CHARTERED ACCOUNTANTS ACADEMY (CAA) – ICAZ ITC BOARD COURSE

MOCK EXAMS:
AUDITING AND GOVERNANCE – PAPER 3

[100 Marks]

13:00 – 13:30	Reading time	30 minutes
13:30 – 16:00	Writing of Paper	150 minutes

INSTRUCTIONS

1) **Enter your student number on the front of the answer book.**
2) **Your name must not appear anywhere.**
3) **Use of non-programmable calculators is permissible.**
4) **Any calculations must be shown in your answer book.**
5) **Working papers must be handed in with the scripts.**
6) **Answers Must Be Written In Ink Not Pencil**

This is a limited open book examination (use of SAICA handbooks and relevant act is permissible)

PPE MOCK EXAM: PAPER 2

Your employer was recently appointed as the external auditor of Oil Rush Limited (*Oil Rush*). The previous auditor resigned after a disagreement with the` Managing Director of the company, Chris Tucker about, *inter alia* the morality of fracking and risk ratings of certain report points in the management report from the prior year. This change in auditor was properly implemented in compliance with all relevant legal and ethical requirements.

The audit team is currently planning the audit for the financial year ending 30 September 2013 and has prepared the following Working Papers. You specifically requested the risk register.

Working Papers	**Reference**	**Page number*****
Knowledge of the client: Nature of operations	B1/9	3
Knowledge of the client: Staffing	B2/9	4
Statutory: Regulatory environment	C3/7	4
Statutory: Ownership & Management structure	C6/7	5
Finances and reporting	D1/1	6
Systems and controls	F4/4	6
Extracts from Minutes of meetings	H1,4,5&7-/7	7, 8, 9 & 10

****Only information and Working Papers relating to the company that are relevant to the question have been provided.*

**** Note that some pages contain multiple Working Papers.*

Oil Rush is involved in small scale fracking for oil and gas reserves along the great dyke of Zimbabwe. Oil Rush is mainly involved in the exploration of natural oil and gas resources, as well as the extraction of natural oil and gas as fuel from existing natural gas fields that belong to the company, and the processing thereof.

Client: Oil Rush Limited	Prepared by: Oil Baron	Date: 14/10/13	B1/9
Year-end: 30 September 2013	Reviewed by:	Date:	
Subject: **Knowledge of the client**			

The following Working Papers document background information concerning the client.

Nature of operations

Oil Rush conducts business from its premises in Montague Gardens operation, including the service depot, refinery, processing plant etc., is located at these premises.

The company owns 48 large portable Hydraulic-fracturing pump installations consisting of various components and associated equipment. These components, each with different economic useful lives, when combined are commonly referred to as "pumps". All pumps and related components are currently sourced locally and are financed through finance lease agreements with a leading Zimbabwen bank. The difference between the accounting and tax treatment of the finance leases results in a deferred tax asset that will be included in the Statement of Financial Position (Other net temporary differences are not significant and the company does not have an assessed loss). Pumps are classified under Plant and Equipment in the Statement of Financial Position and carried at historical cost less accumulated depreciation and impairment. Where significant components have different useful lives, these are accounted for as separate items. Expenses incurred to replace or customise significant components are capitalised and any remaining carrying amount of components replaced, is written off in the Statement of Comprehensive Income. Depreciation is written off on the straight-line method over the expected useful lives of the plant and equipment. The estimated remaining useful lives and residual values are revised annually.

These pumps are portable and can be set-up within 24 hours, after which they are able to start extracting oil and gas from the earth. This raw oil and gas is then processed to manufacture motor vehicle fuels and petroleum products with industrial and household applications. These products are sold locally and internationally. Once the oil or gas reserves at a specific site or location have been exhausted, the pumps can be dismantled and moved to a new site or location within 24 hours. Attempts are made to rehabilitate the land after the oil and gas reserves have been exhausted, but this matter is surrounded by controversy.

Pumps are normally stationed at one site for a number of months at a time before being returned to the depot in Montague Gardens to be serviced. In order to reduce wear and tear on the pumps, they are serviced at regular intervals. The company operates at a 70% operating capacity, which means that, at any given point in time, more than 70% of the company's pumps are in operation at locations around the country.

Client: Oil Rush Limited	Prepared by: Oil Baron	Date: 14/10/13	B2/9
Year-end: 30 September 2013	Reviewed by:	Date:	
Subject: **Knowledge of the client**			

Staffing
Because of the temporary nature of the sites, the company employs two categories of employees:

(i) **Hourly wage workers**:
The company makes use of temporary employees from townships around the various sites where they extract gas and oil. The company trains the local community and invests in infrastructure development. These employees are paid an hourly wage in cash. Because of the wide distribution of sites around Zimbabwe, a security company, Hi-Way Robbers Limited ("HWR"), is responsible for the physical pay-out of wage packets to temporary employees. HWR signed a ten year contract with Oil Rush to distribute wage packets.

(ii) **Salaried employees**:
All other employees (including senior management) signed permanent contracts for a fixed salary and a 50 hour work week. Salaries are paid by means of monthly Electronic Fund Transfers.

Client: Oil Rush Limited	Prepared by: O.I.L. Spill	Date: 14/10/13	C3/7
Year-end: 30 September 2013	Reviewed by:	Date:	
Subject: **Statutory**			

Regulatory environment
Oil Rush conducts its business under licences obtained from the Department of Natural Resources of the Zimbabwean government. The licences were awarded under a cloud of controversy and the company received strong opposition from conservation groups. The licences were eventually awarded after the company obtained assistance from well-known tender-preneur, Mr. Harvey Spector.

The licences allow Oil Rush to extract a predetermined number of cubic metres of gas and oil per year. The Department of Natural Resources determines the cubic metre supply limits on an annual basis and publishes the limits per licence in the Government Gazette. Each licence is valid for a period of between five and ten years and specifies cubic metres of gas or oil per year. Assuming the company can maintain its 70% operating capacity; management expects that each licence will be used for its entire period of validity. These licences are not transferable. The cost price model is used for measuring licences.

In March 2013, following a large outcry from the public against fracking, the Department of Natural Resources gazetted that all existing cubic metre supply limits on existing licences will be reduced by 30% effective from 1 October 2013.

Client: Oil Rush Limited	Prepared by: O.I.L. Spill	Date: 14/10/13	C6/7
Year-end: 30 September 2013	Reviewed by:	Date:	
Subject: **Statutory**			

Ownership structure
Oil Rush listed in the Oil and Gas Sector of the ZSE Limited in 2011. They did this, because until then, the company was very reliant on shareholder loans, it used part of the capital raised to repay a proportion of the shareholder loans. At year end, only 35% of the company's capital structure is funded by shareholder loans.

During the listing, as part of a share incentive scheme, the company awarded 1, 5% of the company's shares to the directors. For every share awarded to the directors, the company awarded an equivalent number of shares to the permanent employees through an employee share incentive trust. Oil Rush Pension Fund holds 6,5% of the publically traded shares. The shares are well traded with a large institutional investor shareholding of 81%.

Management structure
Oil Rush was originally a family run business managed by the Tucker Family and the family remains strongly involved in management. Chris Tucker Jnr. has been the Managing director of the company for the past five years. He took over from his father, Gregory Tucker, Snr. who started the company and was responsible for listing the company. His youngest brother, Wilson Tucker is responsible for the extraction process of the oil and gas, while his oldest brother is responsible for the processing of raw oil and gas, as well as the manufacturing process of various fuels and by products.

Suzaan Tucker, the oldest child has a Master's Degree in Marketing and is the head of Marketing and Sales. The youngest of the family, Elzaan Botma is a qualified CA(Z) and heads up the Management Accounting, Accounting and Finance Department.

Client: Oil Rush Limited	Prepared by: O.I.L. Spill	Date: 14/10/13	D1/1
Year-end: 30 September 2013	Reviewed by:	Date:	
Subject: **Finances and reporting**			

Financial information

The draft annual report of Oil Rush, for the year ended 30 September 2013, has already been approved by Elzaan Botma and presented to the audit team, with the budgeted figures for the 2013 financial year and audited figures for the 2012 financial year. Based on discussions with the previous auditors (as required by the Code of Professional Conduct), you do not expect that management will be required to make material adjustments to the draft financial statements to correct audit differences as the company strives to implement good controls and create a good control environment. Management confirmed that no changes in accounting policy have taken place since the previous financial year or are proposed or expected for the 2014 financial year.

Client: Oil Rush Limited	Prepared by: Vrot Gas	Date: 14/10/13	F4/4
Year-end: 30 September 2013	Reviewed by:	Date:	
Subject: **Systems and controls**			

Computer system

During the current financial year, Oil Rush installed a new computer system, SAP. This is a fully computerised accounting system used for the production process and its entire accounting function. During the first two months of implementation, the new system experienced problems that caused significant delays in data processing, but eventually the Information Technology department completed the upgrades to all the systems, except for the Human Resources and Payroll function which is due to be upgraded in 2014. Previously, the company made use of a manual system for all processes, except for the Human Resources and Payroll function which has always been partially computerised. They used PeopleHard, a partially computerised Human Resources system that relies heavily on manual processing to process the Human Resource transactions and maintain related accounting records. PeopleHard is a generally available computer package. This package was implemented three years ago. Due to the large number of wage employees at the various sites around the country, the company is considering purchasing a new computer package to be used exclusively for the calculation of the weekly wages and processing related accounting transactions. Three possible vendors have been identified.

Client: Oil Rush Limited	Prepared by: O.I.L. Spill	Date: 14/10/13	H4/7
Year-end: 30 September 2013	Reviewed by:	Date:	
Subject: : **Extracts from Minutes of meetings**			

The Risk committee spent the past few months identifying the risks that the company faces and recording them in the risk register as recommended by the previous auditor. This process of risk identification must be repeated at least every six months in order to ensure that changes in exposure to risks are properly addressed.

Risk category
B2 Information technology risk - Unauthorised access and/or changes to system and data.

Background
The Internal auditors identified various errors during their testing of the master file change controls. Although the errors that were identified did not have a material impact, the current system of internal controls needs to be evaluated by the Risk committee.

The following process, as documented in the Accounting manual, is followed when changes are made to standing data in respect of the product ranges and prices:

1. Changes to standing data in respect of product ranges and prices are made by the head administration clerk.
2. Changes are made on the basis of authorised, pre-numbered requests received from the sales manager.
3. As soon as changes to the standing data are made, the sales manager receives a system generated e-mail notifying him of the changes made.
4. On a weekly basis, the system prints a register of all changes that indicates the following in respect of each change:
   - the date on which the change was made,
   - the username of the person who made the change,
   - the reference number of the request with which the change was requested, and
   - the details of the field(s) to which the change(s) was/were made.
5. These registers are reviewed by Elzaan Botma and the sales manager on a weekly basis, after which they sign and file the registers.

Matter for discussion

Consideration must be given to the effectiveness of the controls documented above.

Risk committee response or recommendations

____

____

____

Client: Oil Rush Limited	Prepared by: O.I.L. Spill	Date: 14/10/13	HS/7
Year-end: 30 September 2013	Reviewed by:	Date:	
Subject: **Minutes of meetings**			

Risk category

C1 Business risk Foreign exchange fluctuations

Background

Much of Oil Rush's gas and oil (and related products) is consumed locally, although some is exported to South Africa. As a consequence, a large portion of Oil Rush's debtors are denominated in South African Rand (ZAR). During the current financial year, the Rand/US Dollar exchange rate was stable and moved around the R9,50/$ mark. However, at year end the exchange rate suddenly weakened, following general unrest and speeches by prominent politicians in South Africa. Due to this temporary weakening of the Rand against the US Dollar, the accounts receivable balance at year-end includes an exchange rate gain of $654 197.

Matter for discussion

Strategies must be put in place to protect the company against the fluctuation of the Rand/US Dollar exchange rate.

Risk committee response or recommendations

Client: Oil Rush Limited	Prepared by: O.I.L. Spill	Date: 14/10/13	H7/7
Year-end: 30 September 2013	Reviewed by:	Date:	
Subject: **Minutes of meetings**			

Risk category

C3 Business risk Supply of Drill Heads

Background

During the course of 2013, Oil Rush started to develop new gas fields close to Chinhoyi in Mashonaland West. It appears that the company is incurring larger than expected costs in developing these fields. Oil Rush must constantly replace drill heads. A second layer of hard sandstone, located 50 metres under the surface, is damaging the drill heads. The site manager must replace drill heads every two month and, in an e-mail to the Board, he stated that he is experiencing problems with current suppliers of drill heads. He has investigated and identified two new suppliers of drill heads:

1. Hammer head CC, a local company known for manufacturing quality parts.

2. Swiss Deep Drilling Limited, a supplier located in Switzerland, with very competitive prices. They can ship good quality parts cheaply and free-on-board (FOB) to Zimbabwe.

Risk committee response or recommendations

____

____

____