

Part (e) Discuss, with reference to the information provided in sections 1 and 2, any ethical threats and concerns you may have regarding the behaviour and actions of Michaela.		Marks
<ul style="list-style-type: none"> <li>Do not discuss the significance of any threat.</li> <li>Do not provide any safeguards.</li> </ul>		
1.	Michaela is a professional accountant (CA(SA)) in public practice (audit manager at CAI) and in business (director and shareholder of DentOut), which means she needs to adhere to part 1, 2, 3 and 4 of the SAICA Code of professional conduct (depending on her role).	1
2.	<p><u>Roles and Responsibilities</u></p> <p>2.1 Michaela is a full-time employee (audit manager) at CAI who also executes duties for DentOut that one would normally expect to be done on a full-time basis.</p> <p>2.2 The aforementioned matter creates a <b>self-interest</b> threat to <b>professional competence and due care</b> since;</p> <ul style="list-style-type: none"> <li>She may not be able to perform both parties' work with the necessary diligence and dedication as she might not be able to execute her responsibilities at CAI and DentOut with due care and would have the necessary time to perform all her duties with the care needed.</li> </ul>	<p>1</p> <p>½ ½</p> <p>1</p>
3.	<p><u>Preparation of AFS</u></p> <p>Michaela did not adhere to IFRS 16 requirements (not applying lease accounting to the rental of the premises) and IAS 16 requirements (accounting for assets at R0 value when they are still in use) when she prepared the financial statements of DentOut. This is in breach of the following sections of the Companies Act:</p> <p>3.1 <b>Section 29</b> of the Companies Act as the financial statements of DentOut are not in compliance with the chosen accounting framework (IFRS 16 and IAS 16), being IFRS, when she states that they are provisions/accurate inventory records not kept when she prepared the financial statements of DentOut.</p> <p>3.2 <b>Section 76</b> of the Companies Act since she did not adhere to IFRS 16 requirements thus not performing her functions as director with the degree of care, skill and diligence expected or is acting in her own best interest.</p> <p>3.3 This could create a <b>self-interest threat to Michaela's Integrity/ professional competence and due care / Objectivity</b> because;</p> <p>3.4 <b>Integrity</b> as she was dishonest in pretending that the financial statements were prepared based on IFRS whilst they were not;</p> <p><b>Professional competence and due care</b> as she was not acting diligently and in accordance with the applicable technical and professional standards being the IFRSs.</p> <p><b>Objectivity</b> due to possible bias towards preparing own AFS especially since Michaela has financial interest (significant</p>	<p>1</p> <p>1</p> <p>½ ½½½</p> <p>1</p> <p>1</p> <p>1</p>

	financial stake) in DentOut and might use her position as an opportunity to further her own interests.	
4.	<p><u>Income Taxes</u></p> <p>4.1 Michaela is responsible for the calculation of income taxes and preparation of tax returns, and based on the due diligence report DentOut aggressively attempts to keep the tax liability low, hence:</p> <p>4.2 there is a <b>self-interest</b> threat to <b>integrity</b> since</p> <ul style="list-style-type: none"> <li>• She might get involved in tax evasion, thereby contravening laws as Michaela might be dishonest in declaring the company's income and claiming the company's expenses to keep the tax liability low.</li> </ul>	<p>1</p> <p>½ ½</p> <p>1</p>
5.	<p><u>Conflict of Interest</u></p> <p>5.1 Michaela has a conflict of interest in so far it relates to her recommendation for CAI to become the auditor and non-assurance service provider to DentOut since she is a director and shareholder of DentOut and an employee of CAI.</p> <p>5.2 The above creates a <b>self-interest /Self-review</b> threat to his <b>independence/objectivity</b> since</p> <ul style="list-style-type: none"> <li>• the audit team at CAI for the audit of DentOut would be biased since she is an audit manager and directly involved in the maintenance of financial records and preparation of the financial statements of DentOut.</li> </ul>	<p>1</p> <p>½½ ½</p> <p>1</p>
6.	<p><u>Reward for recommending CIA.</u></p> <p>6.1 Michaela would be rewarded for recommending CAI as Jack specifically promised her a reward if she secures work from the RVR group.</p> <p>6.2 The reward creates a <b>self-interest</b> threat to <b>integrity/objectivity</b> since</p> <ul style="list-style-type: none"> <li>• she was not transparent in relation to being well rewarded if CAI is awarded the audit</li> <li>• she might overlook certain issues during the audit due to her involvement in the financial statements and the audit thereof</li> </ul>	<p>1</p> <p>½½ ½</p> <p>1</p> <p>1</p>
7.	<p><u>Use of Substandard Parts</u></p> <p>7.1 Customers are billed the prices of new parts and spares, but the products they receive are substandard/second-hand without their knowledge.</p> <p>7.2 This causes a <b>self-interest</b> threat to her <b>Integrity</b> since</p> <ul style="list-style-type: none"> <li>• charging customers for new parts whilst</li> </ul>	<p>1</p> <p>½½</p>

	<p>substandard/second-hand parts are used, is dishonest and is acting in good faith as per section 76 of the Companies Act as dubious operational practices are occurring under her nose.</p> <ul style="list-style-type: none"> <li>It is illegal (against the Customer Protection Act) to fit used/refurbished parts and services to customer vehicles without their knowledge. If Michaela is aware of this practice she is committing a common law offence.</li> </ul>	<p>1</p> <p>1</p>
8.	<p><u>Non-Disclosure Agreement</u></p> <p>Michaela shared confidential information she obtained from RVR management (related to the audit and other services requested) with the managing partner of CAI in <b>breach of the non-disclosure agreement</b> signed and is therefore in breach of the fundamental principle of <b>confidentiality</b>.</p>	<p>½</p> <p>1</p>
9.	<p><u>Professional Behaviour</u></p> <p>Based on the above, Michaela might compromise professional behaviour as it would cause harm to the reputation of the profession if her dishonesty, negligence in applying IFRS, breach of confidentiality and non-compliance with the Companies Act become known.</p>	<p>½</p> <p>1</p>
10.	<p><b>KING IV</b></p> <p>Michaela are of the view that DentOut would not really gain any benefit from adopting the King IV Report principles, which brings into question their commitment to good corporate governance as well as adopting an ethical culture as suggested by King IV as evident by the various ethical threats that does not seem to be addressed.</p> <p>Michaela as director have also not encouraged a stakeholder inclusive approach as her actions are good for self but not for others (e.g. customers getting old parts, quality of audit possibly compromised.)</p> <p>DentOut knowingly fitting reconditioned parts without customers knowledge demonstrates how the directors, specifically Michaela might be unethical as the action is not good for others. This <b>action is not good for others</b> because customers are being incorrectly charged for the parts and in addition some fatalities have occurred.</p>	<p>1</p> <p>1</p> <p>1</p>
11.	<p>Michaela are not committed to sound internal controls, as is evident in the fact that there are limited internal controls and an example is that no accurate inventory records are kept. This role points to behaviour that could promote fraudulent activities (taking cost-benefits into account).</p>	<p>1</p>
12.	<p>Most employment contracts contain a clause prohibiting a full-time employee from also receiving remuneration from other employment.</p> <p>Michaela may be in breach of her employment contract with CAI and be acting in breach of her employment conditions, or at least should have declared the interest to CAI.</p>	<p>1</p>
<b>Available</b>		<b>34</b>

	<b>Maximum</b>	<b>12</b>
	<i>Communication skills – logical argument</i>	<i>1</i>
	<b>Total for part (e)</b>	<b>13</b>

<p>Part (f) Discuss, with reference to the information provided in sections 1 and 2, factors that Jack Hammer needs to consider in deciding whether to accept the audit engagement of DentOut.</p> <ul style="list-style-type: none"> <li>• Exclude any discussion related to the ethical conduct of Marcello and Michaela.</li> <li>• Do not discuss the significance of threats.</li> <li>• Do not provide any safeguards.</li> </ul>	<p>Marks</p>
<p><b>Client integrity</b></p>	
<p>1. Since there are currently <b>inadequate controls</b> (no accurate inventory records are kept, limited segregation of duties) related to the <b>accounting records and management of assets</b> (no stock count of used parts), which brings management’s commitment to good governance into question.</p>	<p>1</p>
<p>2. <b>King IV</b> is currently not being applied to the company which brings management’s commitment to good governance into question.</p>	<p>1</p>
<p>3. There are indications of the Companies Act (s29 1(a) &amp; 2) being disregarded, since DentOut has <b>not adopted IFRS 16 Leases yet and IAS16 PPE assets (machinery) are included at no value when they are still in use</b> which indicates that there may be <b>other instances of non-compliance with the Companies Act.</b></p> <p><b>Section 76</b> of the Companies Act since she did not adhere to IFRS 16 requirements thus not performing her functions as director with the degree of care, skill and diligence expected or is acting in her own best interest.</p>	<p>1</p> <p>1</p>
<p>4. The fact that DentOut (and its management) <b>aggressively attempts to keep income tax payable as low as possible</b>, could signal tax evasion, which brings the integrity of management into question.</p>	<p>1</p>
<p>5. The <b>operational practices of DentOut are questionable since the company allegedly charges</b> customers for new spares and parts when they fit reconditioned / used parts that the customers are unaware of.</p>	<p>1</p>
<p>6. <b>Incorrectly charging</b> customers for new spares and parts when they fit reconditioned / used parts is illegal in terms of the <b>Consumer Protection Act</b> and <b>NOCLAR</b> which indicates a lack of integrity of management.</p>	<p>1</p>
<p>7. <b>DentOut is an owner managed entity</b>, hence there might be an incentive or opportunity be tempted to manipulate the financial statements and it would be easier to commit fraudulent financial reporting that goes undetected.</p>	<p>1</p>
<p><b>Legal risk perspective (association with client)</b></p>	
<p>8. From a <b>legal risk</b> perspective, there are already indications of a reportable irregularity related to the use of reconditioned / used spares and parts that may have already resulted in the fatality of a customer, hence it needs to be considered whether the auditor would want to be associated with DentOut because of the <b>potential reputational risks</b></p>	<p>1</p>
<p>The <b>reportable irregularity</b> related to the use of reconditioned / used spares might result in <b>reporting obligations</b> to IRBA in terms of APA</p>	<p>1</p>

9.	The Mondri family has taken the matter of the death of Mandi to <i>Blanche Carte</i> , hence the company will be receiving bad publicity soon and the auditor would need to decide whether he/she wants to be associated with it potential reputational risks	1
<b>Financial responsibility</b>		
10.	There is a possibility that DentOut <b>might not be able to pay</b> the audit fee since there may be <b>new claims</b> for refitment of parts on vehicles they have serviced or repaired and the <b>additional capital investments</b> that are required by RVR, which could place significant pressure on the cash flows.  Or  The company has a loyal customer base, showed steady growth over the years and Michaela and Marcello re-invest at least 25% of their equal share of profits each year, which could be an indication that, despite the possible claims against the company, it will still be able to pay the audit fee	1
<b>Auditor independence (objectivity and integrity)</b>		
11.	<u>Securing a client</u>	
	11.1 There was aggressive action by CAI to get the RVR audit contract as the managing partner instructed Michaela to spare no effort to secure the audit contract.	1
	11.2 This creates a self-interest threat to independence/objectivity and integrity since	½ ½ ½
	<ul style="list-style-type: none"> <li>It is likely that the audit team will overlook audit differences or questionable practices in order for CAI to keep the audit contract and potentially obtain the audit contract of RVR</li> </ul>	1
	<ul style="list-style-type: none"> <li>It is questionable that the managing partner is demonstrating strong moral principles in their instruction to Michaela to spare no efforts in securing this client</li> </ul>	1
12.	<u>Designing Internal Controls</u>	
	12.1 The CAI audit team will have to assess the efficacy of internal controls, which the CAI firm designed and implemented.	1
	12.2 This creates a <b>self-interest</b> threat to <b>independence/objectivity and integrity</b> since	½ ½ ½
	<ul style="list-style-type: none"> <li>CAI might overlook certain errors in the financial statements that were caused by their design of the internal controls.</li> <li>the design of internal controls could be regarded as assuming management responsibilities on behalf of CAI since the request is to assist with the implementation of the controls as well, which is prohibited by the SAICA CoPC</li> </ul>	1 1
13.	<u>Selecting Accounting Software</u>	
	13.1 CAI will be assisting with the selection of an integrated accounting software	1

	(ET606).  This creates a <b>self-review threat</b> to <b>objectivity/independence</b> since  as the auditor's professional judgment will be compromised due to him being biased as they assisted with the selection of the integrated accounting software	$\frac{1}{2}$ $\frac{1}{2}$    1
14.	<u>Tax planning and restructuring advice</u>  14.1 CAI will be assisting DentOut with provision of tax planning and structuring advice. 14.2 This creates a <b>self-review</b> and/or <b>advocacy</b> threat to <b>objectivity/independence</b> since <ul style="list-style-type: none"> <li>• CAI will be biased when auditing the financial statements and specifically the tax treatment as they assisted with the tax treatment, which compromise their professional judgment.</li> </ul>	  1  $\frac{1}{2}$ $\frac{1}{2}$ $\frac{1}{2}$  1
15.	<u>Relationship between engagement partner and Michaela</u>  Michaela is the audit manager at CAI and Jack Hammer is the engagement partner at CAI that will audit Dentout for whom Michaela performs financial functions.  This creates a <b>familiarity</b> threat to <b>Independence/Objectivity</b>  Since Jack may be biased when auditing the work performed by Michaela as he may not want to do something that may reflect negatively on her.	  1  $\frac{1}{2}$ $\frac{1}{2}$  1
16.	Based on the above, CIA might compromise <b>professional behaviour</b> as the actions compromising their independence/objectivity regarding the audit client might discredit the profession.	1
<b>Auditor resources, competence and skills considerations</b>		
17.	CAI is one of the largest audit firms in South Africa, hence it is expected that it would have sufficient staff to execute the audit of DentOut, which is a small to medium sized company.	1
18.	The panel-beating industry is not too complex; hence it can be assumed that the <b>audit staff of CAI would be able to obtain relevant knowledge and information about how the industry functions</b> without having to get an expert on board.	1
19.	The company will be moving from an off-the-shelf accounting package to an advanced integrated accounting system. Hence CAI needs to consider whether CAI will have an <b>expert available to assist with the assessment of the integrity of the IT system and the completeness of the transfer.</b>	1
20.	<b>Machinery and equipment</b> that are in use and has no carrying amount as useful lives need to be reconsidered. Hence CAI needs to consider whether <b>it has an expert available to assist with reconsidering the useful lives.</b>	1
21.	It needs to be considered whether the audit team will be able to apply <b>professional judgement and professional scepticism during the audit of DentOut</b> given that the CAI management partner is adamant that it wants the contract for the audit of the RVR group.  They would also need to consider if they have sufficient resources to audit the group as ultimately RVR wants the same auditors for the entire group of companies.	1    1

	They would further have to consider if they have sufficient time to perform the audit as they may not be able to do interim audit work (due diligence report 1/10/2023 whereas year end is 30/9/2023).	1
	The audit fee of CAI will be reduced based on the additional services to be performed by them, which could impact on their ability to perform a proper audit.	1
<b>Consideration of whether the preconditions of the audit are present (ISA210.6) and potential limitation of scope</b>		
22.	It appears that DentOut has not adopted <b>any formal financial reporting framework</b> for the majority of the 2023 financial year (evident in non-adoption of IFRS 16 and IAS 16).	1
23.	There might be a <b>limitation of scope</b> since <b>opening balances and comparative figures might be difficult to obtain for sufficient related audit evidence</b> due to the prior financial statements only being reviewed and not audited. Or More time would also need to be spent on opening balances as they were not audited in the past, but merely reviewed.	1
	Due to the questionable integrity of management, there is a risk opening balances are manipulated due to fraud and CAI might not be able to pick up on this leading to an incorrect opinion.	1
<b>Agreeing to the terms of engagement</b>		
24.	Terms and Conditions of the letter  Michaela is desperate for CAI to be awarded the audit contract, hence there is no indication that as a director she would not be willing to accept the terms of engagement (she might also persuade Marcello).  Or  Discussing TCs, eg the roles and responsibilities of management and the auditor as management want the auditors to assist with management functions (tax planning and restricting advice).	1
25.	CAI should consider whether they will be able to contact the current independent reviewer to enquire whether there are professional reasons to not accept the appointment as auditor.	1
		<b>Available</b>
		<b>43.5</b>
		<b>Maximum</b>
		<b>22</b>
		<i>Communication skills – clarity of expression</i>
		<b>1</b>
		<b>Total for part (f)</b>
		<b>23</b>



Part (g) Discuss, with reference to the extract of the trial balance provided in section 1, the substantive procedures on the opening balances that can be performed to confirm the existence of DentOut's assets as at 1 October 2022.	Marks
1. In terms of ISA 510, with respect to opening balances, <b>sufficient appropriate audit evidence</b> needs to be obtained about whether the opening balances contain material misstatements and whether accounting policies have been consistently applied.	
<p><b>In relation to existence of DentOut assets at 1 October 2022</b>  <i>Based on the due diligence report assets comprise machinery and equipment, inventory, debtors and bank and cash.</i></p>	
2. Compare the opening balances disclosed in the comparative financial statements and reviewers report to the opening balances in the general ledger accounts of asset accounts to confirm that the balances have been brought forward correctly.  Read the reviewer's report and determine if there are any modifications in the report that would materially effect these balances	1  1
3. Analytical procedures need to be conducted on opening balances, whereby at the very least 2023 balances, liquidity and solvency ratios are compared to 2022 balances and ratios to assess the reasonability of the opening balances.	1
4. Physically inspect the assets as at 30 September 2023, or shortly after year end and reconstruct the balance as at the beginning of the year by inspecting supporting documentation for assets disposed of or acquired in FY2023	1 1
5. Inspect insurance contracts as at 1 October 2022 to identify the machinery and equipment insured at this date. (External confirmation with the insurer.)	1
6. Obtain the working papers from the independent reviewers regarding the attendance of the stock count and assess whether any reliance can be placed on the stocktake work performed by the independent reviewers to obtain sufficient audit evidence regarding the existence of stock by – <ul style="list-style-type: none"> <li>- Inspecting CV/certificates of independent reviewer to determine whether they are competent</li> <li>- Inspect the independent reviewer's membership to a recognised professional body. (1 mark)</li> <li>- Enquire from the independent reviewer and management regarding any matters that could affect the independent reviewer's independence. (1 mark)</li> <li>- Obtain evidence regarding the independent reviewer's experience by enquiring from the independent reviewer about other clients and other review engagements previously performed. (1 mark)</li> <li>- inspecting the working papers to determine whether the stock count was properly organised;</li> <li>- inspecting whether sample counts were selected from both the stock records and the stock room to test existence and completeness; and</li> <li>- verifying that sufficient coverage of all the stock items were obtained.</li> <li>- Inspect the inventory count working papers to determine whether each item included as part of the count was counted twice, by different counters.</li> <li>- Inspect the inventory count working papers to determine whether any count discrepancies were recounted, and theoretical inventory adjusted where applicable.</li> </ul>	1 1 1 1
7. Perform roll-back procedures by verifying the sales and purchases of parts in October 2022 and compare it to the theoretical stock balances at the beginning of the financial year – compare the roll-back balances to the opening balances of inventory.	1

8.	Perform substantive analytical procedures comparing the sales of parts during October 2022 with the opening inventory balances plus purchases – if there are unexplained variances with the closing stock balances, investigate the reasons for any differences.	1
9.	It would be difficult to determine the existence and value of inventory at 1 October 2022 since the stock count was not attended by staff members of CAI, which already signals that a qualified / disclaimer of audit opinion would need to be provided in this regard.	1 BP
10.	Debtors' balances at 1 October 2022 would need to be verified by means of a debtors circulation (3 <sup>rd</sup> party confirmation) that needs to be sent out directly to customers to verify the amount.  This should be done using a positive debtors circularisation.  Obtain permission from management to perform 3 <sup>rd</sup> party confirmation.	1  1  1
11.	Inspect the signed contracts and confirm that debtors' balances are made up of 30% of the invoiced amount as per the payment terms and conditions – investigate any amounts in excess of 30%.	1
12.	If the debtors do not respond to the aforementioned circulation, the audit team would need to determine if the debtors paid their outstanding balances in FY2023 through verification in the bank statements / cash receipts register (or journal) by performing subsequent receipts testing	1
13.	If the debtors did not respond to the above confirmation and no payments were received after year-end, test the detail of the transactions making up the balance of the debtor in question by selecting the invoices making up the balance(s) at 1 October 2022 in the debtors' accounts in the debtors ledger and inspecting the corresponding delivery notes for the debtors' signatures. (1 or 2 marks)	
14.	Inspect the bank statement to confirm if the physical cash on hand was banked on 1 October 2022 or soon thereafter and perform roll-back procedures to verify its existence.	1
15.	The bank account balance as at 1 October 2022 could be verified by way of executing a bank confirmation (3 <sup>rd</sup> party confirmation) and requesting the bank balance directly from the bank.	1
16.	Obtain a management representation letter specifically addressing the existence of assets at the beginning of the year..	1
17.	Obtain a confirmation from the independent reviewer that approval for access to working papers and other information regarding opening balances was given.	1
	<b>Available</b>	<b>16</b>
	<b>Maximum</b>	<b>9</b>
	<i>Communication skills – clarity of expression</i>	1
	<b>Maximum for part (g)</b>	<b>10</b>
	<b>TOTAL FOR PART II</b>	<b>46</b>