (ISA 265 Communicating Deficiencies in Internal Control to Those Charged with Governance and Management)

1. The **supervisor not authorising the overtime** may indicate a deficiency in an internal control.  
   - this was discovered **during the audit** and accordingly the reporting requirements of ISA 265 should be considered.

2. **THOSE CHARGED WITH GOVERNANCE** (significant deficiencies in internal control):  
   - a breakdown in control occurred that led to the employee erroneously being paid excessive overtime,  
   - together with the fact that the supervisor **tried to cover** up his mistake and **offer the auditor a “bribe” to not report this**, also makes this and ethical issue;  
   - **Conclusion:** based on the above **this is considered a significant deficiency** and therefore should be reported in writing to those charged with governance.

3. **TO MANAGEMENT** (significant and other deficiencies)  
   - Significant and other deficiencies in internal control identified during the audit should be reported to management as well, and therefore the breakdown in controls should be **reported in writing to them**.

4. When reporting the significant deficiency, the auditor is required to **report the detail of the breakdown as well as the possible effect.** i.e. that the deficiency has resulted in excess overtime being paid to an employee.

5. The auditor would also need to explain the context of the error – i.e. that it was identified during the audit of the financial statements as a whole, that the auditor does not express assurance on the internal controls themselves and that only deficiencies identified are reported and not all those that could be present (**cannot provide assurance that all deficiencies detected**).

**Available: 9 Maximum for part (c) 5**
### Part (d)  XYZ’s response regarding the intentional delay of the payments to SARS

<table>
<thead>
<tr>
<th>ISA 250 Consideration of laws and regulations in an audit of financial statements is relevant here.</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Obtain an <strong>understanding of the nature of the non-compliance</strong>, the circumstances thereof, and sufficient further information to evaluate the <strong>effect on the financial statements</strong>.</td>
<td>1</td>
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<tr>
<td>2. Factors to consider regarding the possible effect of the intentional delay in payments to SARS on the financial statements:</td>
<td>1</td>
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<tr>
<td>2.1 The <strong>potential financial consequences</strong>, such as interest, fines, penalties and litigation.</td>
<td>1</td>
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<tr>
<td>2.2 <strong>Whether</strong> the potential financial consequences require disclosure (interest &amp; penalties).</td>
<td>1</td>
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<tr>
<td>2.3 The <strong>materiality of fines, penalties, etc if not correctly accrued and disclosed</strong> and the impact on the audit report (audit difference).</td>
<td>1</td>
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<tr>
<td>3. The auditor should:</td>
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<tr>
<td>3.1 Inform the <strong>board of directors or senior management</strong> of the non-compliance OR obtain proof that they were aware of it.</td>
<td>1</td>
</tr>
<tr>
<td>3.2 Consider the need to report the non-compliance to regulatory bodies, considering that the duty of confidentiality may be overridden by statutes, law or by courts of law.</td>
<td>1</td>
</tr>
<tr>
<td>3.3 Consider seeking legal advice regarding appropriate course of action.</td>
<td>1</td>
</tr>
<tr>
<td>Reportable Irregularity i.e.o. section 45 of the AP Act</td>
<td>1</td>
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<tr>
<td>4. Consider whether this meets the requirements of a reportable irregularity that should be reported to IRBA:</td>
<td>½</td>
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<tr>
<td>- when the auditor in his/her <strong>capacity as auditor</strong> detected</td>
<td>½</td>
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<tr>
<td>- an <strong>unlawful act or omission</strong></td>
<td>½</td>
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<tr>
<td>- committed by a person responsible for the <strong>management</strong> of the entity, and which</td>
<td>½</td>
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<tr>
<td>- has, or is likely to <strong>cause material financial loss</strong>, OR</td>
<td>½</td>
</tr>
<tr>
<td>- is <strong>fraudulent, or amounts to theft</strong>, OR</td>
<td>½</td>
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<tr>
<td>- represents a <strong>material breach of fiduciary duties</strong>.</td>
<td>½</td>
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<tr>
<td>5. With regard to the intentional withholding of payment of amounts owing to the South African Revenue Service (SARS):</td>
<td>1</td>
</tr>
<tr>
<td>5.1. The intentional <strong>non-payment of PAYE is an unlawful act</strong> as the Income Tax requires that this be paid over within seven days of month end. It also represents employees’ cash withheld and to be paid over on their behalf (unlawful act);</td>
<td>1</td>
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<tr>
<td>5.2. the <strong>Financial Director is aware of the matter</strong> (i.e. management);</td>
<td>1</td>
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<tr>
<td>5.3. the amount will <strong>cause financial loss to the company in terms of fines/penalties</strong> and interest that will be levied by SARS; and</td>
<td>1</td>
</tr>
<tr>
<td>5.4. the financial director also has a <strong>fiduciary duty to comply with all laws &amp; regulations</strong> and <strong>withholding of PAYE payments</strong> from SARS are likely to constitute a <strong>material breach of fiduciary duties fraud &amp; fiduciary duty</strong>.</td>
<td>1</td>
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<tr>
<td>6. <strong>Conclusion</strong>: As all the conditions as for the PAYE delay to qualify as a Reportable Irregularity (RI), the auditor must report the matter to the Regulatory Board without delay, giving full particulars of the reportable irregularity and comply with section 45.</td>
<td>1</td>
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<tr>
<td>7. The auditor should further consider an <strong>appropriate modification of the auditor’s report</strong>.</td>
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<tr>
<td>Going concern status</td>
<td>1</td>
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<tr>
<td>8. Given the severity of the cash flow problems, there is a <strong>high risk of the company not being a going concern</strong>, and the auditor should reassess the correct application thereof in the financial statements.</td>
<td>1</td>
</tr>
<tr>
<td>9. The auditor should <strong>audit &amp; evaluate management’s assessment of the going concern ability</strong> of the company in terms of ISA 570:</td>
<td>1</td>
</tr>
<tr>
<td>9.1. review <strong>cash flow forecasts &amp; budgets</strong> for the next 12 months, and</td>
<td>1</td>
</tr>
<tr>
<td>9.2. consider and audit the <strong>reasonableness of the assumption</strong> made thereof.</td>
<td>1</td>
</tr>
<tr>
<td>9.3. test the clerical accuracy thereof</td>
<td>1</td>
</tr>
<tr>
<td>10. <strong>Discuss with management their plans</strong> to mitigate the cash flow problems and consider the viability and reasonableness thereof.</td>
<td>1</td>
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<tr>
<td>11. Obtain <strong>bank confirmation</strong> regarding the company’s <strong>overdraft facility and credit</strong> status.</td>
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<tr>
<td>12. Consider the financial impact of the <strong>late payment of PAYE</strong>, as well as possible penalties and interest on the <strong>cash flow and going concern</strong> status of the company.</td>
<td>1</td>
</tr>
<tr>
<td>13. Obtain confirmation from lawyers regarding pending legal action and contingencies that could affect the going concern status of the company.</td>
<td>1</td>
</tr>
</tbody>
</table>
14. Obtain a management representation letter regarding the company’s going concern.

15. Consider whether a contravention of section 22 of the Companies Act has not taken place – company trading recklessly and incurring debts that they will be unable.

16. Also consider Section 76 of the companies act as the directors might not be acting with the required care and skill required of them.

Other statement’s and considerations (ISA 240, 315, 330, etc)

17. Reassess the assessment of risks at the overall financial statement level, given the going concern problems, and legal compliance issues.

18. Reassess the planning, precision and final materiality given the risk.

19. Consider and adjust the overall audit strategy:
   - applying more professional judgment,
   - more unpredictability in selecting and testing items;
   - use more senior staff and apply more supervision in areas of judgment and uncertainty, such as provisions, etc;
   - also consider following a more substantive based audit approach to all significant areas of the audit so as to limit the risk of misstatement.

20. The delay in PAYE payments also can be viewed as a breakdown in controls that should be reported to those charged with governance.

21. The auditor should also consider the effect of non-compliance on other aspects of the audit:
   - The integrity of management and the pervasive risk it has on the audit
   - The auditor’s risk assessment of the entity risk and the effect on the audit strategy
   - The reliability of management’s representations/responses

Available 38 : Maximum for part d) 20

Communication skills – clarity of expression; 1
   - logical argument 1

Maximum 22