



The Southern African Institute of Government Auditors

Qualifying Examination for Registered Government Auditors

Paper 3: Auditing

November 2012

INSTRUCTIONS TO CANDIDATES

- 1 Maximum marks: **160**.
- 2 Total time available: **four hours**.
- 3 The marks allocated to each question are an indication of the expected length and required depth of the answer.
- 4 Ensure proper planning and avoid exceeding the time you have allocated for each question as suggested by the number of marks allocated to the question.
- 5 Present your arguments clearly, using well structured, clear and precise language and appropriate professional terms.
- 6 No books or notes are allowed in the examination room.
- 7 All working papers must be handed in together with all paper provided for the examination (including unused answer sheets).
- 8 Answers written in pencil will not be marked.
- 9 You are reminded that this examination will be held under the rules set out in the document "RGA-QE Examination Matters & Examination Policy 2012".
- 10 You are required to observe all Examination Instructions on the separate sheet of paper handed to you before commencement of this examination.

QUESTION 1

(80 marks)

You are part of the audit engagement team that is responsible for the audit of the Department of Agriculture, Forestry and Fisheries (DAFF), as required in terms of the *Public Audit Act*. You are currently concerned with the audit of the financial statements of DAFF for the year ended 31 March 2012.

This question consists of four parts (A to D). Each part starts with information that is relevant to the particular stage of the audit process that the question refers to. You can assume that each part is independent from the other parts and that the "Required" section in each instance only relates to the information provided in that particular part of the question.

PART A

(33 marks)

The mandate of the Department of Agriculture, Forestry and Fisheries (DAFF) requires that it focus on three sectors, namely agriculture, forestry and fisheries. Its policies, strategies and programmes are aimed at enhancing sustainable use of resources and achieving economic growth, job creation, food security, rural development and transformation.

In general, the economic situation of the agricultural sector weakened during the year under review, which resulted in various stakeholders looking to the Department for support with respect to job retention, farmer development, food security and the extension of advisory services to farmers. There have been calls during the last two years for advisory services in particular, to be granted increased spending. The Department is satisfied with the current year's results (31 March 2012) that indicate that expenditure in this area has indeed increased by 18%.

Transfer payments remain the single largest line item in the statement of financial performance, representing 53.3% of total expenditure in 2012. The total amount has decreased from the previous year, since certain transfer payments had to be withheld due to the entities and organisations concerned not having complied with regulatory terms and conditions.

On the capital side, the Department consolidated its holdings of movable capital assets. Assets to the value of R38.2m (a material amount) were disposed of, and the fixed assets register was "cleaned up" across the entire Department.

One of the main focuses of the Department during the 2012 financial year was the restructuring, undertaken in order to ensure a more integrated approach to performance management and financial management. A more integrated accounting system was also introduced, and financial reporting was extended across agriculture, forestry and fisheries, all driven by the strategic plan that was approved by parliament at the end of the previous financial year. Unfortunately, the restructuring resulted in the termination of employment contracts of certain administration and finance staff.

PART B

(17 marks)

On inquiries of those charged with governance, the audit team is provided with the DRAFT *Report of the Audit Committee* which will ultimately be included in the annual report of the DAFF.

Subsequent discussions amongst the audit team, have focused on the following two paragraphs in particular:

- Paragraph from the DRAFT report

"The system of internal control applied by the department over financial risk and risk management is not operating effectively, efficiently or transparently. As reported in prior years the latest departmental risk assessment was performed over five years ago."

Comment made during discussions amongst the engagement team

This further supports the other information we have obtained in relation to the Department having a weak control environment and there being a lack of a proper risk assessment processes. We will not be able to place any reliance on internal control and will have to adopt an overall substantive audit approach.

- Paragraph from the DRAFT report

"As reported last year the Audit Committee considers the internal audit function to be under-resourced and internal audit cannot operate optimally, given its current resources and budget."

Comment made during discussions amongst the engagement team

This means that there are significant constraints on the internal audit department's ability to perform its functions properly. In these circumstances we do not have to engage with the internal audit department.

REQUIRED:

- (a) Indicate what the significance of a "weak control environment" is in relation to the decision by the audit team to apply a substantive audit approach overall. (3)

- (b) Assume a material total in the statement of financial performance such as Compensation of employees, and indicate in general, the *nature* of the audit procedures that would be performed in accordance with the audit team's substantive audit approach decision. (4)
- (c) Discuss why you do not agree with the audit team's comment in relation to not having to engage with the internal audit department. (3)
- (d) Assume that, in a different set of circumstances than those described above, some specific aspects of the work of the internal audit department can be used to provide audit evidence and to reduce the work to be performed directly by the audit team. Indicate, in principle, what audit work the external audit team would be required to perform in order to determine whether a specific body of work performed by internal audit was adequate for your audit purposes. (7)

PART C

(18 marks)

Departmental revenue is a material item in the Statement of Financial Performance of the DAFF. Departmental revenue for the year ended 31 March 2012 comprises the following items for inclusion in the financial statements:

	2012 R'000	2011 R'000
Sales of goods and services	202,266	236,348
Sales of capital assets	513	1,605
Fines, penalties and forfeits	52	62
Interest, dividends and rent of land	8,130	12,519
	210,961	250,534

Accounting policy relating to departmental revenue

In the Statement of Financial Performance all departmental revenue is recognised when received, and is subsequently paid into the NRF (National Revenue Fund), unless otherwise indicated. Any amount owing to the NRF is recognised as a payable in the Statement of Financial Position. No accrual is made for the amount receivable from the last receipt date to the end of the reporting period. These amounts are, however, disclosed in the Disclosure Note, Receivables for departmental revenue.

Other information

- Sales of goods and services (R202,266 in 2012) includes a *material amount* relating to statutory services provided by the Department with respect to initial registrations and renewal of registrations required within the agricultural, forestry and fishery sectors. This includes the registration of, for example, cooperatives, associations, breeders, products, etc.

- The statutory services concerned are controlled through a process of registration applications (for initial registrations), and renewal notices for registration renewals. In the case of an initial application, payment of the prescribed fee is a condition for approval of the application and a receipt is issued for the payment once received. Once approved, a customer/debtor account is opened on the system, and is the basis for future transactions with the customer, including the renewal of registration in future periods.
- In the case of renewals, a renewal notice is generated in advance that also represents the invoice with respect to the prescribed fee that is receivable by the Department. On payment of the renewal fee, a receipt is issued and the customer/debtor account is credited with the payment.
- Initial applications and renewal applications may require the submission of prescribed supporting documentation, depending on the nature and type of the application or registration.
- Invoices and receipts are generated electronically and there are effective numbering and sequence controls in place.

REQUIRED:

Assume that a substantive approach is applied with respect to the audit of departmental revenue. Design a program of detail tests of transactions to obtain audit evidence in relation to the amount of revenue from statutory services included in the total of "Sales of goods and services" in the statement of financial performance.

- Your audit procedures must collectively be directed in order to test the following assertions: occurrence, accuracy and classification.
- You are not required to deal with any CAATS (Computer Assisted Audit Techniques).

PART D

(12 marks)

You can assume that all information provided in this part is material.

The 2011 auditor's report included a qualified opinion owing to the fact that payments amounting to R26,552,542 were made in contravention of supply chain management requirements. The amount was not included in the irregular expenditure disclosure note, resulting in irregular expenditure being understated by R26,522,542 in the prior period.

In the current year, management has corrected the above misstatement and ensured that the irregular expenditure note correctly discloses the amounts relating to irregular expenditure for 2012 and 2011. The audit client has appropriately restated the corresponding figures and the audit team is satisfied with all aspects of this matter.

The following additional information is relevant at the end of the audit for the current year (31 March 2012):

- The audit team has concluded that the 2012 auditor's report will include a 'basis for qualification' paragraph relating to Receivables for departmental revenue that has been misstated as a result of omissions in respect of amounts due, but that have not been raised. Because of certain limitations imposed, the audit team was unable to determine the extent of the misstatement. The Senior Manager on the audit has formulated the appropriate basis for the qualified opinion paragraph.
- The Annual Financial Statements for publication includes Annexure 1A through to Annexure 5 (on pages 175 to 188 of the annual report). The audit team has not audited this supplementary information.

REQUIRED:

- (a) Discuss your evaluation of the effect on the current year's auditor's report of the matter relating to irregular expenditure that resulted in the qualification of the previous year's auditor's report. (3)
- (b) Write the paragraphs to be included under the following headings in the auditor's report on the Financial Statements of the DAFF for the year ended 31 March 2012: (9)

Qualified opinion

Emphasis of matters

(Only deal with the above two headings in the auditor's report – you are not required to write any paragraphs preceding or following these two headings.)

QUESTION 2

(25 marks)

You are a Registered Government Auditor (RGA) employed by the Auditor-General South Africa (AGSA), and have been assigned to the annual audit engagement at the Tlou Local Municipality. The municipality consist of five departments: the office of the mayor; technical services; financial and support services; community safety, and economic development. You have been asked to take responsibility for the creditors payment accounts and processes. The auditor in charge has informed you that the municipality's electronic files can easily be copied to the generalised audit software package that is on your laptop computer. In assessing the municipality's control environment you noticed the following:

- All requisitions and payments are processed electronically on the MuniPay software system. This system consists of three main sub-routines: the requisition sub-routine, the quotation sub-routine and the payment sub-routine.
- Requisitions are completed by the relevant departments that need specific goods and/or services, and are submitted to the procurement clerk. Requisitions must contain the type of need, a description of the need and the applicable budget vote number from which the payment must be made (for example: stationery, black ballpoint pens from vote number 8000-4110). The system automatically assigns a sequential requisition number.
- The procurement clerk prints all the requisitions on a daily basis and obtains three quotations in accordance with the procurement policy and approved supplier list. Once the quotations have been sourced, the clerk captures the three quotation amounts on the MuniPay system and notifies the procurement officer to proceed with the transaction.
- The procurement officer approves the transaction, selects the best supplier for the transaction and places the order and captures the order information on the MuniPay system.
- Once the requested goods and/or services have been delivered, the invoice and delivery notes are forwarded to the procurement officer in accordance with the sequential order number assigned by the MuniPay system. The procurement officer then captures the delivery information on the system, which initiates the payment sub-routine. The requisitions, invoices and delivery notes are also forwarded to the creditors accountant.
- At the end of each month, the creditors accountant prints a report which contains all the outstanding payments and matches the payments on the report to the applicable requisitions, invoices and delivery notes.

- Payments are then approved by the expenditure manager (if the amount is below R50 000) or the chief financial officer (if the amount exceeds R50 000) and made through electronic funds transfers.
- Requisition and payment transaction information is kept in two separate transaction files, namely the Requisition File and the Order File. An extract from these files appears below (please note that these records do not contain all the fields in the files).

Requisition File:

Requisition Number	Need Category	Need Description	Vote Number	Quotation 1 Amount	Quotation 2 Amount	Quotation 3 Amount	Selected Quotation Amount	Approved By	Order Number
...
8471	Stationery	Black pens	8000-4110	1,071.00	890.00	920.00	890.00	User77	7001
8472	Cleaning	Carpet wash	7041-0031	7,140.00	-	-	7,140.00	User77	7002
8473	Electricity meters	Repair work	8045-1100	-	-	-	-	-	-
...

Order File:

Order Number	Requisition Number	Need category	Need Description	Supplier	Transaction Amount	Invoice Number	Delivery Note Number	Transaction Status
...
7000	8469	Art Day	Equipment	Belroc	-	-	-	Ordered
7001	8471	Stationery	Black pens	POW Sups	1,071.00	1149	D87011	Delivered
7002	8472	Cleaning	Carpet wash	JJ Cleaning	7,250.00	JJ1007	JJD1990	Paid
...

REQUIRED:

- (a) Discuss the general *logical* access controls that you would expect to be in place with regard to the staff members that operate the MuniPay software system. (5)
- (b) Discuss the specific *programmed* application controls (excluding access controls) that you would expect to be in place with regard to the requisition and quotation sub-routines of the MuniPay computer system. (15)
- (c) Formulate five engagement procedures that can be performed on the above transaction file using *generalised audit software*. (5)

QUESTION 3**(25 marks)****QUESTION 3.1****(6 marks)****REQUIRED:**

Please answer the following short questions.

- (a) Explain why there is a need for performance audits **and** the audit of pre-determined objectives in the public sector. (2)
- (b) Explain the difference between a strategic outcome oriented goal and a strategic objective. (2)
- (c) Section 45 of the *Public Finance Management Act* (PFMA) describes one of the responsibilities of 'other officials' to be the effective, efficient, economical and transparent use of financial and other resources within that official's area of responsibilities. Provide examples of two procedures the Supply Chain Manager can implement to ensure compliance with section 45 of the PFMA. (2)

QUESTION 3.2**(19 marks)**

The following are extracts from the Strategic Plan and the Annual Report of the Public Administration Leadership and Management Academy.

Strategic Plan

Vision: a public service whose members are:

- Capable
- Committed
- Innovative
- User-oriented

in the service of the South African developmental state.

Mission: To provide, directly and through suitable partnerships, management development and training that is:

- High-quality: accredited and monitored
- Relevant: to government delivery needs
- Practical: covering "hard" and "soft", generic and specific skills
- Aligned: to MPSA competency frameworks

for all management levels across all three spheres of government.

The five current strategic objectives that have been adopted by the Academy are:

- Service delivery, with a focus on delivery of Academy training outputs.
- Stakeholder relations, with a focus on formation of strategic relationships with relevant partners and providers for capacity building.

- ❑ Lateral contribution, with a focus on creating synergies and improving systems and processes within the Academy.
- ❑ Corporate Governance, ensuring compliance with the requirements of the regulatory environment, and transformation, supporting a smooth transition from the former SAMDI to PALAMA.

The following performance indicators have been set:

- ❑ Number of courses accredited per year: target - to accredit six courses.
- ❑ Number of certificates of competency issued: target - to issue 3 500 certificates.
- ❑ Revenue from course fees per year: target - to raise R130M in 2010/11.
- ❑ Average number of days for debt recovery collection: to collect all outstanding debts within 160 days.
- ❑ Senior management system employed: keep in line with the national imperatives for better management opportunities for female and black South Africans.

Training Coordination Programme

Training Coordination				
Strategic objectives	Outputs	2010/11 Indicators	2011/12 Indicators	2012/13 Indicators
Services to be delivered.	Coordination of training activities.	Approximately 1 000 training interventions delivered to PALAMA clients when needed and in line with service standards.	Approximately 1 500 training interventions delivered to PALAMA clients when needed and in line with service standards.	Approximately 2 000 training interventions delivered to PALAMA clients when needed and in line with service standards.
Corporate Governance.	Development and maintenance of training management systems.	Review and prepare data within the existing training management system. Review and update the learner records database.	Ongoing maintenance of the training management system. Ongoing review and update of the learner records database.	Ongoing maintenance of the training management system. Ongoing review and update of the learner records database.

Training Coordination Programme

The Junior and Middle Management Service (JMMS) Training Coordination branch connects departmental users to training opportunities by booking candidates on training courses and managing the training calendar throughout the year. The branch is also responsible for the training contact centre, logistical arrangements for training to take place in different venues across all nine provinces, administration of post-course processes such as certification, and the development and maintenance of an integrated training management system for managing course information, registrations, invoicing, learner records and training statistics.

Branch: Training Coordination					
Strategic objective	Output	Indicator	Target for 2010/11	Actual performance	Performance status
Services to be delivered.	Coordination of training activities.	Number of training interventions delivered to PALAMA clients.	Approximately 1 000 training interventions delivered to PALAMA clients when needed and in-line with service standards by 31 March 2011.	During the financial year, PALAMA delivered 1 063 training interventions to its clients.	Achieved.
Corporate governance.	Development and maintenance of training management systems.	Existing training management system reviewed.	Review and prepare data within the existing training management system on a quarterly basis.	Conducted system maintenance on a quarterly basis and in accordance with report requirements for client.	Achieved.

REQUIRED:

- (a) Evaluate the extracts included above against the main criteria of usefulness. (12)
- (b) Based on the information provided, indicate one possible focus area for the performance against pre-determined objectives audit. (1)
- (c) Indicate what supporting evidence you as an auditor would request to ensure the validity, accuracy and completeness of information on actual performance included in the extract above. (3)
- (d) Explain what role internal audit should play in the audit of pre-determined objectives. (3)

QUESTION 4**(30 marks)****QUESTION 4.1****(10 marks)**

During compliance testing, the auditor evaluates the effectiveness of the internal controls which, amongst others, are designed to provide the auditor with reasonable assurance regarding reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. Internal controls remain not only one of the primary safeguards against fraud, but also one of the most effective mechanisms to detect fraud. When two or more individuals collude and conspire to commit fraud against an organisation, it can have an especially harmful effect, particularly when the combined efforts of the fraudsters enables them to circumvent or override anti-fraud (internal) controls.

REQUIRED:

- (a) Discuss which red flags could prove evidence of collusion. (5)
- (b) List and briefly discuss red flags the auditor can consider “collusion proof”, i.e. where, regardless of the collective effort of two or more fraudsters, the careful assessments of these red flags could or should lead to the discovery of fraud. (5)

QUESTION 4.2**(10 marks)**

According to the Fraud Triangle theory originally developed by Dr Donald Cressey, fraud may occur where a person is exposed to an un-shareable pressure (often financial difficulties), has the opportunity to commit fraud and rationalises his / her actions to him or herself. From an audit and internal control perspective, the “opportunity” to commit fraud can be managed through effective internal controls.

REQUIRED:

Explain how an auditor can assess the environment and evaluate the fraud risk by seeking evidence of “un-shareable pressures” or “rationalisation” in key staff members.

QUESTION 4.3**(10 marks)**

“The risk of a procurement fraud is greater for the 'repairs and maintenance' expense items than the purchase of an asset.”

REQUIRED:

Explain from a financial / audit perspective why the above statement might be true.