

FULL AUDIT

QUESTION ONE

BACKGROUND

Rosette & Co. is a firm of ZICA Chartered Accountants. It is a global firm with offices in over thirty (30) countries across the world. Its mission is to provide distinctive customer focused professional services in order to serve public interest and contribute to the development of strong international economies. It was formed twenty (20) years ago by Chris Manda. The firm has ten (10) partners and Chris Manda is the Managing Partner.

Chris Manda has stated that the economic environment in Zambia, is less certain than it was a few years ago, and the firm is struggling to meet its performance targets. Despite the decline in economic activities, most companies are still interested in assurance services and are good corporate governance conscious. Chris Manda wants the Business Development Partner to evaluate the firm's current strategic position. The Business Development Partner has delegated this to you.

Although Chris Manda still has control over the firm, it is now totally run by professional staff in all managerial positions. However, Chris Manda is concerned that some of the qualified employees are still struggling with the ZICA CPE examinations. He wants to know the eligibility requirements for a member to obtain full audit practicing certificate. The firm is seriously considering assisting those writing ZICA CPE examinations. The firm has a very attractive remuneration policy, which include index linked salaries.

The firm recently invested heavily in advanced audit software, following the various weaknesses revealed in the quality control review report. Most weaknesses related to audits conducted in computerised environments. Chris Manda had earlier warned all members of staff that the overall objectives and

scope of an audit do not change when an audit is conducted in a computerised environment. He further stated that the application of auditing procedures may require the consideration of techniques that use the computer as an audit tool (Computer-Assisted Audit Techniques – CAATs). Some of the huge financial reserves developed by the firm over the years, were used to finance the investment in the advanced software.

Three (3) new firms of accountants have set up in direct competition. Some partners have suggested that the firm should consider closing the Copperbelt office following the recent decline in copper prices which has starved the province of the much needed liquidity required for business activities.

The firm spends 0.1% of its budget on various marketing and corporate social responsibility (CSR) programmes. There are a number of clients who want to do business with firms who demonstrate real empathy towards customer problems and are seen to have the right ‘green credentials’ regarding the environment. The public is aware that accountancy firms use a lot of paper, which has a direct link to deforestation. The government has promised to give Rosette & Co. tax incentives for its right ‘green credentials’.

You are an Audit Manager in the audit department of Rosette & Co., responsible for the audits of:

- Kadimba Plc;
- Mabinda Plc; and
- Dakimba Ltd.

There are a number of issues in each case which have been brought to your attention.

KADIMBA PLC

Kadimba Plc is a company which specializes in retailing various food supplements. It has ten (10) outlets in Lusaka. Most of the food supplements are imported from countries in Asia. The company has been operating profitably for over twelve (12) years, but in the past two (2) years, profitability has been declining marginally. The Managing Director, Mr. Luke Zimba is concerned and is putting pressure on senior managers to improve or be fired. Three (3) senior managers separated from the company last month, and joined a new competitor. Cheap imports have reduced Kadimba Plc's overall market share by 4%.

The Secretary to the Managing Partner of Rosette & Co. has joined Kadimba Plc as a marketing officer. She holds a degree in marketing and greatly contributed towards improving the image of Rosette & Co., over the three (3) years in which she was employed by Rosette & Co. Mr. Luke Zimba is confident that she will assist the marketing director in developing and implementing a marketing strategy which will frustrate the competitors' efforts to dominate the Lusaka market. The Lusaka market accounts for 40% of the total profits of the company.

The company is planning to open two (2) outlets in Mongu. A bank loan at variable rate will be used to finance the expansion. The business opportunities in Mongu have improved significantly following the completion of the Mongu - Kalabo road. Kadimba Plc has also introduced internet sales and the contribution towards the overall sales is increasing steadily.

Rosette & Co. has always assessed Kadimba Plc's control environment as poor, even though Mr. Luke Zimba shows passion for effective controls. However, the weak control environment was so pronounced last year, resulting in Rosette & Co. issuing a modified opinion. Mr. Luke Zimba is still seeking a second opinion from another audit firm, and this has come to the attention of the

Engagement Partner, who is the Managing Partner of Rosette & Co. In addition, Mr. Luke Zimba has threatened to sue Rosette & Co. over the conduct of the last year's audit which he claims was poorly done. He claims the entire audit was basically completed by junior auditors. Rosette & Co. has continued auditing Kadimba Plc because it charges significantly low fees. The Engagement Partner has requested you to remind him of the professional guidance on second opinions. He is worried that competitors may use this opportunity to dent the firm's image.

The Zambia Revenue Authority (ZRA) has conducted two tax investigations in the charge year 2017. Mr. Luke Zimba is a chemist, but has had serious arguments with ZRA officials and other regulators. He wants Rosette & Co. to advise the company on effective tax planning methodologies.

The company spends huge sums of money on advertising its fair trade credentials as a means of getting an edge over its competitors and improving its public image.

The Managing Partner of Rosette & Co. owns shares in Kadimba Plc, which he recently inherited from his uncle's estate. He intends to sell the shares next year since the company is expected to revalue its assets.

MABINDA PLC

Mabinda Plc is a large, mining company. It is publicly quoted and has excellent corporate governance structures. The audit committee is one of the committees of the board. It consists entirely of independent non-executive directors and excludes the board chairman. Two of the non-executive directors have significant and recent financial experience.

The audit committee charter clearly specifies the responsibilities of audit committee, which include the following:

1. Making a recommendation on the appointment, reappointment and removal of the external auditors.
2. Monitoring and reviewing the effectiveness of the internal audit activities.
3. Reviewing internal financial controls, internal control in general and risk management systems.
4. Monitoring the integrity of any formal announcements on financial performance including financial statements.

The performance appraisal of the audit committee recently conducted by an international external reviewer rated the audit committee as very effective. However, the chairman of the audit committee has advised the members to guard against the common pitfalls of audit committees.

The Chairman of the audit committee has requested management to engage Rosette & Co. to conduct a workshop for all board members regarding effective financial statement analysis. At the moment, discussions on financial reporting are dominated by the two (2) accountants on the board. The workshop should include vertical and horizontal analysis.

You have assigned an audit trainee, as part of his training programme, to carry out the following audit procedures contained in the audit plan for audit of Mabinda Plc:

- Review after-sales cash receipts by inspecting bank statements and cash receipts documentation.
- For a sample of sales invoices around the year-end, inspect the dates and compare with the dates of dispatch and the dates recorded in the ledger.
- Examine the underlying documentation (purchase order, dispatch documentation, duplicate sales invoice etc).
- Agree the balance from the individual sales ledger accounts to the aged receivables' listing and vice versa.
- Examine large customer accounts individually and compare to previous year's balances.
- Inquire from management explanations for invoices remaining unpaid after subsequent ones have been paid.
- For a sample of sales transactions recorded in the ledger, vouch the sales invoice back to customer orders and dispatch documentation.
- Complete the disclosure checklist.

- Recalculate the mathematical accuracy of a sample of suppliers' invoices.

DAKIMBA LTD

One year ago, Rosette & Co. recruited a new Partner – in- Charge of quality. The Partner has been working on the firm's policies and procedures which hopefully will address the lapses in the current client acceptance procedures. These have not been updated for a long time. You have just returned from a workshop abroad which adequately addressed current issues on money laundering.

Rosette & Co. has recently been approached by Dakimba Ltd, a potential audit client. Rosette & Co. is keen to take up the appointment, and the Partner – in – Charge of quality is currently screening Dakimba Ltd. The company sells second hand vehicles which it imports from several countries in Europe and Asia. It recently diversified into operating Casinos and has opened Casinos in Kabulonga, Roma and Kabwata. However, the Casinos incomes have been decreasing.

The company has 60 full-time and 20 part – time employees. The Financial Accountant of Dakimba Ltd, James Kunda has already set up basic systems in the casinos, since he has worked in the entertainment industry before.

The Partner – in - Charge of quality wants you to assist him in finalizing the screening process and critique the recommended firm's policies and procedures. He is aware that you once worked for a casino and can even advise the Engagement Partner on the areas in the financial statements which may be highly susceptible to misstatements.

From experience, you know that Casinos:

1. Spend a lot of money on advertising.
2. Are significantly financed by debt.
3. Have significant intangible non-current assets.

SECTION A

1. (a)

(i) State the eligibility requirements for a member to obtain a full audit practicing certificate.

(ii) Explain the importance of each requirement.

[8 marks]

(b) Identify and explain five (5) ethical and other professional issues relating to the matters raised in Kadimba Plc.

[10 marks]

(c) Suggest suitable safeguards in respect of each matter identified in Kadimba Plc.

[5 marks]

2. (a) Discuss the business risks faced by Kadimba Plc.

[15 marks]

(b) Using the form of briefing notes, give advice to the Engagement Partner on professional guidance regarding second opinions.

[6 marks]

(c) Perform a SWOT analysis for Rosette & Co. using the information given and recommend an appropriate business strategy for the firm.

[6 marks]

[Total marks: 50 marks]

SECTION B

3. (a) Discuss the common pitfalls encountered by audit committees, which could impact negatively on the decision-making process necessary to ensure the long-term success of the company, and to protecting individual members of the committee from being held personally liable.

[14 marks]

- (b) Explain what is meant by vertical and horizontal analysis of financial statements.

[6 marks]

- (c) Explain the importance of carrying out each audit procedure given in the audit plan for the audit of Mabinda Plc.

[9 marks]

4. (a) Discuss why it is important for auditors to consider money laundering laws and regulations.

[5 marks]

- (b) Advise the Engagement Partner on three (3) possible areas in the financial statements for Dakimba Ltd which might be susceptible to the risk of material misstatements.

[6 marks]

- (c) Explain the policies and procedures that a ZICA firm of Chartered Accountants should establish in order to meet its responsibilities in relation to money laundering.

[10 marks]

[Total 50 marks]

QUESTION TWO

BACKGROUND

Kasanji Associates is a firm of ZICA registered Accountants. It offers both audit and audit-related services. It has offices in Lusaka, Chipata and Mongu. The firm has six (6) partners. Its profits have been rising at an average rate of 12% per annum. It has over fifty (50) clients and mainly uses the risk based approach, when carrying out assurance assignments.

Risk-based approach is required by the International Standards on Auditing (ISAs). In this approach, auditors analyse the risks associated with the client's business, transactions and systems. This is in contrast to a procedural approach which is not in accordance with ISAs. In a procedural approach, the auditor would perform a set of standard tests regardless of the client and its business.

Kasanji Associates has been approached by the following organizations to provide professional services:

1. Sakanji Ltd
2. ZICA.
3. Frapcb Show Society
4. Obongo Banking Ltd
5. Bin Ltd.

SAKANJI LTD

Sakanji Ltd's principal business activity is farming, specializing mainly in fruits, vegetables and fish rearing. It was incorporated in Zambia twenty two (22) years ago. It has subsidiaries in Botswana, Zimbabwe and Egypt. It is the

first time Kasanji Associates is auditing a farming enterprise. Mr. Evaristo Mandebwe is the Managing Director.

The various farm produce are sold for cash since no credit is allowed. At the moment, most of the farm produce are sold to individuals who come to the farms. The company expanded its operations by 30% in the year ended 31 December 2017, in all the countries. However, the storage facilities are inadequate. There are plans to upgrade the storage facilities next year. Some of the maize has been destroyed due to poor storage. Health Inspectors regularly carry out random inspections and ensures all inventories harmful to human and animal life are destroyed.

The Managing Director's wife, Mrs. Veronica Filimina Kafeka, uses part of the company's land to cultivate various crops on a commercial basis. Her crops are marketed and sold together with those for Sakanji Ltd. The wife is an accountant registered with ZICA. She pays rent for the use of the land.

During the year ended 31 December 2017, Sakanji Ltd computerized most of its processes. There was an opinion amongst a number of board members that the quality of the service had deteriorated due to lack of investment in information technology (IT). Management used a direct changeover, because they did not want to incur unnecessary cost by using parallel running. IT has enabled Sakanji Ltd to respond flexibly to customers orders while maintaining the cost base low. In addition, by using IT, the company switched to e-Sourcing and e-Payment. Significant purchases of inputs and agricultural implements are being imported, while a number of fruits and vegetables are being exported. Both overseas (import and export) transactions are on 60 days' credit terms. To finance the overseas business, the company issued a \$100m Eurobond bond on the Asian market. The issue was oversubscribed and the underwriters' returns were significantly above industry average. The company does not hedge its foreign currency exposure.

At the beginning of 2017, one of the audit managers in Kasanji Associates joined Sakanji Ltd, as Chief Accountant. This has strengthened the financial systems and controls in the company.

The Director of Finance, a Mr. Muyunda Muhanga, wants an audit team which will deliver a quality audit on time. The newly promoted Engagement Partner feels the demands by the Director of Finance could compromise objectivity and

independence. You are a Senior Audit Manager in Kasanji Associates, with fifteen (15) years practical experience. The newly promoted Engagement Partner has requested you to remind him of his role in the selection of the audit team members, and whether he can include new audit trainees and a recently qualified experienced auditor who previously worked on a commercial farm, as the Accountant-In-Charge (AIC).

ZICA

ZICA is a self-regulated body for the accountancy profession in Zambia. It was established by an Act of Parliament of 1982 and repealed by the Accountants Act of 2008. The primary mandate of the institute is to promote the accountancy profession through the regulation of the accountancy practice and education.

In 2007, ZICA introduced the ZICA Accountancy Programme and has since received international acceptability with the endorsement by the International Federation of Accountants (IFAC). It also offers a Taxation programme which prepares students to carry out duties as:

- Tax Accountants
- Tax Advisors
- Compliance Officers
- VAT Accountants
- VAT Inspectors; and
- Customs officers.

To effectively consolidate its gains, ZICA is rebranding its ZICA Accountancy Programme. This has excited students and employers. ZICA will, from December 2017, run two programmes in accountancy namely:

- Diploma in Accounting; and
- CA Zambia.

CA is used globally and the move by ZICA will significantly benefit ZICA trained accountants.

You are an Audit Manager in Kansaji Associates, responsible for IT audits and forensic investigations. You are reviewing two (2) situations which were recently discussed with the Director - Education and Training at ZICA:

1. ZICA has embarked on a serious modernization programme aimed at improving accessibility to its website, and customer service by offering a number of services online. The Director - Education and Training is concerned about possible cyber attacks, given the sensitive nature of examinations. He has heard of computer and digital forensic investigation and would like you to provide more details.
2. There has been a marked increase in payables for various outsourced education and examination services following automation of the payables ledger. The Director - Education and Training has requested you to carry out detailed audit procedures and state whether the figure is fairly stated. If not, give possible reasons for the increase to enable management carry out further investigations.

FRAPCB SHOW SOCIETY

Frapcb Show Society is a government initiative aimed at promoting Small and Medium Sized Enterprises (SMEs) in the rural parts of Zambia. It is a registered charity and the operations of the Society are run by a board of trustees, comprising elected members of local communities.

The society raises money through the various shows it holds in the rural parts of Zambia, which are very popular since the entry fees are affordable and the various items sold are very cheap. The government gives the charity a quarterly grant of K180,000 towards administrative expenses.

The society is considering establishing an internal department due to increased show activities. The internal audit department will assist the finance department in the development of systems. There are only two (2) peak periods in any year, that is, when the shows are being held. During this period, a lot of volunteers from various reliable faith-based organizations assist the society with various tasks, including collection of money.

The draft financial statements for the year ended 31 March 2017 show revenue of K1.8 million (2016 K1.6 million), surplus of K400,000 (2016 K350,000) and total assets of K3.6 million (2016 K3.1 million).

The following issues are outstanding from the audit fieldwork and have been left for your attention as the Audit Manager responsible for the audit of Frapcb Show Society:

1. During the year, Frapcb Show Society incurred training costs for all the board trustees. The training was held in South Africa and the total cost was K120,000. The board of trustees has capitalized this expenditure since it will benefit the society for several years. An expert in human development who has also done social accounting has estimated the useful life to be five (5) years. The audit senior has proposed an unmodified opinion and the inclusion of a description of the key audit matters (KAMs).

2. Included in receivables, which total K26,000, is a debt amounting to K8,000 from Mwambazi, who went into liquidation on 17 April 2017. You have ascertained from the liquidator that only 50% will be paid. The board trustees have agreed to amend the receivable balance but they have been advised to effect the amendment in the 2018 financial statements, by the liquidator.

The Audit Senior has proposed an unmodified opinion.

In addition, the society has been informed that the Auditor General's office will be conducting an audit in next two (2) weeks. The board trustees are surprised since this is the first time they will be audited by the Auditor General's office.

OBONGO BANKING LTD

This is a newly opened bank. It was incorporated in 2015 and only started operating on 1 January 2017. The delay was caused by the need to raise enough funds to meet the increased capital requirement. The audit committee has appointed Kasanji Associates for a period of twelve (12) years, to ensure continuity, given the sensitive nature of financial institutions, and stringent corporate governance requirements by Bank of Zambia (BOZ).

During the year ended 31 December 2017, the bank recruited an experienced Risk Manager who is responsible for:

1. Providing the overall leadership, vision and direction for enterprise risk management.
2. Establishing an integrated risk management framework for all aspects of risk across the organization, integrating enterprise risk management with other business planning and management activities and framing authority; and for enterprise risk management in business units.
3. Dealing with insurance companies.
4. Implementing a set of risk indicators and reports.

On 5 June 2017, one of the directors obtained a loan of K10,500 from the bank at market rate. The loan was repaid on 7 August 2017. This has not be disclosed in the financial statement since it was fully repaid before the 31 December 2017. The Audit Senior is proposing a qualified opinion with an emphasis of matter paragraph. The value is immaterial to the financial statements.

The Bank of Zambia has again increased the capital requirement to further strengthen the liquidity position of banks. Obongo Banking Ltd has been given six (6) months to ensure it is fully compliant. At the time of the audit, Obongo Banking Ltd was still negotiating with possible financiers. This has been adequately disclosed in the financial statements. The Audit Senior is proposing an unmodified opinion with other matter paragraph.

BIN LTD

The company specializes in mineral quarrying and opencast mining. The company carries out social risk assessment for major projects, assessing how the local social, economic and cultural conditions may affect the project. These assessments reflect the impact that mining projects often have on environmentally and socially sensitive areas such as wildlife habitats, biodiversity points and indigenous communities. Linked issues normally include poverty, conflict, political instability and human rights violations. Management knows that failure to take account of these issues may result in serious opposition, cultural conflict, delays in granting of mining rights and rejections of mining licenses.

You are currently planning the audit procedures for the forthcoming audit of the financial statements of Bin Ltd. During the year under review, significant sums of money were spent on various repairs and refurbishments. The aim was mainly to ensure operations were in line with the company's environmental policy.

SECTION A

1. (a) Explain the importance of risk assessment in the performance of statutory audits. [3 marks]
- (b) Identify and explain ten (10) audit risks in Sakanji Ltd. [20 marks]

- (c) Advise the newly promoted Engagement Partner, on the issues relating to the selection of the engagement team members. [5 marks]

2. (a) Explain any six (6) challenges of computer and digital forensic investigations. [6 marks]
- (b) Discuss any six (6) computer forensic programmes and devices that make computer and digital investigations possible. [6 marks]

- (c) Suggest seven (7) audit procedures you should perform to determine whether the ZICA payables are overstated and explain three (3) possible reasons for the high payables figure.

[10 Marks]

[Total: 50 marks]

SECTION B

3. (a) Discuss the recent legal and regulatory changes in Zambia, aimed at strengthening the Auditor General's powers, and state one issue which is very relevant to Frapcb Show Society. [6 marks]
- (b) Explain whether Frapcb Show Society should establish an internal audit department. [3 marks]
- (c) In relation to each of the issues raised in Frapcb Show Society:-
- (i) Comment on the matters that you would consider, [8 marks]
- (ii) State two (2) audit evidences that you should expect to find, in undertaking your review of the audit working papers and financial statements for the year ended 31 March 2017. [4 marks]
4. (a) Briefly discuss the new rules for auditors of banks and financial institutions in Zambia, and mention one issue which is very relevant to Obongo Banking Ltd. [3 marks]
- (b) For each situation given in respect Obongo Banking Ltd, comment on the suitability or otherwise of the Audit Senior's proposals for the auditor's reports. Where you disagree, indicate what type of audit opinion should be given instead. [9 marks]
5. (a) Discuss the implications for the Statutory Audit of the social and environmental issues in Bin Ltd. [12 marks]
- (b) Suggest five (5) audit procedures to be undertaken regarding the expenditure on the repairs and refurbishments. [5 marks]

[Total: 50 marks]