



# Initial Test of Competence Professional Paper 1

**JANUARY 2016**

**TOTAL MARKS – 100**  
**READING TIME – 30 minutes**  
**WRITING TIME – 150 minutes**

## INSTRUCTIONS TO CANDIDATES

- 1 Enter your examination number on the front of the answer book. Your name must not appear anywhere.
- 2 You are reminded that answers may **NOT** be written in pencil.
- 3 The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and the required depth of the answer.
  - **Even if it is not explicitly required, you should show workings and cross-reference them to your answer.**
  - Marks are awarded for appropriate arrangement and layout, clarity of explanation, logical argument and clear and concise language.
- 4 Working papers must be handed in with scripts.

Disclaimer clause: All names of persons, places and business entities mentioned in this examination paper are fictitious and any resemblance to real persons, living or dead, places and business entities are purely coincidental.

### NOTES

- 1 The questions in this paper are not intended to reflect the reality of the Zimbabwean economy. Hence reference to exchange rates, interest rates, return on capital, inflation, etc., are to be taken at face value and there is an assumption that financial instruments such as foreign exchange contracts will be freely available. Unless otherwise stated, an effective tax rate of 25,75% should be used.
- 2 Any proposed amendments to tax legislation from the National Budget announced in November 2015 **ARE NOT EXAMINABLE** in this ITC.

## QUESTION 1

100 marks

### Background

Ambition Apparel (Pvt) Ltd ('Ambition') is a manufacturer of men's and ladies' fashion garments and accessories. Its factory and adjoining warehouse and administrative buildings are located in Bulawayo. The company sells its products to wholesalers and exclusive boutiques throughout Zimbabwe. The company's year end is 31 December 2015.

The company has always been profitable, and its business has expanded rapidly over the past few years. This is largely because the company employed a widely respected fashion designer three years ago, and consequently the company's garments and accessories have become highly fashionable and sought after. In order to keep up with sales orders, the company increased its manufacturing staff complement from approximately 80 wage earners to the current 300. The company's turnover exceeds \$300 million per annum.

Because of the increase in the staff complement, Ambition's payroll software became inadequate. As a result, the company decided to upgrade its payroll software to be capable of dealing with its increased staff complement. The new software was implemented on 1 January 2015.

You are a trainee on the external audit team responsible for the audit of Ambition. Your firm, XYZ, the registered auditor of Ambition, is considering the appropriate audit approach for payroll for the 2015 financial year and the audit partner has instructed that as far as possible a combined audit approach with a focus on control measures should be adopted.

Your firm has already tested the general controls at Ambition (including the logical access controls) and concluded that these controls are operating effectively.

### The payroll system for weekly wages

During the planning process, you documented the payroll system in use for weekly wages. This has been summarised in workpaper V5 – 001, System description: Payroll system for weekly wages.

<b>Client:</b> Ambition Apparel (Pvt) Ltd	<b>Prepared by:</b> JE	<b>Date:</b> 21/1/2016	<b>V5 – 001</b>
<b>Year end:</b> 31 December 2015	<b>Reviewed by:</b> FW	<b>Date:</b> 24/1/2016	
<b>Subject:</b> System description: Payroll system for weekly wages			
<b>Function of the system</b>	<b>Procedures and key controls</b>		
Maintenance of employee master file	<ul style="list-style-type: none"> <li>• All master file amendments are recorded on pre-printed, pre-numbered master file amendment forms (MAFs), which are authorised by the human resources (HR) manager and the manager of the section in which the relevant employee works, after having agreed the details on the MAF to the supporting documentation. The managers sign the MAFs as evidence of the control performed.</li> <li>• All authorised MAFs are entered on the system by members of the HR department, and access to the system is properly restricted.</li> <li>• All master file amendments are automatically logged by the system in sequence, and the logs are appropriately reviewed and signed by the Financial Director.</li> <li>• The HR manager conducts regular sequence checks of MAF logs to identify any missing logs. Missing logs are investigated.</li> </ul>		
<b>Timekeeping</b>			
Use of biometric data	<ul style="list-style-type: none"> <li>• The payroll system uses biometric data (a thumb print) to identify employees when they enter or exit the premises.</li> <li>• The biometric data per employee are stored on the employee master file.</li> <li>• Access to the module which enables the recording of the biometric data is restricted via appropriate logical access controls.</li> </ul>		
Employee identification and recording of hours worked	<ul style="list-style-type: none"> <li>• There are five entry/exit points to the factory and related buildings. Staff are allocated to one particular entry/exit point.</li> <li>• When entering or exiting the factory, a biometric device scans the employee's thumbprint before activating a turnstile which allows entry or exit to the factory. As employees enter and exit the factory, the payroll software automatically calculates the hours worked by each employee for the week.</li> <li>• Security personnel are present at the entry/exit points to observe the clocking in and clocking out processes. They investigate all unsuccessful attempts to gain entry to the premises.</li> </ul>		
Review of employee attendance	<ul style="list-style-type: none"> <li>• The payroll system produces a detailed log of all entry and exit activities ('entry and exit logs'). These logs are reviewed weekly by the factory foremen for details of absent employees, late arrivals, early departures and unexplained exits from the factory area.</li> <li>• The foremen follow up on all unexplained activities in a timely manner.</li> </ul>		
Approval of hours worked	<ul style="list-style-type: none"> <li>• At the end of the week, a schedule of total hours worked is generated from the payroll system, utilising the entry and exit logs above. The schedule reflects the normal and overtime hours worked per employee and is known as the 'total hours worked schedule'.</li> <li>• The foremen approve the total hours worked schedule for the week after performing the following activities: <ul style="list-style-type: none"> <li>▪ Scrutinising the schedule for any incorrect or unusual hours</li> </ul> </li> </ul>		

	<p>recorded, such as normal hours exceeding 40 hours per week, high overtime hours and low normal time hours.</p> <ul style="list-style-type: none"> <li>▪ Confirming that the overtime hours recorded were authorised prior to being worked, and that they were actually worked. Authorisation is evidenced by the foreman's pre-approved permission for overtime to be worked stated on the job card.</li> <li>▪ Confirming that there are data for all employees, and that any missing hours correspond to entry and exit logs generated by the access device.</li> </ul>
<b>Payroll activities</b>	
Preparation of the payroll	<ul style="list-style-type: none"> <li>• When the payroll is processed, the entry and exit logs are used by the payroll preparation module to calculate the hours worked by each employee for the week.</li> <li>• The automated system determines the amounts to be paid to the weekly wage earners by using these hours worked and the standing data (rate per hour, allowances and benefits) contained in the employee master file, and generates a sequentially numbered pay slip. A payroll clerk performs detailed checks on these calculations to ensure they are accurate.</li> <li>• Logical access controls are in place to limit access to the payroll preparation module.</li> <li>• A second payroll clerk (with read-only access) independently checks the amounts to be paid to employees after these have been checked and approved by the first payroll clerk. This is performed as an extra precaution to ensure the amounts to be paid to employees have been correctly calculated by the system prior to payment.</li> <li>• Both payroll clerks confirm the accuracy and completeness of the payroll by selecting the 'approve' option of the module.</li> </ul>
Approval of the payroll	<ul style="list-style-type: none"> <li>• The payroll administrator performs the following procedures and controls based on payroll and supporting schedules that have been produced: <ul style="list-style-type: none"> <li>▪ Agreement of the number of employees on the payroll to the number of employees on the employee master file.</li> <li>▪ Follow-up on system-generated exception reports, for example unusual net earnings amounts identified by automated checks.</li> <li>▪ Review of analytical summaries, such as a comparison of wages per cost centre and corresponding prior periods.</li> <li>▪ Review of overtime schedules.</li> </ul> </li> <li>• Where errors are detected, they are followed up immediately.</li> <li>• The payroll administrator does not have write access to the file and therefore all changes must be referred back to the wages clerk for correction.</li> <li>• All changes are sequentially logged and reviewed regularly by the Financial Director.</li> <li>• Once the payroll administrator is satisfied with the payroll, he will select the 'approve' option, and there will be no further access to the file, with read-only access given to those who need it.</li> </ul>
Recording weekly wage expenses and related balances in the general ledger	<ul style="list-style-type: none"> <li>• A manual journal entry is processed to the general ledger on a weekly basis to record the weekly wage payroll expenses and related balances. These entries are processed by a bookkeeper within the finance department.</li> </ul>

## **Discussions with the Financial Director**

The following matters were identified during planning discussions with the company's Financial Director:

### ***Request for assistance to prepare weekly wage expense journal entries***

The Financial Director explained that the bookkeeper responsible for the preparation of the manual journal entries to record the weekly wage expenses and related balances has been on maternity leave since the end of November 2015. As a result the weekly wage journal entries have not been prepared or recorded in the general ledger for December 2015. The Financial Director and her team are under significant time pressure and requested that you prepare the journal entries for her to process. She emphasised that the preparation of the journal entries would not take very long and that she would really appreciate your help. She also promised to let the audit partner know how helpful you had been this year.

### ***Right of use of company motor vehicles***

The Financial Director informed you that two employees had each been given the right to use a company motor vehicle from 1 January 2015. This was a new development as the company had not previously offered company motor vehicles to its employees. The details of the vehicles are as follows:

- The factory engineer had received a brand new 2.2 litre Double Cab Ford Ranger pickup to use during office hours and in his private capacity as a perk of his management position. This pickup had cost \$55 000 (including VAT) and had been purchased specifically for him.
- The company driver also received a vehicle, of the same make and model as the one given to the factory engineer. However, unlike the engineer who was allowed to take his vehicle home, the driver could only use the bakkie during office hours. It is parked at the factory at night.
- Neither employee had kept logbooks of their use of these vehicles.
- Salaries to these two employees are paid on a monthly basis.

### ***Delay of payment to the Zimbabwe Revenue Authority***

Pay as you earn (PAYE), manpower development levy (MDL), and National Social Security Authority (NSSA) contributions in respect of December 2015 had not been paid when due in January 2016. The Financial Director stated that the company simply did not have funds available to pay the amount owing in January. She explained that the December shutdown always puts strain on the company's cash flows and that the delay in payment to the Zimbabwe Revenue Authority (ZIMRA) tends to happen every year. She added that nobody has ever queried this practice before. The relevant amount is below planning materiality and performance materiality limits.

### **Error regarding employee overtime**

When testing the design and implementation of the payroll system for weekly wages, you discovered an error regarding an employee's overtime. The employee had incorrectly been paid for 25 hours of overtime instead of for the five hours actually worked. Upon further investigation you found that the warehouse supervisor had not checked the overtime worked by the employee before signing the total hours worked schedule as evidence of authorisation. When you followed up the matter with the relevant supervisor, he broke down in tears and told you that his child was very ill and his wife had been unemployed for several months. He begged you not to tell anyone of his mistake, as his family was solely dependent on his salary and he could not afford to lose this job. He promised to give you expensive tickets to a one-night only concert if you agreed not to report the matter.



## INITIAL TEST OF COMPETENCE, JANUARY 2016 PROFESSIONAL PAPER 1

The required section of this question consists of two parts. Answer each part in the correct, separate answer book.

QUESTION 1 PART I – REQUIRED		Marks	
		Sub-total	Total
(a)	(i) Describe the tests of controls that XYZ should perform to evaluate the operating effectiveness of the controls over the payroll system for weekly wages.	25	
	(ii) Describe the substantive analytical procedures that XYZ should perform to obtain assurance over the payroll expense for weekly wages.	7	
	<i>Communication skills – layout and presentation</i>	1	33
(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 –		
	(i) the <i>Companies Act</i> , Chapter 24:03; and	5	
	(ii) the ICAZ Code of Professional Conduct.	10	
	Include safeguards which you could apply to mitigate any independence risks.		
	<i>Communication skills – clarity of expression</i>	1	16
(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.	5	5
(d)	Discuss, with reasons, what XYZ's response should be to Ambition's intentional delay of the payments to ZIMRA.	20	
	<i>Communication skills – clarity of expression; logical argument</i>	2	22
<b>Total for part I</b>			<b>76</b>

**INITIAL TEST OF COMPETENCE, JANUARY 2016  
PROFESSIONAL PAPER 1**

The required section of this question consists of two parts. Answer each part in the correct, separate answer book.

QUESTION 1 PART II – REQUIRED		Marks	
		Sub-total	Total
(e)	Discuss the ethical implications for you, a member of the external audit team, arising from the warehouse supervisor's request.	8	8
(f)	Calculate, with reasons, the amounts to be included in the monthly remuneration for December 2015 of the factory engineer and the company driver with regard to their use of the company motor vehicles.	5	5
(g)	Discuss, with reference to relevant case law and the Income Tax Act, whether the PAYE withheld at the end of December but not paid over in January would be deductible for normal tax purposes by the company in the 2015 year of assessment.	10	
	<i>Communication skills – clarity of expression</i>	1	11
<b>Total for part II</b>			<b>24</b>
<b>TOTAL FOR THE QUESTION</b>			<b>100</b>