

**Background information**

E-buy Ltd ('E-buy') was incorporated in June 2010 by Chris Edwards and soon thereafter acquired the shares of an existing e-commerce business called Shop-till-you-Drop (Pty) Ltd. E-buy is listed on the Johannesburg Stock Exchange and it has disclosed to its shareholders that it complies with all the recommended practices of King IV. Chris stepped down as the Chief Executive Officer (CEO) of E-buy on 31 December 2016, upon which the Board of Directors appointed his son, Stephan Edwards, as the new CEO.

E-buy is South Africa's largest, most innovative e-commerce retailer. The company's head office is situated in Johannesburg. E-buy regards its customers as its main asset, which is reflected in its passion for providing an exceptional customer experience from the moment customers access its website, until the product they ordered, is delivered. E-buy is also committed to positively impact its shareholders, society and the environment in which it operates. The financial year end of E-buy is 31 December.

The company has proven to be financially stable and the Board of Directors hopes to maintain the significant growth that the company has shown during the difficult economic conditions and despite an increase in competition. Accordingly, the Board has awarded the executive directors lucrative remuneration packages based on the increase in earnings year on year.

In October 2017, the previous auditors of E-buy resigned for the following reasons:

- Their fees for the prior-year audit, being the 2016 financial year (FY2016) audit, had not been paid, because Stephan felt the four months that the audit took to complete was excessive. They completed the audit at the end of April 2017; and
- Stephan refused to grant them access to certain financial data which they required to perform their audit duties for FY2017. In order to ensure a quicker completion of the FY2017 audit, the previous auditors commenced auditing certain transactions as they occurred from July 2017.

You are a first-year trainee accountant at the audit firm Nauru & Partners Inc. ('Nauru & Partners').

Lindi Nauru, one of the partners at your audit firm, and Stephan have been good friends since their childhood. For this reason, and since E-buy does not have an audit committee, Stephan unilaterally appointed Nauru & Partners as the external auditor for E-buy for FY2017, with Lindi as the audit engagement partner. In addition, E-buy paid a 10% deposit for the services to be rendered to ensure that Lindi would sign the engagement letter. A condition set by Stephan was that Lindi should not contact the previous auditors and she agreed to that.

Nauru & Partners are satisfied that Lindi has the necessary knowledge, skills and experience to complete the audit, for the following reasons:

- In addition to being a Registered Auditor and CA(SA), she has a master's degree in e-commerce; and
- She is the audit engagement partner of Fantastic-online-Shopping (Pty) Ltd ('Fantastic'), a company that the directors of E-buy are planning to take over in 2019 as part of their 'long-term strategic market share growth programme'. Stephan advised that there 'may be something in it' for Lindi if she is able to assist in making the deal happen and can ensure that the profits of Fantastic are not as high as one would expect.

You attended the audit 'kick-off' meeting on 18 January 2018 with Lindi and the rest of the audit team. This was after you and the other audit team members were reassigned from other audit clients to focus on the audit of E-buy. You were all, however, informed that you would have to find the time to perform this audit while still completing outstanding work on other clients and despite many of you already working overtime. You were therefore not surprised to learn of recent instances where audit team members were under such extreme work pressure that when tasked to audit a sample of items, they completed the workpaper as having actually audited these items without having done any work. Lindi is of the opinion that it is sometimes necessary to find shortcuts to ensure all audit work is completed on time.

During the kick-off meeting Lindi made it clear that E-buy is a very important client of the firm as the audit fee would boost the turnover of Nauru & Partners significantly and there is also the possibility of additional services being provided to E-buy. She stated that in her opinion this could result in further significant increases in turnover, such that E-buy would be one of the top five clients of Nauru & Partners.

She also noted the following:

- The accounting staff of E-buy are all competent and experienced CAs(SA). Therefore the audit team should not spend more hours than those budgeted. Each audit team member who did not work longer than the budgeted hours would be guaranteed a good performance rating and consequently a good annual performance bonus. She stated that she believed that the accounting staff of E-buy were the best she had come across and could be trusted, which meant that the audit team did not need to ask too many questions.
- Her husband, Barry Nauru, is the financial controller of E-buy and he would ensure that the audit team obtained the necessary supporting audit documentation to enable them to finalise and sign off on the audit as quickly as possible. This is important as potential investors in E-buy required the audited financial statements of E-buy for FY2017 before 31 March 2018.
- She had agreed on the terms of the audit engagement with Stephan over dinner a few nights before and stated that she would document their agreement and place it on file at a later stage. She would get Stephan to sign the engagement letter when he returned from his vacation on 28 March 2018. She had reassured Stephan that the audit team would commence with the audit in the meantime.
- She is under a great deal of work pressure and would have limited time to review all of the audit workpapers herself and monitor the audit team closely. However, she expressed confidence in the capabilities of her staff.
- The audit team includes team members who have some knowledge, skill and experience of the e-commerce retail industry. She mentioned to the team that if they have any questions they were welcome to contact a friend of hers who works at Takealot.com and can share details of the transactions they are auditing to gain a better understanding of the appropriate accounting treatment.
- The management of E-buy has indicated that they would like to invite the audit team to the final national rugby league match, since E-buy has a corporate hospitality area in the stadium. This is an elite event and E-buy will ensure that all costs are covered, which includes food, drinks and branded supporter shirts.
- The team has also been requested to be available on 4 April 2018, as E-Buy and Naura & Partners have arranged to co-host an exhibition stand at the annual African E-Commerce Expo.
- Lindi also announced a new remuneration policy for Naura & Partners, in terms of which audit team members would receive a bonus if they identified viable additional services that the firm could render to audit clients.

Shortly after the kick-off meeting, the audit senior provided you with the following workpapers:

<b>Description</b>		
C01 Extract from the system description for a sale transaction at E-buy		
D01 Other audit matters		
<b>Workpaper</b>		<b>C01</b>
<b>Client:</b> E-buy Ltd	<b>Prepared by:</b> KLM	<b>Date prepared:</b> 24 January 2018
<b>Year end:</b> 31 December 2017	<b>Reviewed by:</b>	<b>Date reviewed:</b>
<b>Subject:</b> Extract from the system description for a sale transaction at E-buy		
<p><b>C1 Background</b></p> <p>E-buy sells retail products online via its website and mobile application called E-mobile. There are 25 categories of products, ranging from electronics, lifestyle, media and computer games to fashion items. E-buy owns all the products it sells to its customers. E-buy outsources the delivery of purchased products to Fast Delivery (Pty) Ltd ('Fast Delivery'), a company that specialises in the delivery of e-commerce retailers' sale products. E-buy has one warehouse in Johannesburg and another in Cape Town.</p> <p>E-buy makes use of an enterprise resource planning (ERP) programme called <i>SmartCount</i>. <i>SmartCount</i> was specifically tailored to the needs of the business so as to provide seamless and direct access to both E-buy warehouses by Fast Delivery via a wide area network (WAN). <i>SmartCount</i> is hosted on a server situated at E-buy's head office in Johannesburg. E-buy makes use of firewalls to prevent unauthorised access to the <i>SmartCount</i> system, the WAN connection and its server. The firewalls are updated regularly by E-buy's IT department.</p> <p>It is E-buy's policy that all employee profiles and passwords should comply with E-buy's data protection policy. These profiles determine their access levels and authorisation limits. The policy includes password composition, password validity timeframes, password automatic system changes and secrecy of passwords.</p> <p>The process that customers follow is exactly the same for purchases of E-buy products via the E-buy website and E-mobile. Market research has shown that most customers prefer using E-mobile. E-buy only accepts payment by credit card.</p> <p><b>C2 Registering a profile</b></p> <p>A customer has to register a profile in order to purchase E-buy products online by completing the following details in the fields provided:</p> <ul style="list-style-type: none"> <li>• First name</li> <li>• Surname</li> <li>• Email address (with a retype of the email address to confirm it)</li> <li>• Password (with a retype of the password to confirm it)</li> <li>• Cell phone number.</li> </ul> <p>After completing the required fields, a customer has to accept the E-buy terms and conditions by selecting the 'I agree' option. All the required fields, including the acceptance of the E-buy terms and conditions, are mandatory for the successful registration of a customer's profile. Once a customer has successfully registered a profile, the <i>SmartCount</i> system automatically sends a registration confirmation email to the customer as well as a notification to the customer's cell phone number.</p> <p><b>C3 Shopping</b></p>		

Once a customer's profile has been registered, the customer can start to shop online. All categories of products are displayed on the E-buy website and E-mobile. Customers can also search for specific products. Customers are able to filter categories of products by price and popularity. Each product has a short description, its price, and reviews by other customers who have already purchased the product.

Once a customer has identified a product he/she would like to purchase, the customer selects the 'add to cart' option, which results in the product being added to a virtual shopping cart. The customer can add more than one product to the virtual shopping cart.

#### C4 Checkout

On completion of his/her shopping on the E-buy website or E-mobile, the customer selects the 'checkout' option. This will direct the customer to the virtual checkout screen, which contains a summary of all the products selected by the customer. At this stage the customer is able to delete a product or change the quantity selected.

The *SmartCount* system automatically calculates the sale price of each product on the virtual checkout screen by multiplying the number of product items selected with the price per the product price masterfile stored on the E-buy server. Each product is identified by a unique number. The *SmartCount* system also calculates the VAT at 14% on the sales transaction automatically. A customer then has to enter a delivery address by completing the required fields. The next step is the completion of credit card payment details, via a third party website which interfaces with the customer's bank, in the following fields:

Payment details										
Account holder name and surname	<i>(name and surname here)</i>									
Credit card number										
CVV				<i>(three-digit code on the back of the credit card)</i>						
Expiry date	M	M	Y	Y						

#### C5 Payment

Once the payment details have been completed and submitted, the customer is directed to his/her bank's secure online banking page, where the customer enters his/her secret bank card personal identification number (PIN). If a payment is successful, the *SmartCount* system emails an invoice to the customer and automatically sends a dispatch note to the applicable warehouse manager (see section C6 below).

In the event that the payment is unsuccessful, a message to this effect is displayed to the customer. The system then reverts to the checkout screen to re-initiate the process.

The *SmartCount* system automatically generates an exception report for instances where a customer invoice was issued without a corresponding dispatch note. The exception report is reviewed daily by Stephan, who receives it electronically. Stephan approves the report with his unique password and sends it to the correct staff member in the accounting department for further investigation and correction. Once this has been done by the relevant staff member, the *SmartCount* system automatically matches the correction with the exception report and changes the status of the discrepancy to 'corrected'.

#### C6 Dispatch of sales

The *SmartCount* system identifies the closest dispatch warehouse from which the delivery

is to take place, based on the delivery address field completed by a customer. The warehouse manager logs onto the *SmartCount* system with a unique username and password and assigns the dispatch note to the first available dispatch clerk. At the same time, Fast Delivery is automatically notified of the pending delivery via the *SmartCount* system. Each dispatch clerk and controller have mobile dispatch devices to which the *SmartCount* system sends the dispatch note, which notifies them of the order and details of the products that are to be selected for delivery. The mobile dispatch devices can only be accessed via a unique username and password. Dispatch devices are kept in a locked safe overnight.

The dispatch clerk selects the products (indicated on the mobile dispatch device) and takes them to a holding area for collection where the dispatch note is printed and attached to the ordered products. The holding area is a secured area to which relevant persons can only gain access by means of fingerprint identification. A dispatch controller checks the goods against the dispatch note, seals the order in a box, if it is correct, and electronically marks it as being ready for collection. Each order is packed in a single box.

If the goods do not match the dispatch note, the dispatch controller marks the dispatch note on the mobile dispatch device as 'not matched' and the dispatch note is returned electronically to the dispatch clerk. A message on the dispatch clerk's mobile dispatch device will also indicate that the dispatch was 'not matched'. The dispatch clerk then investigates and finds the correct goods, if possible.

If a dispatch note remains unmatched to goods for more than 24 hours, the *SmartCount* system generates an exception report that is automatically sent to the relevant warehouse manager. The warehouse manager investigates the exception reports, ensures that they are resolved and releases the dispatch notes electronically with a note on how it was resolved. The system does not allow partial orders to be collected and delivered.

Fast Delivery drivers collect the completed boxes from the warehouse holding area. They electronically sign the dispatch note on the dispatch controller's mobile device as evidence of receipt of the sealed box relating to such dispatch note. Thereafter the drivers may load the goods for delivery. Once the dispatch note has been signed by the driver, the invoice is flagged as executed.

The *SmartCount* system then processes the sales transaction in E-buy's accounts receivable sub-ledger. This is done by multiplying the number of product items purchased by a customer by the sales price. At the same time the inventory sub-ledger is updated to reflect the sale of inventory based on the cost price per the product price masterfile. The cost price is calculated on a first-in-first-out basis.

## **C7 Changes to the sale prices of E-buy's products**

Sophia Malala is the Marketing Director of E-buy. Her department's main duty is to ensure that the prices of E-buy's products stay competitive and up to date in order to maximise E-buy's profits. Her staff accordingly make recommendations to Sophia on price changes to products on a daily basis. The staff do this by logging on to the *SmartCount* system with their unique usernames and passwords, reviewing the applicable product prices, amending product prices based on professional judgement and selecting the 'submit' option that appears on their screens. The *SmartCount* system then sends a system-generated notification of the proposed change to Sophia.

Sophia reviews the recommendations by logging onto the *SmartCount* system with her unique username and password, and electronically approves them. Once approved, the *SmartCount* system automatically updates the relevant product selling prices, generates an

electronic log and saves the log in an encrypted folder on E-buy's server.

Workpaper		D01
Client: E-buy Ltd	Prepared by: DDW	Date prepared: 24 January 2018
Year end: 31 December 2017	Reviewed by:	Date reviewed:
Subject: Other audit matters		

#### D1 Chris Edwards's put option agreement

In terms of an agreement concluded between Chris and E-Buy while Chris was the CEO of E-Buy, E-buy is required to repurchase shares from Chris. This was negotiated as part of his remuneration package discussions held at the time. The repurchase of the shares must be at the prevailing price on the date that Chris exercises his put option. Chris exercised his put option on 30 June 2017 when E-buy shares were at an all-time high of R400 per share. He sold 375 000 shares back to the company. Subsequently, some prominent shareholders of E-buy stated that they had never heard of or seen this agreement.

E-buy did not have sufficient cash resources to make such a significant cash pay-out at that time and therefore had to raise external debt financing to honour its obligation. However, Stephan, E-buy's current CEO and the son of Chris, stated that the Board of Directors had acted in the best interests of the company by making the repurchase, as this transaction was critical to ensure that a large block of shares was not sold to an unknown external party.

#### D2 B-BBEE scheme

E-buy is considering setting up a share ownership scheme to address the B-BBEE requirements for South African companies and to contribute to reducing income inequalities as well as to enhance economic transformation. At their last meeting, the Board of Directors proposed the introduction of a scheme that could be used to improve E-buy's B-BBEE rating.

Stephan has asked his university friend, Mpho Dodgee, a leading attorney with extensive experience as a legal advisor to state-owned enterprises, to facilitate the B-BBEE scheme. Stephan proposes the following:

- A private company, E-Dodge (Pty) Ltd ('E-Dodge') would be set up to buy the shares in E-buy at market value on the Johannesburg Stock Exchange.
- Chris would personally lend the full amount required to acquire the shares in E-buy to E-Dodge.
- Mpho would own 100% of the class A shares, which would have full voting rights. He would not be entitled to participate in any distribution of dividends.
- Chris would own 100% of the class B shares, which would have full economic rights (such as entitlement to the dividends declared by E-Dodge) and no voting rights.
- Mpho would charge a facilitation fee of R1 million for setting up the scheme.

Stephan is very excited about the proposed scheme as he has identified the public sector as a potential growth avenue.

**INITIAL TEST OF COMPETENCE, JANUARY 2018  
PROFESSIONAL PAPER 4**

**This question consists of two parts. Answer each part in a separate answer book.**

QUESTION 1 PART I – REQUIRED		Marks	
		Sub-total	Total
(a)	Identify and discuss the threats to the independence of Lindi and/or Nauru & Partners with regard to the audit of E-buy with reference to the information in the scenario. Do not include the possible safeguards that could eliminate or reduce the threats to an acceptable level.  <i>Communication skills – clarity of expression</i>	20  1	  21
(b)	Discuss the aspects Lindi should have considered with respect to the integrity of key management and those charged with corporate governance, prior to accepting E-buy as an audit client for FY2017.	15	15
(c)	Discuss any concerns you may have regarding the quality of the audit of E-buy arising from the discussions at the audit kick-off meeting on 18 January 2018.	10	10
(d)	Assume that Nauru & Partners has accepted E-buy as a client and plans to rely on controls.  Describe, with reference to the information provided in workpaper C01 under the headings: background, registering a profile, shopping, checkout and payment, the tests of controls you would perform to test the occurrence of E-buy's sales for FY2017.  Ignore cost of sales.  <i>Communication skills – clarity of expression</i>	15   1	   16
(e)	Assume that Nauru & Partners has accepted E-buy as a client and plans to rely on controls.  Describe, with reference to the information provided in workpaper C01 under the headings: dispatch of sales and changes to the sale prices of E-buy's products, the tests of controls you would perform to test the accuracy and completeness of E-buy's sales for FY2017.  Ignore cost of sales.  <i>Communication skills – clarity of expression</i>	   10   1	     11
<b>Total for part I</b>			<b>73</b>

**INITIAL TEST OF COMPETENCE, JANUARY 2018  
PROFESSIONAL PAPER 4**

**This question consists of two parts. Answer each part in a separate answer book.**

<b>QUESTION 1 PART II – REQUIRED</b>		<b>Marks</b>	
		<b>Sub-total</b>	<b>Total</b>
(f)	Write a memorandum, addressed to the Board of Directors, in which you – (i) discuss your concerns with regard to Chris Edwards’s put option agreement from a corporate governance perspective; and (ii) critically analyse the proposed B-BBEE scheme.  <i>Communication skills – logical argument; presentation</i>	14 11 2	27
<b>Total for part II</b>			<b>27</b>
<b>TOTAL FOR THE QUESTION</b>			<b>100</b>