

Part (e) Discuss the ethical concerns you might have with regard Pharmasave, the potential new client, with reference to the SAICA Code of Professional Conduct.	Marks
Virat and George are CAs(SA) , and are required to adhere to the SAICA CPC. They are responsible for the firm's requirement (together with Faith) to adhere to the 'ethical requirements' objective of ISQC 1 and review on the audit, and accordingly are ultimately responsible for identifying and reporting all aspects that are deemed necessary (ISA 220).	1
<p>Pam Nel, the marketing director of Pharmasave, is George's sister-in-law. This relationship creates the following threats to independence/objectivity:</p> <p>Self-interest and Familiarity</p> <ul style="list-style-type: none"> - The association with Pam may result in Virat overlooking issues at the company (independence in mind and appearance) or Virat not applying professional scepticism (accepting of her work, without question) in areas where Pam influence the financial statements. <p>Intimidation</p> <ul style="list-style-type: none"> - Pam might use the family relationship with George to convince/pressure Virat to turn a blind eye to any irregularities in Pharmasave financial records. 	<p>½</p> <p>½</p> <p>1</p> <p>½</p> <p>1</p>
These threats can be considered at an acceptable level due to the impression/fact that the marketing director cannot necessarily influence the outcome of the audit in her role / These threats could be considered not at an acceptable level due to the fact that Pam is a director with influence over George and may be able to influence Virat (the engagement partner) regarding the outcome of the audit.	1
The threats can be reduced by following quality control procedures , such as getting a quality control reviewer .	1
<p>Pharmasave is a <u>very large client</u> and DNA only has <u>two audit directors</u> creating a self-interest threat to the professional competence and due care.</p> <ul style="list-style-type: none"> - There may be a shortage of partner capacity, staff and time (competencies to perform the professional service) to service this very large audit client. 	<p>½</p> <p>1</p>
The threat could be considered not at an acceptable level due to the fact that George already admitted that Virat will sign off as audit director, but Virat already has limited capacity.	1
The threat can be reduced by getting an external quality control reviewer or additional external resources to assist on the audit (another registered auditor)	1
<p>Pharmasave have <u>changed auditors three times in the last five years</u> which create an Intimidation threat independence/objectivity:</p> <ul style="list-style-type: none"> - Due to the possibility that Pharmasave may threaten to change auditors if they disagree about something with DNA. 	<p>½</p> <p>1</p>
<p>Pharmasave will make up a <u>significant part of DNA's audit revenue</u>, which create a Self-interest threat to independence/objectivity:</p> <ul style="list-style-type: none"> - As the high fee will create concerns/pressure to keep Pharmasave as a client, regardless of the problems of integrity with management at Pharmasave or disagreements on the judgement exercised during the audit. 	<p>½</p> <p>1</p>
These threats could be considered not at an acceptable level due to the fact Pharmasave fee would be a significant part of DNA's audit revenue , and DNA is budgeting a potential loss for the audit division.	1
These threats can be reduced by getting an external quality control reviewer and/or additional external resources to assist on the audit (another registered auditor)	1

DNA proposing to <u>discount the audit fee</u> in comparison to current auditor, could be considered 'low-balling', which create a Self-interest Threat to Professional competence and due care .	½
- Pharmasave (Pty) Ltd is a nationally operating chain with 75 stores. Currently, there is a total of 25 trainees in the employ of DNA this is a significant resource constraint and the level of fees quoted might impact a <i>professional accountants'</i> ability to perform their duties, as it may limit the resources to execute on the audit due to fee constraints	1
The threat could be considered not at an acceptable level due to the size of the client (25% of the budgeted 43 million) and the consideration of DNA's resources, as well as the budgeted loss for the audit division.	1
To ensure the threat is reduced to an acceptable level , DNA would need to ensure that additional resources are contracted for this audit, in addition to ensuring that sufficient hours and resources are provided to maintain the quality, regardless of the lower fee	1
Pharmasave is <u>renowned in industry for tough negotiations with suppliers and disregarding healthcare regulations</u> , which creates a Self-interest Threat to Professional Competence and due Care .	½
- DNA's industry knowledge (competence) with regard to the healthcare industry and the necessary regulations is questionable and would DNA be able to conduct the audit knowing the negotiations for overruns will be tough.	1
The threat can be considered not at an acceptable level due to the reputation of Pharmasave and DNA's lack of industry knowledge, which could point to non-compliance and/or integrity of management.	1
To reduce the threat to an acceptable level, DNA would need to ensure that necessary resources are contracted for this audit , including experts in healthcare regulations, regardless of not being able to recover all costs incurred to do a quality audit.	1
Overall action: If any of the threats above cannot be resolved, reconsider whether the audit engagement should be accepted.	1
Available	23
Maximum	13
<i>Communication skills – logical argument</i>	1
Total for part (e)	14

<p>Part (f) Describe the substantive procedures (ISA 500) to audit DNA's payroll expenses, on the assumption that you are DNA's external auditor.</p> <ul style="list-style-type: none"> • Exclude all the 'general audit procedures' that are listed in DNA's audit manual (; • Exclude procedures on presentation (ISA 315); and • Assume you have audit software available for the execution of CAAT procedures. 	<p>Marks</p>
<p>Gross Salary</p>	
<p><u>All employees</u></p> <ol style="list-style-type: none"> 1. From a month of payroll, obtain the breakdown of the payroll expenses and select a sample of individuals and inspect the documentation in the employees' file, e.g. signed employment contract, tax registration forms and valid ID. (Occurrence) 2. Calculate and compare the average pay per employee to prior year and perform analytical procedures (Accuracy, Completeness, Occurrence), such as – <ul style="list-style-type: none"> • Comparing salaries per month to the prior year; • Comparing deductions paid to third parties, month on month; and • Comparing the ratio of salaries as a percentage of total expenses <p>And enquiring from management regarding any unexpected fluctuations</p>	<p>1</p> <p>Max 2</p> <p>1</p> <p>1</p> <p>1</p>
<p><u>New appointments</u></p> <ol style="list-style-type: none"> 3. Obtain a list of new appointments in respect of the current financial year. Select a sample from the list and trace to valid signed contracts. (Occurrence) 	<p>1</p>
<p><u>Increase</u></p> <ol style="list-style-type: none"> 4. Enquire from management when the annual increases were approved. Compare feedback to company's remuneration policies. (Occurrence) 5. Select a sample of increases across salary bands and inspect supporting documentation authorizing the increase in line with the policy. (Occurrence) 6. Perform a physical verification of employees, such as visiting the employee at his place of work and inspecting his ID or staff identity tag. (Occurrence) 	<p>1</p> <p>1</p> <p>1</p>
<p><u>Deductions</u></p> <ol style="list-style-type: none"> 7. Recalculate UIF, SDL/Other 3rd party payments and agree % to appropriate tables/rules to confirm the correct amounts were deducted. (Accuracy, Classification) 8. Trace the monthly third party payments to the bank statement. (Occurrence) 9. For a sample of employees: <ul style="list-style-type: none"> • Recalculate the income tax deduction (PAYE) and agree to the tax calculated per the system in accordance with SARS tax tables. (Accuracy, Classification) • Compare all other deductions, e.g. pension, medical aid, etc. to the appropriate rules/supporting documents to confirm the correct amounts were deducted. (Accuracy, Classification) 10. Inspect returns to outside entities for the inclusion of employees selected in the sample, e.g. PAYE reconciliations, EMP201 or medical aid contribution returns. (Completeness, Classification) 	<p>1</p> <p>1</p> <p>1</p> <p>1</p> <p>1</p>
<p><u>Net Pay</u></p> <ol style="list-style-type: none"> 11. Obtain the 'net remuneration' from the PayBuddy system for all 12 months and trace these amounts to the bank statement. (Occurrence) 12. Inspect the date of payment as per the bank statement and compare to the date on the December 'net remuneration' report from the PayBuddy system, and ensure that it was paid in the correct financial period. (Cutoff) 	<p>1</p> <p>1</p>

<u>Bonus</u>	
13. For the performance bonus obtain a list of utilisation percentages per employee for the financial year. For a sample of employees agree and recalculate utilisation percentages to underlying source documentation, such as time sheets/records/budgets. (Occurrence)	1
14. For the list of employees whose utilisation percentages exceed 10% and have been identified to receive a bonus, confirm that no negative quality related issues were raised. (Occurrence)	1
15. From the list of employees identified to receive a bonus, confirm that no employee with utilisation percentages of less than 10% are included. (Occurrence)	1
16. Recalculate the bonus amount due to the employee as correct according to the bonus policy (Accuracy, Occurrence)	1
17. Inspect the approval given by the directors (e.g. management meeting minutes/bonus schedule signoff) for the payment of the bonus (Occurrence)	1
18. Agree the net bonus paid per the bank statement (or bonus paid schedule) to the individual employee payslip. (Occurrence, Accuracy)	1
<u>Resignations/Dismissals/Termination Benefits</u>	
19. Obtain a listing of staff members that left the employ of the firm for a specific month and inspect the staff member's personnel file for a resignation letter. (Occurrence)	1
20. For a sample of employees, inspect the subsequent months to confirm that the employees does not appear on payrolls subsequent to termination.(Occurrence, Cutoff)	1
21. Inspect the month subsequent to their termination pay-out for any payments subsequently made to the employee.	
• recalculate final amounts owed/due to them; (Accuracy)	1
• agree the final payment to the bank statement (Occurrence)	1
22. For the mobile phone allowance, agree the amount allocated to employees on the payroll to the policy of R350. (Occurrence)	1
23. For the travel allowance, agree the amount allocated to employees on the payroll to the approved policy. (Occurrence)	1
24. By using CAATs:	
• recalculate, cast and cross cast a month's payroll; (Accuracy)	1
By using CAATs confirm that there are no:	Max 2
• duplicated or missing personnel ID numbers; (Occurrence, Accuracy, Completeness)	1
• duplicated or missing tax reference numbers; (Occurrence, Accuracy, Completeness)	1
• Negative balances due to employees (Occurrence)	1
• duplicated bank accounts. (Occurrence, Accuracy, Completeness)	
And enquire from management regarding any exceptions noted.	1
Available	30
Maximum	16
<i>Communication skills – clarity of expression</i>	1
Total for part (f)	17

Part (g) Discuss, with reference to the audit of Zinkwazi, whether the audit work performed on the fair value gains is likely to result in any adverse consequences for DNA and its directors.	Marks
Business Consequences	
Employees of the firm may leave given the reputational risks of being associated with DNA	1
DNA may suffer significant reputational damage due to negative publicity which can affect their operations and also the profession.	1
ISA's	
1 It is inappropriate for DNA to have only a representation letter as audit evidence supporting the valuation of Zinkwazi's sugarcane (Per ISA 580).	
1.1 This is as the revaluation is at significant risk of material misstatement, and the auditor will have to perform detailed testing to specifically be responsive to this risk (ISA 330.21).	1
1.2 In contrast, written representation letters only provide audit evidence of limited reliability.	1
2 DNA should therefore have performed its own procedures over the valuation of sugarcane e.g. such as involving its own experts, etc.	1
3 DNA did not meet its professional responsibilities, as it did not obtain sufficient and appropriate audit evidence relating to the valuation of sugarcane. Therefore they did not comply with the International Standards on Auditing.	1
APA	
In addition, George contravened section 44(3)(a) of the Auditing Profession Act by not performing the audit according to the auditing standards.	
Legal Consequences	
4 As a result, DNA should have the following concerns in relation to the potential litigation :	
4.1 DNA cannot demonstrate that it conducted the audit with due professional care and competence;	1
4.2 George may be subject to disciplinary action by SAICA for not complying with the SAICA Code of Professional conduct;	1
4.3 This may also point to weaknesses in the quality control system in the firm, and their compliance with ISQC. This may also result in disciplinary action against other partners in the firm.	1
4.4 George may be referred for investigation at the IRBA, since he is a RA; and	1
4.5 The liquidators of Zinkwazi may succeed with their action against DNA, and as a result DNA and/or George may be liable for damages, as determined in a court of law.	1
4.6 Audit partners (directors) in this context, not performing audit work diligently could result in 'directors' not acting in the best interest of an organization. Therefore possibly a trigger to section 76 of companies act.	1
4.7 George and/or DNA may be liable for penalties due to negligence in terms of section 46 of the Auditing Profession Act.	1
Conclusion: Based on the above, the audit work performed on the FV gains will likely result in adverse consequences.	1
Available	14
Maximum	6
Total for part (g)	6
TOTAL FOR PART II	37