



The Southern African Institute of Government Auditors

Qualifying Examination for Registered Government Auditors

Paper 3: Auditing

November 2013

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 2013".
- 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)

The Department of Water Affairs (DWA) is one of the national state departments that must be audited by the Auditor-General South Africa (AGSA) in terms of section 4(1) of the Public Audit Act. Assume that the information provided in this question relates to the audit of the financial statements of DWA for the year ended 31 March 2013.

This question consists of four parts (A to D). 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 the particular part of the question.

PART A

(18 marks)

In the previous financial year (31 March 2012) the AGSA issued a qualified audit opinion. The following is a summary of the matters that provided the basis for the qualified opinion paragraphs in the auditor's report on the financial statements of DWA for the year ended 31 March 2012:

- Irregular expenditure: The auditor was unable to determine whether any adjustments are required to address the irregular expenditure disclosed in the financial statements, because the system of internal control is inadequate and does not allow the auditor to determine whether expenditure was in fact made in accordance with the requirements of supply chain management legislation, or not.
- Immovable tangible capital assets: The auditor was unable to obtain sufficient appropriate audit evidence regarding buildings and other infrastructure, because he was not able to physically verify the existence of certain assets and/or the supporting documentation was not provided.

Although the corresponding figures have not been restated in the 2013 financial statements, the audit committee and management of DWA are adamant that the department has done significant work during the 2013 financial year to design, implement, and ensure the effective functioning of internal controls, procedures and accounting processes with respect to the acquisition of assets, goods and services, and procurement and contract management. Since this was at the core of the prior period's qualifications, they are confident that the same matters will not arise during the current period audit.

REQUIRED:

- (a) Discuss the auditor's considerations for the current period audit of DWA, and the current period auditor's report addressing the issues that gave rise to the qualified opinion paragraphs from the previous audit period. (8)
- (b) Taking cognisance of the AGSA's audit methodology that presumes significant risk with respect to procurement and contract management, and management's assertions regarding improved and effective systems of internal control in 2013, discuss the conditions that would prompt the use of tests of controls, and how the auditor could use these as part of the audit plan. (10)

PART B**(25 marks)**

The annual appropriation of the Department of Water Affairs (DWA) is close to R9.5 billion, and total expenditure for the 2013 financial year amounts to R8.922 billion. The planning of the audit requires careful attention to understanding key aspects of the entity and its environment.

Extract of information related to internal controls relevant to the audit

The audit team has identified risk factors and risks of material misstatement while obtaining an understanding of the design and implementation of the Department's major business processes and their related accounting and information systems.

The senior manager (SM) responsible for the audit is not satisfied with the following issues documented by the audit team. The issue is not with the risk factors as such, but in relating them ("linking" them) to specific items in the financial statements, and/or the possible misstatements at the assertion level. The SM's comments have been recorded in square brackets - [...] - in the following table:

Risk no.	Risk factor	Financial statements item(s) affected	Assertion(s) affected
(i)	Inadequate controls for acknowledging receipts of goods and services and checking the details of goods and services being paid for	Expenditure – Goods and services [what else ...]	[not completed] [to be completed]
(ii)	The relevant software application is not able to provide a comprehensive report on all "open orders" placed with suppliers at a specific cut-off date	[not completed]	[not completed]
(iii)	Regular physical inspections of movable tangible capital assets are not carried out in all nine regions	Movable tangible capital assets	Completeness [what else ...]
(iv)	No formal procedures in place to record reconciliations and follow up with organisations and bodies that have received loans from DWA	Loans receivable	Existence [don't agree]
(v)	During walk-through procedures we established that it is possible that payments may still occur for services, after the contract has already expired	Expenditure for capital assets [what else ...]	[not completed] [to be completed]

Extract of information related to other aspects of the entity and its environment

During the audit planning process the nature of the department's activities and events and circumstances that portray DWA to various stakeholders were discussed with management, those charged with governance, the audit committee and internal audit.

Despite severe capacity limitations, the accounting officer is satisfied with the achievements of the DWA for the year ended 31 March 2013. Capacity limitations were as a result of high vacancy rates at all levels within finance and administration

in the Department, and at all nine regional offices. The transfer of identified functions to other departments would certainly relieve the burden going forward. The transfer of certain capital assets to the Department of Environmental Affairs was finalised in November 2012, and signed off by both Accounting Officers in accordance with section 42 of the PFMA.

The Accounting Officer admitted that there had been difficulties, but that there had also been numerous “positives”. The audit team obtained information regarding significant transactions and events through inquiries and inspection, as detailed in the following three paragraphs.

The Department is especially proud that it has succeeded in enabling 4 174 “Resources Poor Farmers” to access water, which is a significant over-achievement when compared with the 1 000 it had planned to assist. Subsidies are provided in accordance with regulations to the National Water Act that allow the Minister to allocate assistance to those farmers that fulfil the requirements. (The regulations state that financial assistance may be granted and used only for activities that ensure water is protected, used, developed, conserved and managed in a sustainable and equitable manner.)

“XYZ Water Authority” was and continues to be used as a Special Purpose Vehicle (SPV) to fund and implement the construction of water resources infrastructure. Funding for these projects is raised “off-budget”, from capital markets and banks. DWA collects revenue on behalf of “XYZ Water Authority”, and in terms of the agreements, the Department is required to cover the costs of any under-recovery.

Various technical and administrative support services were provided to water services and water resources institutions. Booklets, guidelines and pamphlets were distributed free of charge to municipalities, civil society and NGOs working in the water sector. Free training was also provided to operators of water and wastewater works, councillors and water board members. However, none of these training publications had the potential to generate any significant revenue even if a tariff were to be charged.

REQUIRED:

- (a) Using the following format, respond to the SM’s comments by providing the information you believe should be reflected in the table under the heading “Extract of information related to internal controls relevant to the audit” (i.e. update the table of risk factors). (10)

Risk no.	Financial statements item(s) affected	Assertion(s) affected
(i)		
(ii)		
(iii)		
(iv)		
(v)		

- (b) To the extent allowed by the available information under the heading “Extract of information related to other aspects of the entity and its environment”, identify relevant risk factors and link or relate these to what can go wrong at the financial statements level or at the assertions level (as applicable). (15)

Present your answer as follows:

- Risk factor: ...
- What can go wrong: ...

[1 mark per relevant risk factor and 2 marks per proper description of “What can go wrong”]

PART C

(20 marks)

One of the audit sections which has been allocated to you is “Creditors and accruals”. The following information is relevant to the audit work that you are expected to perform.

- Accounting policy

Accruals are not recognised as a liability in the statement of financial position, nor as expenditure in the statement of financial performance, but are included in the disclosure notes.

- The balance of “Accruals” as included in the disclosure note to the financial statements = R207,321,000. The relevant general ledger accounts have been grouped / mapped as follows to provide the information for inclusion in the financial statements:

General ledger accounts	Dt. / (Ct.)
Supplier control – goods and services	66,071,000
Supplier control – property and leases	29,555,000
Sundries and other accruals	6,707,000
<i>Sub-total of the above accounts = R102,333,000 Included in the disclosure note as “Goods and services”</i>	
Supplier control – assets and infrastructure	63,472,000
Retention creditors	41,516,000
<i>Sub-total of the above accounts = R104,988,000 Included in the disclosure note as “Capital assets”</i>	
Total “Accruals” in disclosure note	207,321,000

- Each supplier control account shown above agrees with a creditors’ ledger that is maintained for the different sub-categories of suppliers. The creditors’ lists provide an ageing of individual creditors.

- Amounts owing to suppliers are initially recorded based on a system of goods received notes (supported by supplier invoices and delivery notes), and purchase orders, and reconciled monthly to supplier statements. Goods and services, and capital assets are provided in accordance with supplier contracts, or in accordance with service level agreements in all those instances where it is required in terms of supply chain management legislation.
- Retention creditors represent the final retention amounts payable on completed capital project contracts, after the contracted retention period has lapsed.
- Assume a performance materiality figure of R12,000,000.
- Assume that a substantive approach is applied with respect to the audit of the relevant disclosure notes in the financial statements of DWA.

REQUIRED:

Design a program of substantive tests of detail to audit the disclosure note, "Accruals" in relation to all the relevant assertions, except for completeness.

Your audit procedures do not necessarily have to be presented on the basis of one per individual assertion, but should never-the-less address all relevant assertions, overall (except for completeness).

PART D

(17 marks)

During the course of the audit, the auditor is required to exercise professional judgement and to take reasonable decisions with respect to further audit procedures, the results of procedures, and the requirements of International Standards on Auditing (ISAs) relevant to the audit. The following two circumstances, amongst others, presented themselves during the course of the audit of the financial statements of Department of Water Affairs (DWA).

Circumstance D.1

The financial statements of DWA include relevant related party disclosures in disclosure note 30, *Related party transactions*, and disclosure note 31, *Key management personnel*. The information already included in the financial statements will be audited by way of verification of occurrence, rights and obligations, classification and valuation and accuracy.

REQUIRED:

Discuss the audit work that should be performed in order to also obtain assurance that all related party relationships and transactions are identified and considered for inclusion in the financial statements (i.e. audit work to address the completeness assertion). (12)

Circumstance D.2

During the course of reading the Report of the Accounting Officer, as part of the audit work that is required in relation to information other than the audited financial statements, the audit team identifies that the amount stated in relation to compensation paid to family members of key management personnel does not agree with the same item disclosed in disclosure note 31, *Key management personnel*.

REQUIRED:

Discuss how the auditor should proceed to deal with this matter and bring it to conclusion. You must assume that the matter concerned is material. (5)

QUESTION 2**(25 marks)**

As a Registered Government Auditor (RGA) specialising in information technology (IT) auditing, you are currently working on the annual audit of Jet Express Airways (JEA). JEA is a Schedule 2 Public Entity and has been receiving negative publicity in the media for the poor state of its financial records in recent years.

JEA relies heavily on their information technology infrastructure to operate. JEA maintains its own in-house IT function. Not only is the entity's financial function fully computerised, but the majority of procurement and sales transactions are also executed electronically. JEA is electronically linked to suppliers, with all order forms and subsequent purchase documentation exchanged through electronic data interchange (EDI). All purchases in excess of R5 000 must be made from approved suppliers as listed in the Approved Supplier Master File. Major expenses include, *inter alia*, jet fuel, airport landing fees, catering and staff.

As part of your annual general control review, you are currently reviewing the organisational structure of the IT support function. The following table records some of the staff employed in the IT function and their respective duties:

Employee name	Job description on personnel file	Responsibilities determined by interview
Ally, NT	Network administrator	<ul style="list-style-type: none"> - Maintaining data and voice networks at head office. - Adding terminals and printers to the network.
Gandawa, FM	Application programmer	<ul style="list-style-type: none"> - Executing program changes to programs as recommended by Zinzi Khoza, the systems analyst. - Assistant data entry operator when either Obed Kgopa or Mary Skosana is not available.
Kgopa, OJ	Data entry operator	<ul style="list-style-type: none"> - Entering of data from source documents for subsequent processing. - Filing all source documents.
Khoza, Z	Systems analyst	<ul style="list-style-type: none"> - Continuously monitoring users' IT needs. - Analysing JEA's web site availability and operational efficiency. - Making twice weekly back-ups of all master and transaction files. - Reviewing exception and error reports and authorising the resubmission of rejected transactions.

Mabelane, K	Database administrator	<ul style="list-style-type: none"> - Assessing the operational efficiency of the database. - Organising database files based on user needs. - Updating master file information on the database.
Mjali, T	Computer operator	<ul style="list-style-type: none"> - Issuing and resetting of user passwords. - Preparing transaction files for the daily update-run.
Skosana, M	Data entry operator	<ul style="list-style-type: none"> - Entering data from source documents for subsequent processing. - Maintaining back-up copies of files, programs and documentation.
Van Zyl, D	IT Help Desk	<ul style="list-style-type: none"> - Logging of user request for IT assistance. - Issuing and resetting of user passwords. - Obtaining and selecting of quotations for the procurement of IT hardware and software for users.

REQUIRED:

- (a) Explain the main objective of reviewing the organisational structure of the IT function as part of your audit. (2)
- (b) Explain why a general control review of JEA's IT environment should form part of the annual external audit. (3)
- (c) Identify and discuss all the weaknesses in the organisational structure of JEA's IT function. (14)
- (d) Explain the difference between a master file and a transaction file and indicate whether these two types of files should be subjected to the same level of control. (6)

QUESTION 3**(25 marks)****QUESTION 3.1****(10 marks)****REQUIRED:**

Please answer the following short questions.

- (a) Briefly describe the difference in legislative requirements between audit of pre-determined objectives and performance audit. (2)
- (b) Different countries and jurisdiction use different names for referring to reporting on performance. Identify two other names also used when referring to performance information. (2)
- (c) Explain the difference between outputs, outcomes and impacts. (3)
- (d) Formulate a strategic objective, together with an indicator and target, for the Auditor-General South Africa. (3)

QUESTION 3.2**(15 marks)**

The following is an extract from the Strategic Plan of the Department of Community Safety.

Strategic Plan

Strategic outcome orientated goal 4:

Strategic Outcome orientated goal 4:	To increase safety by optimising road safety in the Western Cape.
Goal Statement	To promote road safety in the Province by providing: traffic law enforcement services; facilitating road safety education; communication and awareness; and by providing training and development opportunities to all traffic policing officials and other law enforcement officials.

REQUIRED:

- (a) Discuss to what extent the defined strategic outcome orientated goal complies with requirements stipulated by Treasury in the Framework for Strategic Plans and Annual Performance Plans. (5)
- (b) Based on the information contained in the strategic outcome orientated goal, identify two possible focus areas for a performance audit. (2)
- (c) Describe two advantages of performance auditing. (2)
- (d) Identify three factors that can be used to evaluate and assist with the selection of a focus area for a performance audit. (3)
- (e) Define what is meant by 'performance audit criteria', and design a performance audit criteria that can be used during a performance audit that focuses on *training and development of traffic policing officials*. (3)

QUESTION 4**(30 marks)****QUESTION 4.1****(15 marks)**

Fraud is often described as an “unlawful, intentional misrepresentation which serves to the actual or potential prejudice of another”.

REQUIRED:

Elaborate on all of these elements of fraud.

QUESTION 4.2**(15 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.

REQUIRED:

Explain how the management of a company can utilise their understanding of this theory to reduce their company’s exposure to fraud.