

## QUESTION ONE

Your name is Jani Musonda and you are a senior manager in Macks & Co, a firm of Chartered Certified Accountants. In your capacity as engagement quality control reviewer, Macks Kondwe, the managing partner has asked you to review the audit files of Kalundwe Trading Ltd, Lamise Packaging Materials Ltd and Shikita Ltd, all of which have a financial year ended 31 December 2017.

The managing partner has also intimated that Macks & Co is likely to be reviewed by the review team from Zambia Institute of Chartered Accountants (ZiCA). Macks is sceptical about the benefits of ZiCA reviews

### A. Kalundwe Trading Ltd – Review of planning

The Company operates in the supply chain management sector, offering distribution, warehousing and container handling services. The audit was planned by another manager and you have extracted the following information from the audit files:

- a) Notes from meeting with Anna Puupwe, the financial director
- b) Draft financial statements for year ended 31 December 17, together with comparatives for 2016

### Notes from meeting with the Company Finance Director

The Company has not changed its operations significantly this year. However, it has completed a modernisation programme of its warehousing facilities at a cost of K25 million. The programme was financed with cash raised from two sources: K25 million was raised from a bank loan, and K5 million from the sale of idle plant and machinery.

### Financial information provided by the Company finance director

#### Statement of financial position

|                                 | Note | 31 December 2017<br>Km | 31 December 2016<br>Km |
|---------------------------------|------|------------------------|------------------------|
| <b>Assets</b>                   |      |                        |                        |
| <b>Non-current assets</b>       |      |                        |                        |
| Property, plant and equipment   | 1    | 230                    | 187                    |
| Intangible assets – R/D         |      | 30                     | 30                     |
| Deferred tax asset              | 2    | 10                     | 15                     |
| <b>Total non-current assets</b> |      | <u>270</u>             | <u>232</u>             |
| <b>Current assets</b>           |      |                        |                        |
| Inventories                     |      | 35                     | 28                     |
| Trade and other receivables     |      | 62                     | 45                     |
| Cash and cash equivalents       |      | –                      | 10                     |
| <b>Total current assets</b>     |      | <u>97</u>              | <u>83</u>              |
| <b>Total assets</b>             |      | <u><u>367</u></u>      | <u><u>315</u></u>      |

**Equity and liabilities****Equity**

|                                      |                   |                   |
|--------------------------------------|-------------------|-------------------|
| Equity share capital                 | 50                | 50                |
| Retained earnings                    | 131               | 103               |
|                                      | <u>          </u> | <u>          </u> |
| <b>Total equity</b>                  | <b>181</b>        | <b>153</b>        |
|                                      | <u>          </u> | <u>          </u> |
| Non-current liabilities              |                   |                   |
| Debenture                            | 75                | 55                |
| Provisions                           | 3      6          | 12                |
|                                      | <u>          </u> | <u>          </u> |
| <b>Total non-current liabilities</b> | <b>81</b>         | <b>67</b>         |
|                                      | <u>          </u> | <u>          </u> |
| <b>Current liabilities</b>           |                   |                   |
| Trade and other payables             | 90                | 95                |
| Overdraft                            | 15                | –                 |
|                                      | <u>          </u> | <u>          </u> |
| <b>Total current liabilities</b>     | <b>105</b>        | <b>95</b>         |
|                                      | <u>          </u> | <u>          </u> |
| <b>Total liabilities</b>             | <b>186</b>        | <b>162</b>        |
|                                      | <u>          </u> | <u>          </u> |
| <b>Total equity and liabilities</b>  | <b>367</b>        | <b>315</b>        |
|                                      | <u>          </u> | <u>          </u> |

**Statement of profit or loss for the year to 31 December**

|                                 | <b>2017</b>       | <b>2016</b>       |
|---------------------------------|-------------------|-------------------|
|                                 | Km                | Km                |
| Revenue                         | 375               | 315               |
| Operating expenses              | (348)             | (277)             |
|                                 | <u>          </u> | <u>          </u> |
| Operating profit                | 27                | 38                |
| Profit on disposal of equipment | 10                | –                 |
| Finance costs                   | (4)               | (3)               |
|                                 | <u>          </u> | <u>          </u> |
| Profit before tax               | 33                | 35                |
| Tax expense                     | (10)              | (15)              |
|                                 | <u>          </u> | <u>          </u> |
| Profit for the year             | <b>23</b>         | <b>20</b>         |
|                                 | <u>          </u> | <u>          </u> |

**Notes:**

1. Several old warehouses were modernised during the year. The modernisation involved the redesign of the layout of each warehouse, the installation of new computer systems, and the replacement of electrical systems.
2. The deferred tax asset is in respect of unused tax losses (tax credits) for the period of three years from 2012 to 2014.
3. The provisions relate to onerous leases in respect of vacant properties which are surplus to the company's requirements.

## **B. Lamise Packaging Materials Ltd (LPM)– Review of working papers and substantive procedures**

From your review of the audit working papers, you have noted that the level of materiality was determined to be K1.5 million at the planning stage, and this materiality threshold has been used throughout the audit. There is no evidence on the audit file that this threshold has been reviewed during the course of the audit.

From your review of the audit planning, you know that a new packing machine with a cost of K1.6 million was acquired by LPM in March 2017 and is recognised in the draft statement of financial position at a carrying amount of K1.4 million at 31 December 2017. The packing machine is located at the premises of a subsidiary company, Mulundu Co. Mulundu Co is a distribution company which is used to pack and distribute a significant proportion of LPM's products. An arrangement has been agreed for Mulundu Co to charge a nominal custodial fee for the machine. The machine has not been physically verified by a member of the audit team. The audit working papers conclude that *'we have obtained the purchase invoice and order in relation to the machine, and therefore can conclude that the asset is appropriately valued and that it exists. In addition, the managing director of Mulundu Co has confirmed in writing that the machine is located at their premises and is in working order. No further work is needed in respect of this item.'*

Inventory is recognised at K2 million in the draft statement of financial position. You have reviewed the results of audit procedures performed at the inventory count, where the test counts performed by the audit team indicated that the count of some items performed by the company's staff was not correct. The working papers state that *'the inventory count was not well organised' and conclude that 'however, the discrepancies were immaterial, so no further action is required'*.

You also had a chance to speak to the audit senior on the audit. The audit senior voiced some concerns about the performance of the audit. A summary of his comments is shown below:

*'The audit manager and audit engagement partner came to review the audit working papers on the same day towards the completion of the audit fieldwork. The audit partner asked me if there had been any issues on the sections of the audit which I had worked on, and when I said there had been no problems, he signed off the working papers after a quick look through them.*

*When reading the company's board minutes, I found several references to the audit engagement partner, Joe Lombe. It appears that Joe recommended that the company use the services of his brother, Mick Lombe, for advice on business development, as Mick is a management consultant. Based on that recommendation, Mick has provided a consultancy service to LPM since September 2017. I mentioned this to Joe, and he told me not to record it in the audit working papers or to discuss it with anyone.'*

## **C. Shikita Ltd– Review of working papers and reporting**

Shikita Ltd is a new audit client operating in the construction industry. Shikita Ltd's financial year ended on 31 December 2017, and the draft financial statements recognise profit before tax of K22.5 million (2016 – K20 million) and total assets of K370 million, including cash of K3 million. The company typically works on three construction contracts at a time. You are reviewing the following matters arising from the audit

**a) Construction of a new bridge**

Shikita Co is working on a major contract relating to the construction of a new bridge in the lower Zambezi, Chirundu area. Work started in July 2016, and it is estimated that the contract will be completed in September 2018. The contract price is K20 million, and it is estimated that a profit of K5 million will be made on completion of the contract. The full amount of this profit has been included in the statement of profit or loss for the year ended 31 December 2017. Shikita Co's management believes that this accounting treatment is appropriate given that the contract was signed during the financial year, and no problems have arisen in the work carried out so far.

**b) Construction of a highway**

A significant contract was completed in September 2017. This contract related to the construction of a 60-km highway in Luanshya. In November 2017, several large cracks appeared in the road surface after a period of unusually heavy rain, and the road had to be shut for ten weeks while repair work was carried out. The Ministry of Works and Supply paid for these repairs; but has taken legal action against Shikita Co to recover the costs incurred of K40 million.

Disclosure on this matter has been made in the notes to the financial statements. Audit evidence, including a written statement from Shikita Co's lawyers, concludes that there is a possibility, but not a probability, of Shikita Co having to settle the amount claimed.

- c) For the first time this year, the financial statements are presented as part of an integrated report. Included in the integrated report are several key performance indicators, one of which states that Shikita Co's profit before tax has increased by 20% from the previous year.
- d) Shikita has adopted the provisions of IFRS 15, Revenue from contracts with customers for the first time this year.

You have also become aware of a press report implicating the managing director of Shikita Ltd, Mr Chien Ho in money laundering activities

Requirements:

- 1) Advise the managing partner Mr. Macks Kondwe on the nature of ZiCA reviews and state FOUR benefits associated with such reviews (8 marks)
- 2) In relation to the review of the planning of Kalundwe Trading:
  - a) Explain why analytical procedures are performed as a fundamental part of our risk assessment at the planning stage of the audit. (5 marks)
  - b) Identify and explain EIGHT audit risks which should be considered in planning the Kalundwe audit. You should ensure that you consider all of the information provided as well as utilising analytical procedures, where relevant, to identify the audit risks. (19 marks)
- 3) In relation to review working papers on the audit of Lamise Packaging Materials Ltd
  - a) Explain the inherent limitations which mean that auditors may not identify related parties and related party transactions; and (6 marks)
  - b) Recommend the audit procedures to be performed in relation to LPM's transactions with Mulundu Co (8 marks)
  - c) Comment on the quality of the audit performed discussing the quality control, ethical and other professional issues raised. (16 marks)
- 4) With regard to Mr. Chien Ho being suspected of being involved in money laundering activities, comment on your responsibilities as required Financial Intelligence Centre (FIC) as promulgated by the FIC Act No. 46 of 2010, as amended in 2016, in relation to compliance with Anti Money Laundering and Combating Terrorism Financing (AML/CTF). (6 marks)
- 5) In relation to the review of working papers for the audit of Shikita Ltd:
  - a) As a new client, state the procedures that should have been undertaken to confirm that the preconditions of the audit were in place (6 marks)
  - b) Discuss the implications of the following matters on the completion of the audit and on the auditor's reporting, recommending any further actions which should have been taken:
    - i) Construction of a new bridge (10 marks)
    - ii) Construction of new highway (8 marks)
    - iii) The integrated report (8 marks)

**Total Marks: 100**

## QUESTION TWO

### NATIONAL HOUSING AGENCY (NHA)

Your name is Langton Mwepu and you are a senior manager in Malaiti Associates, a firm of chartered and management accountants registered with the Zambia Institute of Chartered Accountants (ZiCA). You have received the following e-mail from Mr Jose Malaiti, the managing partner of the firm

|                                                                                                                                                                                                                                                                                                                                                                                                                                                               |          |                                                   |             |          |                     |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|---------------------------------------------------|-------------|----------|---------------------|
| <b>To</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                     | <b>:</b> | <b>Langton</b>                                    | <b>Date</b> | <b>:</b> | <b>14 June 2018</b> |
| <b>From</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                   | <b>:</b> | <b>J Malaiti</b>                                  |             |          |                     |
| <b>Subject</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                | <b>:</b> | <b>The Audit of National Housing Agency (NHA)</b> |             |          |                     |
| <p><i>The Office of the Auditor General has subcontracted the audit of the National Housing Agency (NHA) to our firm, for the audit of the financial statements for the year ended 31<sup>st</sup> December 2016. I am informed that the financial statements for the year ended 31 December 2017 are not yet ready</i></p>                                                                                                                                   |          |                                                   |             |          |                     |
| <p><i>The Auditor General has also requested that our audit should include the examination of specific instances of non-compliance with applicable authorities, laws and regulations. As the previous years have been audited by the Auditor General, I would also request that you evaluate the ethical and professional standing of the Office of the Auditor General as this is expected to have a bearing on our level of professional scepticism</i></p> |          |                                                   |             |          |                     |
| <p><i>The director of audits at the Office of the Auditor General (OAG) has provided some information about the OAG and the National Housing Agency – attached below.</i></p>                                                                                                                                                                                                                                                                                 |          |                                                   |             |          |                     |
| <p><i>The Director of audits has also admitted that one of the reasons for subcontracting the NHA audit is because of lack of both human and technical capacity, especially to deal with recently issued accounting standards. In addition, the OAG has not yet fully implemented applicable auditing standards</i></p>                                                                                                                                       |          |                                                   |             |          |                     |
| <p><i>Thank you</i></p>                                                                                                                                                                                                                                                                                                                                                                                                                                       |          |                                                   |             |          |                     |
| <p><i>JM</i></p>                                                                                                                                                                                                                                                                                                                                                                                                                                              |          |                                                   |             |          |                     |

### OFFICE OF THE AUDITOR GENERAL (OAG)

The Auditor General (AG) is an economist who served as a general manager for the Food Reserve Agency. The members of staff of the OAG are recruited through the public service commission service that deals with all Human Resource affairs of the government as a whole. The recruitment is based on the establishment of the OAG as well as the ability of the government to pay. Although the OAG prepares its own strategic plans and budgets, the actual budgetary allocation is subject to parliamentary approval and availability of funds. Due to limited funds, the OAG has suspended all staff training

The AG's report is first presented to the President before being tabled at parliament.

As a Supreme Audit Institution (SAI), the OAG is required to comply with the International Standards for Supreme Audit Institutions (ISSAI's). These are broadly based on the International Standards on Auditing (ISA's) issued for the private sector audits. For example, the ISSAI 40 on Quality Control is based on the on the key principles in the "International Standards on Quality Control, ISQC-1" of the International Federation of Accountants (IFAC) and was adapted as necessary to apply to SAIs

## **NATIONAL HOUSING AGENCY (NHA)**

### **Background**

The National Housing Agency (NHA) was established by an Act of Parliament in 1971 under Cap 195 of the Laws of Zambia with the objective of providing, securing and promoting the provision of housing throughout the Republic of Zambia. Subject to any direction given by the Minister responsible for housing, the Agency has the sole management and control of the properties, income, and funds of the Agency and affairs and business thereof. Every five years, the NHA develops suitable goals and objectives in relation to this core function

The Agency took over the operations of the Presidential Housing Initiative (PHI) in 2002, ZIMCO properties Limited and INDECO Estates Development Company Limited in 2005 following presidential directives.

### **Financial Reporting**

According to Section 56 of the National Housing Agency Act, *“the Agency shall as soon as practicable and in any case not later than six (6) months after the termination of each financial year submit an annual report to the minister on the activities of the Agency”. The annual report shall include the statement of financial position, the profit and loss account, statement of cash flows and the report of the auditor.”*

NHA has opted for the early adoption of IFRS 15, *Revenue from Contracts with Customers* and IFRS 16, *Leases* for the financial statements for the year December 2016.

### **Sale of properties**

Some of the properties are constructed on instalment basis with an agreed initial deposit of 50% of the total price required from customers who take up this option. NHA immediately recognises all deposits as revenue, on the basis that historically, NHA has always delivered the construction projects on time

### **Lease of Construction Machinery**

On 1 January 2016, NHA entered into a five-year finance lease of a construction machinery from Mpulungu Holdings. The machinery has a useful life of six years. The annual lease payments are K500,000 per annum, with the first payment made on 1 January 2016. To obtain the lease NHA incurs initial direct costs of K100,000 in relation to the arrangement of the lease but the lessor agrees to reimburse Mpulungu Holdings K50,000 towards the costs of the lease. The rate implicit in the lease is 5%. The present value of the minimum lease payments is K2,273,000. The construction machinery has been capitalised and included in non-current assets.

NHA has adopted the cost model for accounting for such construction machinery

### Receivables

Receivable days measures how long, on average, credit customers take to pay once they are invoiced. It helps reveal how efficiently an entity is managing its receivables. The receivables of the Agency are mostly made up of the tenants using its commercial and residential properties. The Agency issues invoices to them at the beginning of every quarter and must be paid within thirty days.

|                   | 2016<br>(Kwacha) | 2015<br>(Kwacha) | 2014<br>(Kwacha) |
|-------------------|------------------|------------------|------------------|
| Trade Receivables | 22,510,295       | 20,287,613       | 21,963,641       |
| Income            | 35,602,963       | 42,693,521       | 49,148,592       |

### Press Release by the Minister of Housing

*“It has come to our attention that the NHA is grossly mismanaged and is rampant with corrupt practices. 70% shown as receivable is due from companies and individuals associated with the top management at NHA. Apparently, this has been going on for the last five years”*

### Management of Investment Properties

The Agency has investment properties in eight (8) provinces of Zambia. Except for caretakers, one per property, the NHA had no other staff to manage the properties on site. Tenants enter into tenancy agreements with the NHA Head Office. Many of the properties are in a dilapidated state. NHA applies the fair value model of accounting to its investment properties. Selected investments were revalued during the year ended 31 December 2015

### Cash flow and Solvency

The status of the Agency as a going concern was questionable in that it was failing to generate profits and positive cash flows from its operations. Further, the gearing ratio was increasing reflecting a lack of recapitalisation. See table below.

|                                      | 2016<br>(Kwacha) | 2015<br>(Kwacha) | 2014<br>(Kwacha) |
|--------------------------------------|------------------|------------------|------------------|
| Operating losses                     | (15,346,202)     | (1,701,548)      | (6,938,176)      |
| Cash flows from operating activities | (56,263,439)     | 4,943,706        | 8,905,324        |
| Gearing ratio                        | 111%             | 82%              | 77%              |

### Financing

Agency was having difficulties to service its long-term loans acquired from Shelter Afrique resulting in an outstanding amount of K9,364,790 (US\$936479) in unpaid interest as of December 2016.

### Management of Information Systems



The NHA operates Pastel Accounting Package which is a core system that is used by the finance department for financial data input, processing and reporting. The system is a commercial off the shelf software, which runs on Windows 2008 Server and contains financial management, purchasing, stores and receipting models. For the IT audit this year, the main purpose for reviewing computer applications is to gain assurance that appropriate policies and procedures related to the management of receivables are in place to support reliable preparation and processing of information over:

- Data Input
- Data Processing
- Data output
- Master File Maintenance

### **Note 15 – Going Concern**

In the notes to the financial statement, note 15 reads:

NHA acknowledges that there is a significant doubt related to the going concern of the Agency, arising from its adverse financial position. The Minister of Finance has provided a letter of undertaking that the Ministry will provide any financial assistance required to keep the NHA afloat. The NHA has also prepared a projected cashflow statement for the next five years that shows a significant improvement in the management of receivables and control of costs, resulting in favourable cashflow and profit positions at the end of the second year.

Accordingly, management is of the opinion that the NHA is a going concern.

### **Required:**

- 1) Discuss to what extent the OAG is in compliant with the firm wide quality controls prescribed by the International Standards on Quality Control, ISQC-1. with regard to the following elements:
  - a) Leadership (4 marks)
  - b) Ethical Requirements (6 marks)
  - c) Human Resources (4 marks)
  - d) Engagement Performance (4 marks)

For each element, recommend immediate steps that can be taken to ensure compliance with ISQC - 1

- 2) Using the information provided, Identify and evaluate EIGHT risks of misstatement for the planning of the audit of financial statements of NHA for the year ended 31 December 2016 (20 marks)
- 3) Recommend substantive procedures that should be performed on
  - a) Receivables (6 marks)
  - b) Carrying value of Investment properties (6 marks)
  - c) Lease of construction machinery (6 marks)
  - d) Sale of properties on instalment basis (6 marks)
- 4) In relation to the Management Information Technology System at NHA

- a) Explain the difference between application and general controls (4 marks)
  - b) Recommend **TWO** procedures to be performed to test the application controls of the **PASTEL** system at **NHA**, for each of the following:
    - i) Data Input (3 marks)
    - ii) Data Processing (3 marks)
    - iii) Data output (3 marks)
    - iv) Master File Maintenance (3 marks)
- 5) In relation to the disclosure note 15:
- a) State the additional procedures you should carry out on the support letter provided by the Minister of Finance (6 marks)
  - b) State the audit procedures you should carry out on the projected cash flow statement (6 marks)
  - c) State the implications for your audit report, assuming
    - i) you satisfied with the provisions of note 15 (6 marks)
    - ii) You are not satisfied with the provisions of note 15 (4 marks)

**Total Marks: 100**