SUGGESTED SOLUTION

Part (1) – Pre Engagement

1. Whether or not there was proper compliance with the firm's internal policies and procedures for the acceptance and approval of new clients. (1)
2. Whether or not a proper new client investigation was conducted and a proper conclusion reached concerning client integrity. (1)
3. Whether or not the firm has the competence and available staff to carry out this audit. (1)
   Oil industry – IFRS and Tax
4. Whether or not the firm, and the engagement team, are independent of the client. (1)
   oil industry
5. Whether or not any conflicts of interest arise relating to other clients, (1)
   Perhaps clients in the oil industry? Clients committed to environmental issues. (1)
6. The fact that the previous auditor set high risk ratings in his management report is a concern regarding the control environment and management's commitment to controls. (1)
7. The issues concerning the morality of fracking and the effect on the environment could cause reputational damage to the firm. (1)
8. The company appears to lack formal governance structures with excessive influence vested in the Tucker family. (1)
   - Whilst there is a risk committee, there is no mention of other necessary committees – audit committee, remuneration committee, nomination committee and social and ethics committee. (1)
9. There is an incentive for management to manipulate results, overstate assets and understate liabilities: (1)
   - The family influence.
   - The family holds significant shareholdings.
   - The company is listed and management would want to show sound results to influence investors. (2)
10. The company is listed on the ZSE:
    - Risk related to possible manipulation of financial information.
    - The possibility of non compliance with ZSE regulations.
    - Particularly, given the lack of governance.
    - Whether or not the firm and the engagement partner are qualified to audit JSE listed companies (Auditors need to be registered with the ZSE before accepting listed audits.) (3)
11. A going concern issue could arise because of the reduction in the allowable cubic metres. (1)
12. Complex aspects of IFRS apply to this audit and it is uncertain whether or not the company has the expertise to deal with these aspects. (1)
    - Examples include accounting for the Pumps, the Licences and possible impairment of assets because of the Going Concern issue. (2)
13. Possible availability of experts that might be needed in certain aspects of the Audit for which the firm does not have expertise. (1)
14. Whether or not the client is able to pay the fee. (1)
15. Proper understanding of the terms of engagement. (1)

(Max: 11)

Part (2) – Risk and audit responses: Plant and Equipment (Pumps)

The 'rights and obligations' assertion has not been addressed in detail as it is given in the question that leases have the substance of finance leases.

Risk(s)	**Audit response**
Risk that pumps do not exist (or have been written-off or stolen) as they are seldom in the depot for management to confirm that they exist. (1)	Evaluate controls implemented by management in order to keep track of the Pumps. (1) Check alternative sources of evidence for proof of existence, such as: (1) i. Proof of registration ii. Sustained payment of insurance premiums iii. Proof of sustained raw gas and oil from the various sites. (Max 1)
Risk of non-disclosure of finance companies' interest in PPE. (1)	Check disclosure note in the annual financial statements. (1)
Risk that not all the pumps are reflected on the Statement of Financial Position as all the pumps are seldom in the depot for management to confirm and move between locations. (1)	Evaluate controls implemented by management in order to keep track of the Pumps. (1) Confirm the completeness of finance lease agreements with the bank. (1)
Risk that historical cost of pumps has been calculated incorrectly as a result of use of a non-market-related interest rate. (1)	• Recalculate calculations of cost at inception, using market-related interest rate. (1) • Consider the appropriateness of the discount rate used. (1)
Risk that the cost of service of pumps is incorrectly capitalised. (1)	• Check journals to debit sides of fixed-asset ledger accounts for incorrect capitalisation of service cost. (1)
Components of pumps • Risk that pumps are not separated into their separate components for recording in accordance with IAS16 (1) • Risk that the allocation of the cost price to the different components are done incorrectly. (1)	• Investigate fixed asset register for components.(1) • Consider reasonableness of basis of apportionment of cost to components. (1) • Reperform the calculations of apportionments to components. (1) • Use of an expert in the petroleum industry. (1)
Depreciation • Residual value of a pump is material and difficult to determine since it depends on factors such as (i) physical condition, damage etc. (ii) it is subjective in nature. (1) • Useful life of a pump is hard to determine as it depends on regularity of maintenance and other factors. (1)	• Review reasonableness of management's policy for determining residual values and useful lives.(1) • Review the physical condition of pumps when in depot on a surprise basis. (1) • Review whether all pumps are maintained regularly by reviewing the service records. (1) • Consider using an expert to determine residual value and (1) useful life. (1) Any valid detail as outlined in ISA 620. (1)

Impairment

- The restriction of 'cubic metre supply limits' will limit the future cash flow that can be generated by the pumps that might complicate the impairment calculation.(1)
- Subjectivity in estimating future cash flows and discount rates. (1)
-

(Max: 7)

- Consider management's strategy to manage effect of restrictions on future cash flows. (1)
- Assess all assumptions underlying impairments for reasonableness. (1)
- Where possible, obtain external confirmation of parameters used. (1)
- Reperform the calculations. (1)

Other risk(s) and response(s) (2)

(Max: 15)

(Max: 22)

Part (3) – Risk at account level: Deferred tax asset

1 Risk that the deferred tax asset does not meet the requirements for recognition of an asset: (1)
- Risk of incorrect estimation of the amount of taxable income, which will be earned in the future, against which the deductible temporary differences can be utilised. (1)
- Risk that insufficient taxable temporary differences are available in respect of the same tax authority, which can be expected to reverse in the same period as the expected reversal of the deductible temporary differences. (1)

2 Risk that the deferred tax asset does not "belong" to Oil Rush. (1)

3 Risk that all deductible temporary differences were not considered in the calculation of the deferred tax asset. (1)

4 Risk that the following is calculated incorrectly:
- Tax bases and (1)
  carrying amounts that result in the deferred tax asset. (1)
- The carrying amount of the deferred tax asset [temporary differences (tax bases and carrying amounts) x rate] (1)

5 Risk that deferred tax asset is measured at the incorrect tax rate. (1)

6 Other valid risks (1)

(Max: 6)

Part (4) – Substantive procedures: Licences

1. Inspect the licence documents for the following:
   - Made out in the name of Oil Rush Limited.
   - Amount paid.
   - Validity period (compare with the licence register). (2)
2. For new licences acquired during the year, inspect the bank statement for the payment of the licence fees. (1)
3. For licences that terminated during the year, inspect that the cost price, accumulated amortisation and impairments are removed from the licence register. (1)
4. Obtain a direct confirmation from the Department of Natural Resources of all existing licences that have been issued to Oil Rush (and are valid) and compare with the licence register. (1)

Amortisation:

Substantive procedures are not performed on the residual value, as it is assumed that the residual value is nil, as the requirements of IAS38.100 are complied with.

1 Obtain a schedule of the balance in respect of licences. (1)
2 Agree the schedule to the trial balance and financial statements. (1)
3 Check any adjusting entries and transfer any unadjusted issues to the final schedule of misstatements. (1)
4 Perform analytical review procedures.
Compare the licence balances to previous years and investigate and anomalies. (2)
5 Inspect in the licence register that each licence is amortised over its individual validity period.(1)
6 Inspect the licence register that new licences acquired during the year are amortised only for the part of the year involved. Check calculations. (1)
7 Inspect the licence register that no amortisation is calculated after the expiry date of a licence.(R)
8 Recalculate the amortisation expense for the year and the accumulated amortisation balance. (1)

Impairment:
1 Inspect the relevant Government Gazette for details of the decrease in cubic metre supply limits. (1)
2 Review and test the process used by management to determine the impairment, as follows: (1)
- Taking into account knowledge of the business and industry, consider the reasonableness of the following assumptions of management: (1)
  - i. Fair value (for 'fair value less selling costs' calculation) (See (3)).
  - ii. Selling costs (for 'fair value less selling costs' calculation). (1)
  - iii. Probabilities and future cash flows (for the calculation of value in use) (See (4). (1)
  - iv. Discount rate (for the calculation of value in use). (1)
- Test (recalculate, inspect evidence *etc*.) data used by management for accuracy. (1)
- Inspect the approval by management (minutes or other documentation) of the impairment.(1)
- Obtain from management a register (or schedule) of licences and calculations of the impairment and:
  - i. Agree the totals of both with the general ledger.
  - ii. Agree the totals of the impairment calculations with the register of licences.
  - iii. Recalculate all calculations, castings and cross-castings. (2)

3 With management's approval, ask an expert on licences and cubic metre supply limits to independently estimate the value of the licences and compare this estimate with that of management. Consider specifically: (1)
- Professional competence;
- Objectivity;
- Scope of work;
- Reliability of data used;
- Assumptions and methods; and
- Reasonableness of results. (Max: 2)

4 Marks for detail on projection of future benefits:
- Competence / Reliability of people and the system.
- Assess management's assumptions.
- Compare past forecasts to actual. (2)

5 Inspect post-balance events for information that can cast light on the reasonableness of management's estimation (for example: decrease in manufacturing and sales volumes; *etc*.) (1)
6 Other valid procedures (1)
7 Include the valuation of licences in the final representation letter. (1)
8 Presentation – proper formulation of substantive procedure. (1)

(Max: 16)

Part (5) – Audit approach for the audit of wages for the current year

1 This is a new appointment and, therefore, the auditor will have to understand the accounting wage system of the company, and specifically which part of the system is manual or computerised. (1)

2 Obtain an understanding of the related internal controls (manual and computerised) that are applied. (1)

3 Perform risk assessment procedures: (1)
- Making enquiries of management.
- Analytical reviews of financial data.
- Inspection of documents relating to understanding of the entity. (2)

4 Assess the design of internal control to determine whether or not controls manage significant risks. (1)

5 If so, it will be necessary to evaluate these controls. (1)

6 Consider whether or not it is practicable to obtain sufficient audit evidence from substantive procedures only. (1)
If not, it will be necessary to test controls. (1)

7 Decide whether a systems-based (tests of controls) or a substantive strategy would be appropriate for the wage system. This will be done after the understanding of the accounting system and related internal controls, the evaluation of additional audit risks and the provisional assessment of the internal controls on which the auditor intends to rely, have been taken into account. (R)

8 With respect to the portion of the system that is computerised:
- Determine which general computer controls will be relied on. Test these general computer controls with tests of control. (1)
- Attention will be paid to security and access controls, organisational controls and adequate segregation of duties, system maintenance and change controls in particular.

(Max: 2)

9 If the conclusion is drawn that the general controls can be relied on, test the application controls with regard to the computerised part of the system by performing appropriate tests of control. (1)
- If the general controls cannot be relied on, a substantive strategy must be followed. (1)
(Alternative: Control risk for the client is set at high for a number of reasons, which means that a substantive strategy is appropriate.)
- If the general, as well as the application controls, can be relied on, perform only limited substantive procedures. (1)

10 The portion of the wage system that is computerised, as well as the complexity of the package that is used, will determine whether I (as auditor) have the necessary technical skill and proficiency to be able to audit the wage system. (1)

11 Consider the necessity for a computer expert to assist with the audit of the wage system. (1)

12 If the computer system with respect to wages is simple and the controls performed are mainly manual, the computer can be disregarded. Tests of control will then be performed only on the manual controls. (1)

13 If they cannot be relied on, a substantive strategy would be appropriate. (1)

14 With respect to the portion of the system that is not computerised:
- Establish which manual internal controls that will be relied on, are present in the wage system. These internal controls will be tested by means of tests of control. (1)
If these manual internal controls cannot be relied on, follow a substantive strategy. (1)

15 Where a control based approach is decided upon, there will be increased reliance on analytical procedures and a reduction in the tests of detail. (1)
16 If a substantive strategy must be followed, ensure that the figures in the financial statements agree to the figures in the trial balance that were generated from the systems. (1)
17 The wages reconciliation process will be reviewed and a sample of reconciliations will be checked by means of reperformance. (1)
18 The auditor can use the computer to perform the audit process by means of electronic Working Papers and automated audit programs (audit with the computer). (1)
19 Where appropriate, the auditor can use computer-assisted audit techniques (CAATs) to perform audit procedures - with respect to tests of control and/or substantive procedures (audit with the computer). (1)
20 With respect to the wage payment process handled by the security company: personally attend the making up and payment of the wage packets on a surprise basis and note the internal controls that apply. (Max: 2)
21 Other valid comments (1)

(Max: 16)

Part (6) – Governance Structure

1. As there seem to be too many members of the Tucker family on the Board, some family members should step down. (1)
2. With five Tuckers on the Board at present, the company would need to appoint a minimum of six non-executive directors. (1)
   This appears to be too many directors, although this would reduce if some Tuckers stepped down. (1)
3. A strong independent non executive chairman should be appointed from the non-executive directors. (1)
4. A minimum of four independent non executive directors is required to enable the company to form a properly constituted audit committee. (1)
5. In order to form a properly constituted audit committee, some of the independent non executive directors should be financially literate. (1)
6. Appointment to the Board should be managed by a nominations committee which should ensure that the new directors are properly qualified and experienced and properly inducted into the company. (1)
7. The Companies Act requires the formation of a Social and Ethics Committee. (1)
8. A properly qualified Company Secretary should be appointed. (1)
9. Nominations, Risk and Remuneration committees should be formed. (1)
10. There should be strong representation of independent non-executive directors on these committees. (1)
    Detail: (1)
11. All committees should be accountable to the board and should have proper terms of reference.(1)
12. There could be improvements in the risk management system with the risk committee prioritising risks, developing strategies to manage risks and reporting to the Audit Committee and/or the Board. (2)
13. The audit committee should take accountability for the internal audit function, ensuring proper competence, proper reporting to the audit committee and proper liaison between internal audit and external audit. (2)

14. Each committee should have proper terms of reference and should report to the Board. (1)
15. As a large company in a sensitive industry the company should be committed to transparency and show more commitment to integrated sustainability reporting It should obtain independent assurance on its sustainability reporting. (2)
16. Other valid issues. (2)

(Max: 10)

Part (7) – Risk in respect of new computer system (excluding the Human Resources and Payroll function)

1 As the computer system is new, an increased risk exists that the system was not properly tested, does not function properly and/or that the necessary controls are not built into it, which increase the risk of errors in the financial statements. (1)
2 The problems experienced since the conversion to the new system might indicate that hardware and/or software problems exist. If these problems/deficiencies are not properly addressed, similar problems may occur in future, which increase the risk of errors in the financial statements. (1)
3 As the computer system is new, there is a risk that staff members, who are not yet familiar with the new system, could make mistakes that would increase the risk of error in the financial statements. (1)
4 A risk exists that during the implementation, data transferred from the manual to the computerised system was, not completely or accurately transferred which would result in incorrect financial information. (1)
5 Delays in data processing were experienced. It could have led to problems with data processing (not completely/accurately processed) or that due to the time pressure under which data processing needed to be done to eliminate any back log in data processing, processing was incomplete/inaccurate, which increases the risk of error in the financial statements. (1)
6 The delays in data processing that were experienced, may lead to a loss of business continuity and income, which may influence going concern negatively. (1)
7 Other valid risk (1)
8 Presentation – proper formulation of risks. (1)

(Max: 5)

Part (8) – Test of controls regarding changes to standing data

Acquire a number of weekly registers of changes to standing data and:

1 Inspect the registers for the signatures of both Elzaan Botma and the sales manager. (1)
2 Check the number sequence of the requests for changes, as indicated on the report. Enquire about any missing/duplicated numbers. (1)
3 Ensure by inspection that in respect of all changes, only head administration clerk's username appears as the initiator of the changes. (1)
4 Follow a number of changes back to the original request form and; (1)
   - Compare the details on the form with the detail on the report and ensure that the changes were made accurately; (1)
   - Inspect that each form was signed and approved by the sales manager. (1)
   - Compare the details of the changes, requested by the sales manager, with supporting evidence (such as minutes of management meetings, pricelists and catalogues of suppliers). (1)
   - Compare the date on which the changes were made with the date of the request and ensure that the changes were made in time. If necessary, make additional enquiries. (1)

5 Follow a number of approved request forms to the computer system to verify that changes were made completely, accurately and timely. (1)
6 Test the access controls to the computer, the option to change the master file and the master file itself and ensure that only head administration clerk can gain access to make changes to standing data. If necessary, use the assistance of an expert to determine the personnel's user profiles. (1)
7 Test that appropriate application controls are built into the system in respect of changes to existing data for example, field size test, alphanumerical test, and reasonableness test. (1)
8 Other valid test of control (1)
9 Presentation – proper formulation of risks. (1)

(Max: 8)

Part (9) – Business risks relating to foreign suppliers

1 Exchange rate differences can expose Oil Rush to exchange rate losses, which could result in cash flow and going concern problems. (1)
2 If problems (delays) occur with the transport (shipping) of parts from Switzerland to Zimbabwe the drilling process may be interrupted or come to a halt, which will negatively influence production, sales and income. (1)
3 Erroneous calculations in the conversion of exchange rates, which may be difficult, can lead to:
- erroneous accounting records (creditors and exchange rate profits/losses); (1)
- under/over payment. (1)

4 The valuation of inventory can be erroneous as a result of:
- erroneous calculations, and/or incorrect inclusion or exclusion of relevant costs relating to the import and transport of the parts; (1)
- the incorrect inclusion/exclusion of parts in transit. (1)

5 Damage to the parts and/or losses/theft while being transported can cause financial losses. (1)
6 Swiss Deep Drilling Limited is a new supplier with which Oil Rush does not have an established relationship. If the supplier is not reliable, it may cause losses for Oil Rush if for example, the parts do not arrive or are not of the required quality. (1)
7 Other valid risks (1)
8 Presentation – proper formulation of risk. (1)

(Max: 6)

Presentation: 2
Logic: 1
Layout: 1
Allocated mark, unless allocated elsewhere (R)