COMPETENCE PRACTICE EXAMINATION

AUDIT PRACTISING CERTIFICATE

JUNE 2021

TIME ALLOWED: 5 HOURS

INSTRUCTIONS TO CANDIDATES

1. This paper has Two Questions.

2. You are required to attempt ALL the two questions

3. Each question has Sections:
   Question one has two sections: A and B

   Question two has two sections: A and B

4. All the two questions carry equal marks.

5. The Examination is divided into sessions of $2^1/_2$ hours each. There will be a 30 Minutes break in between the sessions.

6. Please use your Membership number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.

7. This is an open book examination.

FULL AUDIT COMPETENCE PRACTICE EXAMINATION (CPE)

QUESTION ONE

Background

Lande & Co. is a medium-sized accountancy firm providing both assurance and non-assurance services to a diverse client base. The firm was established twelve (12) years ago and it now has three (3) Partners and five (5) Managers.

Until the year 2018, the services offered were predominately audit of financial statements. However, as a result of the recent company closures mainly due to the COVID-19 pandemic, opportunities have arisen regarding work related to insolvency and forensic investigations. The income from these assignments now account for more than 40% of the total income compared to less than 1% three (3) years ago. This is in line with firm's strategic focus on offering market-driven services.

The Managing Partner, however, knows that these are high risk assignments which must be handled with extra care. A new code of conduct was implemented a year ago but unfortunately disciplinary cases involving unethical conduct continue to rise.

Two (2) months ago, officers from the Practice Review Department of the Zambia Institute of Chartered Accountants (ZiCA) visited Lande & Co. The outcome of the visit has been classified as **"Un*satisfactory*"**. The Managing Partner wants a detailed analysis of the entire Audit Monitoring Report.

A number of audit clients have complained about unnecessary delays regarding financial statement audits and they are contemplating switching business to competitors. The firm is in the process of recruiting two (2) additional Audit Managers in order to cope with the workload. You are an Audit Manager in Lande & Co. and you are currently responsible for the following assignments:

(1) Analysis of the Audit Monitoring Report.

(2) Seya Ltd - Audit of the financial statements for the year ended 31 December 2020

(3) Meya Plc – Audit of the financial statements for the year ended 31 March 2021

(4) Luwana Plc – Forensic investigation involving fake goods received notes (GRNs)

(5) Teya Ltd – Business advisory services

Analysis of the Audit Monitoring Report

The report contained findings from the review of the firm and three (3) audit files:

- **Review of the firm** – The firm has no quality control policies and procedures.
- **File no. 1** – No management letter was prepared for the client. A note from the Audit Senior stated that since the management letter is a by-product of the audit process, the Audit Team had decided not to prepare one. In addition, the audit programme on the section for subsequent event stated not applicable (N/A).
- **File no**. **2 –** There was no audit engagement letter for the year under review and neither was there any documentation to indicate that the firm and the audit client had agreed the engagement terms. The Audit Senior stated that this was a public entity whose audit mandate was clearly specified in the legal framework.
- **File no**. **3** – The financial statements were not signed.

Seya Ltd

Seya Ltd is large importer and distributor of affordable high quality herbal products. Most of the customers are above the age of 55 years and have one or more of the following conditions – diabetes, cancer, high blood pressure, kidney diseases and liver diseases.

Seya Ltd was incorporated in the year 2000 but only started operating in the year 2003 because of the bureaucracy involved in obtaining the necessary permits and licenses. These must be renewed on an annual basis. The Government recently enacted more strict regulatory and compliance requirements.

The company employs five hundred (500) people. During the year ended 31 December 2020, the company significantly invested in training both technical and support staff. The training was conducted by Lande & Co. All sales and marketing staff are paid on a commission basis. The company is in competition with a number of smaller companies, although research and opinion has concluded that Seya Ltd's products are generally more effective.

The year 2020 has been characterized by a challenging macro-economic environment due to several factors including a depreciating local currency, high inflation rate, high interest rates and low electric power supply leading to drastic load shedding. The exchange rate for the Zambian Kwacha against the US Dollar now averages K23 per $1 compared to K7 per $1 two (2) years ago.

On 1 November 2020, Lande & Co. was appointed as external auditors of Seya Ltd. You are currently planning the audit of the financial statements for the year ended 31 December 2020. At a recent planning meeting with Those Charged with Governance and Senior Management, you established the following:

(1) The Annual General Meeting (AGM) will be held on 10 March 2021.

(2) The management accounts for the month of October 2020 show reduced profitability.

(3) The Engagement Partner's best friend is a Non-Executive Director (NED) and is the Chairperson of the Audit Committee.

(4) The audit team members will be provided with free face masks and instant hand sanitizers throughout the audit.

(5) Management has asked an independent firm of consultants to give advice on the new systems as they have little specialist in-house knowledge in this area.

(6) The Engagement Partner is diabetic and buys herbal products from Seya Ltd on credit.

(7) There has been a significant increase in the payables over the past months.

Meya Plc

The audit plan for the audit of the financial statements for the year ended 31 March 2021 is almost complete. The following are some of the audit responses suggested by the Audit Senior in respect of the audit risks identified:

Audit risks	Audit responses
(1) Tight reporting deadlines – there is a risk that the firm may fail to carry out all the planned audit procedures.	Revise the reporting deadlines and advise the client accordingly.
(2) Introduction of online sales – there is a risk that sales made online may not be incorporated correctly in the financial statements.	The controls will need to be documented and evaluated. If these are weak the level of substantive testing will need to be increased accordingly.
(3) The Finance Director is a part-time employee - This may promote a weak control environment, resulting in undetected errors or frauds.	The company should employ a full time Finance Director in order to strengthen the control environment.
(4) There is a risk the company may fail to comply with the loan covenants, resulting	The audit team must maintain professional skepticism.

in the loan being recalled. This could then possibly lead to going concern issues.	
(5) Obsolete inventory – inventory shown in the financial statements could include obsolete inventory.	Attend inventory count and ensure that obsolete inventory is separated from the rest of the inventory.

Luwana Plc

The Finance Director of Luwana Plc, an audit client, contacted the Managing Partner on 4 June 2021 regarding a suspected fraud which the Internal Auditors recently discovered. They have requested Lande & Co. to evaluate the following draft advertisement and also advise whether the Procurement Department should be involved in the tendering process given the sensitivity of the matter:

Luwana Plc

Required Forensic Auditor

Luwana Plc is a reputable Zambian transportation company.

The company is looking for the services of Chartered Accountants as forensic auditors. Interested firms should submit their detailed proposal.

This should be delivered to:

The Managing Director,

Luwana Plc,

Lusaka.

Sealed Envelopes should be deposited at company's head office or emailed to info@luwanaplc.com by 14th April 2021 at 16:00hrs. Proposals received after the deadline will not be accepted.

For more information you can email us at info@luwanaplc.com or visit our website at www.luwanaplc.com

On 5 June 2021, an initial meeting between the Managing Partner and the Finance Director of Luwana Plc was held. The notes from the meeting are given below:

Notes from the meeting with the Finance Director

Luwana Plc has a fleet of three hundred (300) trucks and buys fuel in bulk from local dealers who are relatively cheaper.

While auditing fuel receipts and consumption over the past two (2) months, the Internal Auditors discovered huge variances and suspected fake goods received notes (GRNs). Immediately, this was reported to the Finance Director and the Managing Director.

The company does not want to use Lande & Co. for ethical reasons, but has asked the firm to assist in the selection process.

Teya Ltd

Teya Ltd is not an audit client of Lande & Co. The Directors believe that the company is financially stressed and have obtained the required approvals for business rescue proceedings. This followed intense consultations with shareholders, Government Officials and other key stakeholders. The Managing Partner has been appointed as a Business Rescue Administrator, although he is yet to accept the appointment. The Managing Partner is a fellow of the Zambia Institute of Chartered Accountants (ZiCA) and has twenty (20) years experience in accountancy, audit and finance.

The following information has been provided:

Years ending 30 June	**2021**	**2020**	**2019**	**2018**	**2017**
ROCE	5%	2%	1%	6%	10%
Current ratio	0.1:1	0.7:1	1:1	3:1	4:1
Debt/Equity ratio	60%	50%	40%	30%	30%

Suppliers and employees have not been paid for two (2), while value added tax (VAT) and pay as you earn (PAYE) have not been paid for one (1) month. The Finance Director resigned three (3) years ago and the company has failed to keep proper books of account.

The Union Officials have threatened legal proceedings in order to stop the process as they believe this will greatly disadvantage the employees.

The Directors have requested for independent advice from Lande & Co. on the failure to keep proper books of account, fate of employees and the threat of legal proceedings by the Union Officials.

SECTION A

Required:

(1) Critically analyze the findings contained in the Audit Monitoring Report. (16 marks)

(2) Making particular reference to Lande & Co.:

(a) Discuss how high risk assignments should be managed. (3 marks)

(b) Suggest six (6) possible reasons for the rise in unethical behavior by employees despite having implemented the new code of conduct. (6 marks)

(3) For the financial statement audit of Seya Ltd:

(a) Identify and explain four (4) ethical threats. (4 marks)

(b) Provide a recommendation to address each ethical threat. (4 marks)

(c) Discuss any seven (7) business risks. (7 marks)

(4) Using the information given in respect of Meya Ltd, evaluate each audit response proposed by the Audit Senior in respect of the audit risks identified, and suggest any relevant amendments, where necessary. (10 marks)

[Total: 50 marks]

SECTION B

(5) Using the information given in respect of Luwana Plc:

(a) Identify and explain four (4) key deficiencies of the advertisement. (8 marks)

(b) Discuss whether the Procurement Department should be involved in the tendering process for the appointment of the forensic auditor. (4 marks)

(c) Advise the Managing Partner on any six (6) factors to consider when selecting a forensic auditor. (6 marks)

(6) Using the information given in respect of Teya Ltd:

(a) Assess whether Teya Ltd is insolvent. (8 marks)

(b) Explain what is meant by business rescue proceedings and financially stressed; and advice the Managing Partner whether he is eligible for appointment as a Business Rescue Administrator. (9 marks)

(c) Advise the Directors regarding the:

(i) Meaning of proper books of account and the consequences of failure to keep proper books of account. (5 marks)

(ii) Fate of employees in business rescue proceedings. (4 marks)

(iii) Threat of legal proceedings by the Union Officials. (6 marks)

[Total: 50 marks]

QUESTION TWO

Introduction

Kafeka Accountants is an accountancy firm which is duly registered with the Zambia Institute of Chartered Accountants (ZiCA). It has two (2) offices situated in Lusaka and Kitwe respectively. Its major clients operate in the mining industry.

You are an Audit Manager responsible for the following engagements:

(1) Evaluation of the deficiency letter received from the Zambia Institute of Chartered Accountants (ZiCA).

(2) Audit of the financial statements for Zambezi Ltd for the year ended 31 March 2021.

(3) Audit of the financial statements for Solwezi Mining Plc for the year ended 31 December 2020.

(4) Evaluation of suggested audit opinions for three (3) clients.

Evaluation of the deficiency letter received from the Zambia Institute of Chartered Accountants (ZiCA)

The Zambia Institute of Chartered Accountants (ZiCA) in conjunction with the Financial Intelligence Centre (FIC) recently conducted a motoring exercise at Kafeka Accountants. The findings are in the draft deficiency letter and among the key deficiencies are the following:

- Poor record keeping – The ongoing training for officers and employees of Kafeka Accountants to make them aware of the laws relating to money laundering, the financing of terrorism and any other serious offences, has excluded record keeping because Partners think it will done later.
- Tipping – off offence – Kafeka Accountants, acting as independent professionals, advised a client that a suspicious transaction report was being made in an effort to stop them from engaging in an illegal activity. The Managing Partner thinks there is nothing wrong.
- The Managing Partner appointed a CA Zambia graduate with over five (5) years practical experience as a Compliance Officer but the Financial Intelligence Centre (FIC) considers his appointment as invalid.

The Managing Partner has been assured by the Zambia Institute of Chartered Accountants (ZiCA) and the Financial Intelligence Centre (FIC) that the deficiencies do not border on criminality. You have been requested to prepare briefing notes which will be used to prepare responses to the Zambia Institute of Chartered Accountants (ZiCA) and the Financial Intelligence Centre (FIC).

The Managing Partner thinks the Zambia Institute of Chartered Accountants (ZiCA) is behaving like the Financial intelligence Centre (FIC). He wants to know the duties of the Zambia Institute of Chartered Accountants (ZiCA) as a Supervisory Authority and the possible sanctions which the Zambia Institute of Chartered Accountants (ZiCA) can impose if the above deficiencies remain unresolved.

Audit of the financial statements for Zambezi Ltd

You have received the following email from the Engagement Partner:

To: Audit Manager

From: Engagement Partner

Subject: **Audit of the financial statements for Zambezi Ltd**

I am happy that your audit procedures have proved satisfactory with the exception of audit procedures on the following two (2) matters, which are considered material:

- Share based payment – On 1 April 2020, Zambezi Ltd granted forty (40) share options to each of its one hundred and fifty nine (159) employees. Each grant is conditional upon the employee working for the Zambezi Ltd until 31 March 2025. At the grant date the fair value of each share option is K6. During the year ended 31 March 2021, seven (7) employees left and Zambezi Ltd estimates that a total of 16% of the one hundred and fifty nine (159) employees will leave during the five (5) year period. Management has included an expense and related equity figure in the financial statements.

- Disclosure of directors' emoluments – the following note has been included in the draft financial statements:
  "Administration expenses:

	2020	2019
	K"000	K"000
Staff costs	4,000	3,100
Management fees	3,800	3,200
Directors fees	1,620	760
Depreciation	5,400	4,900
Total	14,820	11,960

The audit team only checked the arithmetic accuracy and obtained management representation letters.

Audit of the financial statements for Solwezi Mining Plc for the year ended 31 December 2020

Solwezi Mining Plc is a company that carries out different mining activities in the Republic of Zambia. These activities cause significant damage to the environment, including deforestation. The company's environmental policies includes setting performance targets for activities such as controlling emissions of noxious substances and limiting use of non-renewable resources.

An expert carried out an environmental audit for Solwezi Mining Plc and the findings have been used as a basis for a material provision for environmental matters recognized in the financial statements for year ended 31 December 2020. The Engagement Partner has advised that an auditor's expert should be engaged for the audit of the provision for environmental matters.

One of the Junior Auditors has told you that it is the first time he is hearing about environmental audit and auditor's expert.

Mwansa Plc

The final audit for the year ended 31 March 2021 is nearing completion and you are reviewing the audit working papers. The draft financial statements recognize total assets of K72 million (2020 – K85 million), revenue of K60 million (2020 – K68 million) and profit before tax of K13 million (2020 – K14 million). The following three (3) issues, which are summarized below, have been brought to your attention:

- A loan of K5 million was taken out on 1 August 2020 to help finance the automation of the production processes. The loan carries an annual interest rate of 6%, with interest payments made annually in arrears. The loan will be repaid in 8 years at a premium of 10%. The Finance Director has used an effective interest rate to allocate the premium over the 8 year life of the loan.
- A contingent asset of K2 million has been recognized as a current asset and as deferred income in the statement of financial position as at 31 March 2021, representing the amount claimed under the insurance policy in respect of the flood which occurred in one of the warehouses on 15 February 2021.
- The current income tax rate is 35% but the directors have used 15% in the computation of deferred tax. This was made into law effective 26 April 2021. The decrease in amount for deferred tax is very material.

The company has various incentives for senior management, including performance bonus based on profitability.

The loan agreement contains a number of conditions.

Evaluation of suggested audit opinions for three (3) clients

As part of your training, the Engagement Partner has requested you to evaluate the suitability of the suggested audit opinions regarding the following clients:

- **Client one** – The client commenced construction of a shopping mall in the year under review. Substantial borrowing costs have been properly capitalized and this is fully explained in the notes to the financial statements.
  The Audit Senior has suggested an unmodified audit report containing an unmodified opinion with an emphasis of matter paragraph.

- **Client two** – The client is a reputable engineering company. The financial statements for the period under review do not disclose the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.
  The Audit Senior has suggested a modified audit report containing a modified pinion in the form of a disclaimer of opinion.

- **Client three** – The client's Board of Directors (BOD) has approved the financial statements and decided that no amendments should be made thereto. However, the financial statements of the client correctly show a loss while the directors' report mentions a small profit figure.
  The Audit Senior has suggested an unmodified audit report containing modified opinion in the form of a qualified opinion.

The Engagement Partner has also asked you to prepare notes on analytical procedures and factors to consider when arriving at an audit opinion which will be included in a training manual for Practical Experience training for CA Zambia graduates.

SECTION A

Required:

(1) Prepare briefing notes to be submitted to the Managing Partner of Kafeka Accountants, in which you:

(a) Explain the duties of the Zambia Institute of Chartered Accountants (ZiCA) as a Supervisory Authority. (4 marks)

(b) State the requirements regarding record keeping. (4 marks)

(c) Evaluate the professional and legal implications of disclosure of the suspected money laundering activity to the client. (7 marks)

(d) State the possible administrative sanctions which can be imposed given that the deficiencies are not criminal. (6 marks)

(e) Advise on the suitability of the individual appointed as a Compliance Officer. (5 marks)

Professional marks available on this question (3 marks)

(2) Using the information given in respect of Zambezi Ltd:

(a) Identify and explain three (3) key financial statement assertions regarding share based payment. (6 marks)

(b) Explain four (4) risks of material misstatement in respect of the share-based payment. (4 marks)

(c) Describe six (6) audit procedures you will carry out to determine whether Zambezi Ltd has correctly accounted for the share-based payment in the financial statements. (6 marks)

(d) State whether the directors' fees are appropriately disclosed in the financial statements of Zambezi Ltd. (5 marks)

[Total: 50 marks]

SECTION B

(3) Using the information given in respect of Solwezi Mining Plc:

(a) Explain clearly what is meant by environmental audit and briefly state the processes involved in an environmental audit for the benefit of the Junior Auditor. (4 marks)

(b) State why it is important for Kafeka Accountants to engage an auditor's expert. (4 marks)

(c) Discuss the matters to be considered in assessing the reliance which can be placed on the work of an auditor's expert. (6 marks)

(4) In undertaking your review of the audit working papers and financial statements of Mwansa Plc for the year ended 31 March 2021, for each of the issues:

(a) Comment on the matters to be considered; and (12 marks)

(b) Explain any two (2) audit evidence you should expect to find during your review. (6 marks)

(5) With reference to the details given regarding the suggested audit opinions for the three (3) clients:

(a) Distinguish the analytical procedures performed at the completion stage and those performed elsewhere in the audit process. (6 marks)

(b) Explain the factors you will consider when forming an audit opinion. (3 marks)

(c) For each client, evaluate the suitability or otherwise of the suggested audit opinions, and make appropriate recommendations where necessary. (9 marks)

[Note: The total marks will be split equally between each client].

[Total: 50 marks]

END OF PAPER

FULL AUDIT COMPETENCE PRACTICE EXAMINATION (CPE)

SOLUTION ONE

SECTION A

(1) **Analysis of the findings contained in the Audit Monitoring Report**

- **Review of the firm** – The firm has no quality control policies and procedures. ISQC 1 *Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements,* requires firms to have quality control policies and procedures. These must be documented and communicated. According to the standard, the objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that:
  - The firm and its personnel comply with professional standards and applicable legal and regulatory requirements
  - Reports issued by the firm or engagement partners are appropriate in the circumstances.

  Lande & Co. has been operating for twelve (12) years and it is totally unacceptable for the firm not to have quality control policies and procedures. It is highly questionable whether the firm and its personnel comply with professional standards and applicable legal and regulatory requirements. If not, then this is highly unethical and must be addressed as a matter of urgency. In addition, the reports may be defective and this could lead to various consequences, including litigation.

  The firm must immediately appoint or recruit an individual or group of individuals to oversee quality in the firm. Such individuals must have:

  - Sufficient and appropriate experience
  - The ability to carry out the job
  - The necessary authority to carry out the job

[Award marks as follows:

½ mark for reference to ISQC1

1 mark for objective

½ mark for unacceptable

1 mark questionable work and/or reports

1 mark for immediate appointment or recruitment]

- **File no. 1** – No management letter was prepared for the client. The note from the Audit Senior is misleading, even if it is correct that a management letter is a by-product of the audit process. ISA 265 *Communicating deficiencies in internal control to those charged with governance and management* gives detailed guidance in this area. Many external auditors produce a management letter (also known as report to management, letter of weakness or letter on internal control) as a by-product of an external audit, listing any deficiencies they have found in systems and making recommendations for improvement. Clients, in general look forward to receiving a management letter from the external auditors. This provides invaluable advice in a number of areas.
  Lande & Co. must have proper policies and procedures on management letters and must not leave this to the audit team.
  The audit programme on the section for subsequent event stated not applicable (N/A). ISA 560 *Subsequent events* provides guidance to auditors in this area. Auditors have a responsibility to review subsequent events before they sign the auditor's report, and may have to take action if they become aware of subsequent events between the date they sign the auditor's report and the date the financial statements are issued. The audit was negligently performed and the competence of the audit team, especially the senior staff is questionable. The firm must ensure competent staff is in charge of all professional engagements.

[Award marks as follows:

½ mark for reference to ISA 265

1 mark for content of management letter

1 mark for client expectation

1 mark for policies and procedures

½ mark for reference to ISA 560

1 mark for negligently performed

1 mark for competent staff]

- **File no**. **2 –** There was no audit engagement letter for the year under review and neither was there any documentation to indicate that the firm and the audit client had agreed the engagement terms. ISSAI 1210 *Agreeing terms for the audit engagement* clearly recognizes that the terms of an audit engagement in the public sector are normally mandated and therefore not subject to requests from, and agreement with, management. It states, however, that the requirements in ISA 210 for an engagement letter, when applied in the public sector context, are useful in establishing an agreed formal undertaking of the respective roles and responsibilities of management and the auditor. In addition, the responsibilities are likely to be broader.

  Hence, an engagement letter should have been prepared. The auditor failed to follow the guidance in ISSAI 1210 may be due to incompetence.

[Award marks as follows:

½ mark for reference to ISSAI 1210/ISA 210

½ mark for legal mandate

1 mark for public sector context

1 mark for incompetence]

- **File no**. **3** – The financial statements was not signed. It is a legal requirement that directors sign financial statements. According to section 252 (1) of Companies Act 2017, the statement of financial position of a company's annual financial statements, to be laid before the company in a general meeting or delivered to the Registrar, shall be signed on behalf of the company by not less than two directors or, where the company has only one director, by that director.

  Section 252 (2) of Companies 2017, states that if the statement of financial position is—

  (a) laid before the company in a general meeting or delivered to the Registrar without being signed as required by this section; or

  (b) not a copy laid or delivered, but is issued, circulated or published without—

  (i) being signed as required by this section; or

  (ii) a copy of the signature or signatures;

  the company and each officer in default commit an offence and are liable, on conviction, to a fine not exceeding one hundred thousand penalty units.

ISA 250 *Consideration of laws and regulations in an audit of financial statements* provides guidance on the auditor's responsibility to consider laws and regulations in an audit of financial statements. Not signing the financial statements could either be intentional or unintentional, which are contrary to the prevailing laws or regulations. The directors may not want to be held accountable. Not signing strictly means the financial statements were not approved by the directors and this could put the auditors in an awkward position, in an event of any legal suits involving the financial statements.
The audit was not conducted as guided by ISA 250.

[Award marks as follows:

½ mark for reference to Companies Act 2017

1 mark for section 252 (1)

1 mark for section 252 (2)

½ mark for reference to ISA 250

1 mark for valid comment on possible legal suit]

(2) **Lande & Co.**

(a) **High risk assignments**

For high risk assignments, Lande & Co. should:

- Develop and implement policies and procedures for closely monitoring such high risk assignments
- For each assignment, the specific risks must be identified and documented
- Assign independent specialists in response to these risks
- Consider commercial reasons by charging a fee which reflect the level of risk or charge a lower fee as a penetration strategy.
- If the risks are too high and there are no commercial reasons for undertaking such an assignment, then it must be rejected.

[Award 1 mark for each valid point – Maximum 3 marks]

(b) **Reasons for rise in unethical behavior**

A code of conduct can set out the firm's expectations; however, merely issuing a code of conduct is not enough. The reasons for the rise in unethical behavior include:

- There was no effective communication carried out to sensitize all employees
- Lack of real commitment of senior management to the code
- Lack of appropriate measures to discourage previous behaviors that conflict with the code
- The code may not be understood by staff due to lack of training
- Some employees perceiving the code as limiting their own earnings and/or restricting their freedom to do their job
- The code may contain unrealistic expectations

It may also be too soon to evaluate the impact of the new conduct and the unethical behavior could be due to other factors unrelated to the new code of conduct.

[Award 1 mark for each valid reason – Maximum 6 marks]

(3) **Seya Ltd**

(a) **Ethical threats and recommendations**

Ethical threats	Explanations	Recommendations
(1) The Annual General Meeting (AGM) will be held on 10 March 2021, and Lande & Co. was only appointed as external auditors of Seya Ltd on 1 November 2020.	This may represent a tight deadline and there is a possibility that Lande & Co. may not perform all audit procedures in order to meet the deadline. This will result in sufficient and appropriate audit evidence not being obtained which would contravene the IESBA code.	If the time is insufficient, Lande & Co. should discuss this with management and those charged with governance. If, this remains unresolved, then Lande & Co. should resign.
(2) Engagement Partner's best friend is the Chairperson of the Audit Committee.	This may create a familiarity threat, especially if the Chairperson lacks integrity. This could impair objectivity. However, since he is a Non-Executive Director (NED), the threat could be insignificant.	No safeguards are required since the threat could be insignificant. However, Lande & Co. should be alert to any indications of unethical behavior by the Chairperson of the Audit Committee.

(3) Audit team members will be provided with free face masks and instant hand sanitizers throughout the audit.	This could give rise to a self-interest threat, which could impair objectivity. Lande & Co. may be obliged to impress Seya Ltd at all costs.	This is likely to be trivial and inconsequential, given that this has become a normal business practice in view of the COVID-19 pandemic. Hence, no safeguard is recommended.
(4) Engagement Partner is diabetic and buys herbal products from Seya Ltd on credit.	Credit purchases may create a serious self-interest threat for the Engagement Partner. Independence and objectivity could be adversely affected. The Engagement Partner could be owing Seya Ltd huge sums of money.	The Engagement Partner must be changed or he must start buying the herbal products for cash.
(5) Lande & Co. conducted training.	Lande & Co. may be faced with self-interest and self-review threats. The amount involved was significant and this could seriously impair objectivity.	Lande & Co. should ensure that those who conducted the training are not part of the audit team. It may also be important to conduct a second partner review.

[Award marks as follows:

½ mark for identification of ethical threat – Maximum 2 marks

1 mark for valid explanation – Maximum 4 marks

1 mark for valid recommendation – Maximum 4 marks]

(c) **Business risks**

- Foreign currency fluctuations – Seya Ltd is a large importer, and is inevitably exposed to the risk of fluctuations in exchange rates. The imports could become too expensive and Seya Ltd may be forced to increase prices, making the products unaffordable.
- Customers – Most of the customers are above the age of 55 years and may not have regular income or insurance to continue buying the products. Revenue and profits may fall due to reduced demand.

- Permits and licenses – If these are not renewed; Seya Ltd will not be in a position to continue in business, especially that Government recently enacted more strict regulatory and compliance requirements.
- Herbal products – These are portable, saleable items at high risk of being stolen, which can have a negative on cash flows
- Employees – Seya Ltd may not be in compliance with the employment laws and other relevant regulations.
- Commission based payments – These may be contrary to labour laws if not structured properly.
- Competition – The smaller companies could merge or go into some strategic alliance in order to offer stiffer competition to Seya Ltd.
- Challenging macro-economic environment – If this continues, Seya Ltd's going concern status could be highly questionable.
- Significant increase in the payables – The suppliers could stop supplies or start demanding advance payments.

[Award 1 mark for each valid business risk – Maximum 7 marks]

(4) **Meya Plc**

Audit responses	Evaluations	Suggested amendments
Revise the reporting deadlines and advise the client accordingly.	This is a management responsibility and it is unlikely that reporting deadlines can be revised by the auditors. This is not an appropriate response to the audit risk.	Discuss with management and those charged with governance the possibility of revising the reporting deadlines. If revision is not possible, consider increasing manpower or resign.
The controls will need to be documented and evaluated. If these are weak the level of substantive testing will need to be increased accordingly.	This response is appropriate, since the approach will depend on the evaluation of the controls.	No amendments suggested.
The company should employ a full time Finance Director in order to strengthen the control environment.	This is a management responsibility and may not even happen immediately. This is not an audit response.	The controls will need to be documented and evaluated. If these are weak the level of substantive testing will need to be increased accordingly.

The audit team must maintain professional skepticism.	Maintenance of professional skepticism is appropriate but may not be adequate on its own.	Obtain and review (or re-perform) covenant calculations to identify any breaches. Assess any likelihood of the bank demanding repayment and the potential impact on the company. The need to avoid breaching the covenants reinforces the audit team's need to maintain professional skepticism in areas that could be manipulated.
Attend inventory count and ensure that obsolete inventory is separated from the rest of the inventory.	The response is appropriate but should include audit procedures regarding valuation of inventory.	Include in the audit response, ensuring that obsolete inventories are valued at net realizable since this is likely to be lower than cost.

[Award marks as follows:

1 mark for each correct evaluation – Maximum 5 marks

1 mark for each correct suggestion – Maximum 5 marks]

SECTION B

(5) **Luwana Plc**

(a) **Evaluation of the contents of the advertisement**

- The advertisement mentions "Chartered Accountants" without including registered with the Zambia Institute of Chartered Accountants (ZiCA). In the Republic of Zambia, before any person engages an accountant to perform any work, they must verify their membership with the Zambia Institute of Chartered Accountants (ZiCA). It is therefore important that the advertisement includes this fact.
- The advertisement mentions submission of detailed proposal but offers no guidance on what should be included in the detailed proposal. The submissions

will not be standard and this will make evaluation of the bids very difficult. The advertisement should provide sufficient guidance on the details to be included in the proposal.

- The advertisement does not mention experience in forensic work. Forensic audit involves the application of financial skills combined with an investigative mentality to suspicions of wrongdoing and other unresolved issues. The normal accounting and auditing skills may not be sufficient for an effective forensic engagement. The experience may include court appearances.
- The advertisement does not mention the issue of references. Referees may provide invaluable information which will be of great help in the selection process.

[Award up to 2 marks for each deficiency – Maximum 8 marks]

(b) **Involvement of the Procurement Department**

The Procurement Department may not have the required technical know-how but can advise on the procedures involved in public procurements even if the matter is sensitive. This could eliminate or minimize future complications, including litigation for bidders who may be aggrieved. If the company is not comfortable with the Procurement Department's involvement, then it can consider outsourcing the procurement services for this assignment.

[Award as follows:

1 mark for no technical know-how

1 mark for advice on procedures

1 mark for future complications

1 mark for outsourcing]

(c) **Factors to consider in the selection of a forensic auditor**

These include:

- Qualifications – this should include membership of an appropriate professional body. In Zambia, Zambia Institute of Chartered Accountants (ZiCA) membership is a must. Specialised training in forensic work is an advantage.

- Experience – having appropriate skill-set for the particular case, given that this could be very challenging.
- Personal skills – these could include interpersonal and communication skills.
- Credibility (Reputation) – having the right credentials is a must.
- Court appearance – it may important to ask the applicant to provide a comprehensive list of attorneys who refer to him. The more experienced the accountant is in court, the greater the chance he will be an asset to the case.
- References – previous clients
- References – legal advisors concerning current or previous litigation
- Availability – Speak with some of the accountant's referral sources about their experiences with the accountant's timeliness
- Cost – this will include the billing arrangements
- Quality of reports – it may be important to ask the accountant to share some sample reports with you (with the identifying information redacted, of course.

[Award 1 mark for each valid point – Maximum 6 marks]

(6) **Teya Ltd**

(a) **Assessment of whether Teya Ltd is insolvent**

According to the Insolvency Act 2017, "insolvent" means having liabilities that exceed the value of assets, having stopped paying debts in the ordinary course of business or being unable to pay them as they fall due. In this case, the required assessment is effectively a "solvency test". The Insolvency Act 2017 states that "solvency test" means a test to determine that:

- a company is able to pay its debts as they become due in the normal course of business; and
- the value of the company's assets is greater than the value of its liabilities, including contingent liabilities;

Assessment of insolvency mainly takes a critical analysis of the assets and liabilities of a company.

The three (3) financial ratios provided indicate that only ROCE is improving. However, the deterioration in the other two (2) financial ratios provided should not in isolation be taken as a sign that the company is insolvent. It is important to note that the financial ratios are calculated on period-end figures and therefore can be distorted by many factors e.g. seasonal factors. A reliable assessment of insolvency requires both financial and non-financial information.

The make-up of current assets and current liabilities is critical when assessing the current ratio. Without any information given on the make-up, industry and nature of business, it is very difficult to judge the company's solvency. Information on quick ratio (acid-test ratio) is also required. This will give an indication of how quickly current assets can be converted into cash.

Teya Ltd seems to be lowly geared since the debt/equity ratio is below 100%. This could have been a significant factor in the approval of the business rescue plan. The Directors should have done a more detailed solvency test.

It is therefore possible that the company is not in imminent danger of failing and as such it may be difficult to conclude that Teya Ltd is insolvent.

[Award marks as follows:

1 mark for "insolvent" definition

1 mark for solvency test

1 mark for valid comment on ROCE

1 mark for valid comment on current ratio

1 mark for valid comment on quick ratio

1 mark for valid comment debt/equity ratio

Up to 2 marks for valid conclusion]

(b) B**usiness rescue proceedings and financial distressed; and eligibility of Managing Partner**

The Insolvency Act 2017, states that "**business rescue proceedings**" means the process of facilitating the rehabilitation of a company that is financially distressed by providing for:

- the temporary supervision of the company and management of its affairs, business and property;
- a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; or

- the development and implementation, if approved in accordance with this Act, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result if the company was to be liquidated.

[Award 1 mark for each valid point – Maximum 3 marks]

The Insolvency Act 2017 states that, "**financially distressed**" means a company is likely to be insolvent within the immediately ensuing six months.

[Award 1 mark]

Section 30 (1) of the Insolvency Act 2017, gives details on **eligibility**. It states that a person may be appointed as a business rescue administrator if that person qualifies to be appointed as a receiver or has other qualification as prescribed.

Section 30 (2) states that accreditation as a business rescue administrator is valid for a period of one year from the date of accreditation and shall be subject to renewal annually.

According to section 9 (1) of the Insolvency Act, an individual is eligible for appointment as a receiver if that individual has been practicing as a chartered accountant or a legal practitioner for a period of at least seven years and is accredited by the Registrar as an insolvency practitioner. (2) An individual who wishes to perform the function of a receiver shall apply for accreditation in the prescribed manner and form and pay the prescribed fee.

Although, the Managing Partner has been practicing as a chartered accountant for a period of at least seven years, he will not be eligible if he is not appropriately accredited.

[Award marks as follows:

1 mark for details under section 30 (1)

1 mark for details under section 30 (2)

1 mark for details under section 9 (1)

1 mark for details under section 9 (2)

1 mark for appropriate advice]

(c) **Proper books of account, fate of employees and threat of legal proceedings**

(i) **Proper books of account** – Section 174. (1) of the Insolvency Act 2017 states that if, on an investigation undertaken in accordance with this Act or where a corporate is wound up, is in receivership or under business rescue proceedings, it is shown that proper books of account were not kept by the company in the period of two years immediately preceding the commencement of the investigation or any such proceedings, every officer in default commits an offence and is liable, on conviction, to a fine not exceeding one hundred thousand penalty units or to imprisonment for a period not exceeding one year, or to both.

Section 174 (2), states that for purposes of this section, proper books of account shall be considered not to have been kept properly, if not kept in a manner that enables the books of account to be conveniently and properly audited, whether or not the company has appointed an auditor.

[Award marks as follows:

Up to 3 marks for details on section 174 (1)

Up to 2 marks for details on section 174 (2)]

(ii) **Fate of employees** – According to section 28 (1) of the Insolvency Act 2017, despite a provision of an agreement to the contrary:

- the employees of the company immediately before the beginning of business rescue proceedings shall, during a company's business rescue proceedings, continue in employment on the same terms and conditions, unless
    - changes occur in the ordinary course of attrition; or
    - the employees and the company, in accordance with applicable labour laws, agree to different terms and conditions; and
- any redundancy or retrenchment of such an employee as specified in the business rescue plan shall be subject to the Constitution, Employment Act and other applicable employment legislation.

[Award up to 2 marks for each relevant point – Maximum 4 marks]

(iii) According to the Insolvency Act 2017, **legal proceeding** shall not be brought, against a company or in relation to any property belonging to the company or lawfully in its possession, during business rescue proceedings, except:

- with the written consent of the business rescue administrator;
- with the leave of the Court and in accordance with any terms and conditions the Court considers suitable in any particular matter related to the business rescue proceedings;
- as a set-off against any claim made by the company in any other legal proceedings, irrespective of whether those proceedings commenced before or after the business rescue proceedings began;
- criminal proceedings against any of the company's directors or officers; or
- proceedings concerning any property or right over which the company exercises the powers of a trustee.

Hence, if any of the exceptions do not apply, the Union Officials may not succeed.

[Award marks as follows:

1 mark for reference to Insolvency Act 2017

1 mark for each exception – Maximum 4 marks

1 mark for valid conclusion]

SOLUTION TWO

SECTION A

(1) **Briefing notes**

To: Managing Partner

From: Audit Manager

Subject: key findings in the deficiency letter

Introduction

These briefing notes explains the duties of the Zambia Institute of Chartered Accountants (ZiCA) as a Supervisory Body, state the legal requirements regarding record keeping, evaluate the professional and legal implications of disclosure of the suspected money laundering activity to the client, state the possible administrative sanctions and advise on the suitability of the individual appointed as a Compliance Officer.

[Award professional marks as follows:

2 marks for format and 1 mark for introduction]

Duties of the Zambia Institute of Chartered Accountants (ZiCA)

Section 36 (1) of the Financial Intelligence Centre Act 2010 states that where a supervisory authority has reasonable grounds to believe that a business transaction indicates that a person has or may have been engaged in money laundering, the financing of terrorism or any other serious offence, it shall disclose, or cause to be disclosed, that information to the Centre.

Section 36 (2) of the Financial Intelligence Centre Act 2010 states that a supervisory authority shall monitor and ensure compliance by reporting entities with their obligations under this Act.

Section 36 (3) of the Financial intelligence Centre Act 2010 states that a supervisory authority may:–

(a)compel the production of any information from reporting entities required for purposes of this Act; and

(b) impose sanctions for any failure by reporting entities to comply with their obligations under this Act.

[Award marks as follows:

1 mark for disclosure to Centre

1 mark for monitor and ensure compliance

1 mark for compel production of any information

1 mark for impose sanctions]

Legal requirements regarding record keeping

Section 22 (1) of the Financial Intelligence Centre Act 2010 states that a reporting entity shall maintain all the books and records with respect to its customers and transactions as set out in subsection (2), and shall ensure that such records and the underlying information are available, on a timely basis, to the Centre.

Section 22 (2) of the Financial Intelligence Centre Act states that the books and records referred to in subsection (1) shall include, as a minimum:—

(a) account files, business correspondence and copies of documents evidencing the identities of customers and beneficial owners obtained in accordance with the provisions of this Act, which shall be maintained for not less than ten years after the business relationship has ended;

(b) records on transactions sufficient to re-construct each individual transaction for both account holders and non account holders, which shall be maintained for not less than ten years from the date of the transaction;

(c) the findings set in writing pursuant to paragraph (c) o f subsection (1) of section twenty-five and related transaction information, which shall be maintained for at least ten years from the date of the transaction; and

(d) copies of all suspicious transaction reports made pursuant to section twenty-nine, including any accompanying documentation, which shall be maintained for at least ten years from the date the report was made.

[Award up to 1 mark for each valid requirement – Maximum 4 marks]

(c) **Professional and legal implications of disclosure of the suspected money laundering activity to the client**

Confidentiality is one of the fundamental principles in the Code of Ethics for Professional Accountants (IESBA code). A member is required to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.

However, section 32 of the Financial Intelligence Centre Act 2010 states that no secrecy or confidentiality provision in any other law shall prevent a reporting entity from fulfilling its obligations under t h i s Act.

Section 33 (1) of the Financial Intelligence Centre Act 2010 states that a reporting entity or any director, partner, officer, principal or employee of the reporting entity shall not disclose to its customer or a third party that a report or any other information concerning suspected money laundering, financing of terrorism or any other serious offence shall be, is being or has been, submitted to the Centre, or that a money laundering, financing of terrorism or any other serious offence investigation is being, or has been, carried out, except in the circumstances set out in subsection (2) or where otherwise required by law to do so.

Section 33 (2) of the Financial Intelligence Centre Act 2010 states that section 33 (1) shall not apply to a disclosure which:

(a) is made to carry out a function that a person has relating to the enforcement of any provision of this Act or of any other law; or

(b) in the case of a legal practitioner or accountant acting as an independent professional, when seeking to dissuade a client from engaging in an illegal activity; that a suspicious transaction report shall be made, is being made or has been made to the Centre.

Section 33 (3) of the Financial Intelligence Centre Act 2010 states that a person who contravenes subsection (1) commits an offence and is liable, upon conviction, to a fine not exceeding five hundred thousand penalty units or to imprisonment for a period not exceeding five years, or to both.

If the Managing Partner acted within the exception under section 33 (2) (b), then he will not be found guilty of the tipping-off offence.

[Award marks as follows:

Up to 2 marks for confidentiality

1 mark for details in section 32

1 mark for each exception under section 33 – Maximum 2 marks

1 mark consequence of contravention

Up to 2 marks for appropriate conclusion]

(d) **Possible administrative sanctions**

According to the Financial Intelligence Centre (Amendment) Act 2016, the Zambia Institute of Chartered Accountants (ZiCA) as a supervisory authority may impose one or more of the following administrative sanctions in addition to an offence under this Act or where a person or reporting entity is in breach of a provision of this Act which is not a criminal offence:

- a caution not to repeat the conduct which led tothe non compliance of any of the provisions of this Act;
- a reprimand;
- a directive to take remedial action or to make specific arrangements;
- the restriction or suspension of certain specified business activities;
- publication of a public notice of any prohibition or requirement imposed by it under this Part and of any rescission or variation thereof, and any such notice may, if the Centre considers necessary, include a statement of the reasons for the prohibition, requirement, variation or rescission; and
- a financial penalty not exceeding one million penalty units.

[Award 1 mark for each valid sanction – Maximum 6 marks]

(e) **Suitability of the individual appointed as a Compliance Officer**

The Financial Intelligence Centre (Amendment) Act 2020 states that a reporting entity shall designate a compliance officer at senior management level to be responsible for the implementation of, and ongoing compliance with this Act by that reporting entity.

It also states that a person shall not be designated as a compliance officer unless that person:

(a) has two years' experience in the field of regulatory compliance;

(b) is not convicted of an offence under this Act or any other written law and sentenced to a term of imprisonment of not less than six months without the option of a fine; and

(c) is certified and approved by the Centre.

It is therefore unlikely that the CA Zambia graduate meets all the stated conditions. The Managing Partner must request more information from the Zambia Institute of Chartered Accountants (ZiCA) or the Financial Intelligence Centre (FIC).

[Award marks as follows:

1 mark for each requirement – Maximum 3 marks

Up to 2 marks for suitable advice]

(2) **Zambezi Ltd**

(a) **Key financial statement assertions regarding share based payment**

- Existence – the scheme-based payment scheme exists
- Completeness – all share-based payment schemes in existence have been disclosed
- Accuracy, valuation and allocation – the expense and related equity figure have been included in the financial statements at appropriate amounts

[Award marks as follows:

1 mark for each identified relevant financial statement assertion – Maximum 3 marks

1 mark for each correct explanation – Maximum 3 marks]

(b) **Risks of material misstatement**

- The model used to assess the fair value of the share options may not comply with IFRS 2 *Share-based payment.*
- The assumptions used in the calculations may not be reasonable
- The calculations of the expense may be incorrect
- Fair value may be measured incorrectly.

[Award 1 mark for each risk – Maximum 4 marks]

(c) **Audit procedures**

- Obtain contractual documentation for the share-based payment scheme and review the specific details
- Check that the model used to estimate fair value is in line with IFRS 2

- Agree management's calculation of the expense amount to the details in the contractual documentation
- Discuss the reasonableness of any assumptions with the directors
- Agree fair value to valuation report
- Check that fair value is calculated at the grant date
- Check disclosures in the draft financial statements

[Award 1 mark for each valid audit procedure – Maximum 6 marks]

(d) **Disclosure of Directors fees**

Section 249. (1) of the Companies Act 2017 states that subject to this section, the annual financial statements of a company shall, in respect of the financial year concerned, state the total amount of:

(a) emoluments paid to, or receivable by, the directors for their services; and

(b) any compensation paid to, or receivable by, the directors or past directors in respect of loss of office.

ISA 250 *Consideration of laws and regulations in an audit of financial statements* requires auditors to obtain sufficient appropriate regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements. Directors' emoluments are material by nature.

IAS 24 *Related party disclosures* gives accounting guidance and requires sufficient disclosure regarding directors' emoluments. ISA 550 *Related parties* gives auditing guidance. Auditors should advise each director of his/her statutory responsibilities regarding the required disclosures.

Zambezi Ltd has disclosed the total directors' fees under administrative expenses and this fall short of the legal and professional requirements mainly because it does not give details regarding each director's fees.

Hence, the directors' fees are not appropriately disclosed in the financial statements of Zambezi Ltd. More details regarding each director's emoluments and other discloseable transactions are needed.

[Award marks as follows:

Up to 2 marks for legal requirement

Up to 2 marks for professional requirement

1 marks for appropriate conclusion]

SECTION B

(3) **Solwezi Mining Plc**

(a) **Environmental audit**

Environmental audits seek to assess how well the organization performs in safeguarding the environment in which it operates, and whether the company complies with its environmental policies.

In general, an environmental audit encompasses three (3) processes:

- Agreeing metrics – determining in what areas targets should be set, and at what level they should be set. This might be influenced by, for instance, the need to meet legal requirements.
- Performance measurement – the measurement of actual performance in terms of the agreed metrics
- Reporting compliance – reporting on the implications of the results for compliance with the targets specified in above.

[Award marks as follows:

1 mark for meaning of environmental audit

1 mark for each process – Maximum 3 marks]

(b) **Auditor's expert**

ISA 620 *Using the work of an auditor's expert* gives defines an auditor's expert as an individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. The professional audit staff of Kafeka Accountants may be highly trained and educated, but their experience and training may be limited to accountancy and audit matters. Hence, it will be important for Kafeka Accountants to employ someone else with expert knowledge in mining to gain sufficient, appropriate audit evidence.

1 mark for reference to ISA 620

1 mark for definition of an auditor's expert

1 mark for lack of knowledge of mining

1 mark for importance of auditor's expert in obtaining sufficient appropriate evidence]

(c) **Relying on an the work of an auditor's expert**

- Independence – Kafeka Accountants must evaluate whether the expert is independent of Solwezi Mining Plc, and so should enquire into whether the expert has any interests or relationships which may threaten independence. Less reliance will be placed on the work of an auditor's expert if independence is questionable.
- Competence – Kafeka Accountants must evaluate the expert's competence e.g. by considering the membership of any relevant professional bodies. Kafeka Accountants will have more confidence in the reliability of the expert's work, if the expert is more experienced.
- Scope of work – Kafeka Accountants should expect the auditor's expert to work within the agreed scope of the work. If the expert deviates from it, then the work may be less reliable to Kafeka Accountants.

[Award up to 2 marks for each valid point – Maximum 6 marks]

(4) **Mwansa Plc**

Issue one – Premium on the loan

(a) Matters to consider

- Materiality – The premium of K500,000 (10% X K5 million) is immaterial to both the statement of financial position and statement of profit or loss at 0.7% of total assets (0.5/72 X 100%) and 4% of profit before tax (0.5/13 X 100%) respectively.
- Risk – Senior Management have an incentive to manipulate the financial statements through fraudulent reporting as their bonus is based on profitability. There is a risk that profit may be overstated.

- Relevant accounting standard – Under IFRS 9 *Financial instruments,* the effective interest rate should be used to allocate the premium over the 8-year life of the loan. The premium is therefore recognized correctly.
- Impact on audit opinion – Since the premium has been correctly recognized, the audit opinion will be unmodified. Since the matter is immaterial, the audit opinion will still be unmodified even the computation of the effective rate is incorrect.

(b) Evidence

- Copy of loan agreement
- Workings for the effective interest

Issue two – Contingent asset

(a) Matters to consider

- Materiality – The contingent asset of K2 million is material to the statement of financial position at 3% of total assets (2/72 X 100%).
- Risk – There is a risk that assets could be overstated, maybe to satisfy a condition in the loan agreement.
- Relevant accounting standard – IAS 37 *Provisions, contingent liabilities and contingent assets* requires an asset to be recognized if it is certain to be received. However, if it is only probable, no asset should be recognized and the insurance claim may be disclosed by way of a note. The question has not provided enough details to assess whether the accounting treatment is correct.
- Impact on audit opinion – This will depend on the additional information to be provided by Management to confirm regarding the certainty of receipt.

(b) Evidence

- Copy of insurance policy
- Correspondence with insurance company

Issue three – Deferred tax

(a) Matters to consider

- Materiality - the question states that the issue is very material.
- Risk – Senior Management have an incentive to manipulate the financial statements through fraudulent financial reporting, as their bonus is based on profit before tax. There is a risk that profit may be overstated. They may want to provide a less figure for deferred tax in order to increase profit.

- Relevant accounting standard – IAS 12 *Income taxes* requires that deferred tax is calculated at a rate of tax that is "substantively enacted" and expected to apply to the period when the deferred tax is to be settled. Substantively enacted generally means that it has been made into law, and this is the case with Mwansa Plc. The accounting treatment is therefore correct.
- Impact on audit opinion – Since the accounting treatment is correct, the audit opinion will be unmodified.

(b) Evidence

- Copy of relevant tax legislation
- Copy of relevant computations

[Award marks as follows:

1 mark for materiality – Maximum 3 marks

1 mark for risk – Maximum 3 marks

1 mark for relevant accounting standard and treatment – Maximum 3 marks

1 mark for impact on audit opinion – Maximum 3 marks

1 mark for each audit evidence – Maximum 6]

(5) **Suggested audit opinions**

(a) ISA 520 *Analytical procedures* give detailed guidance in this area. The analytical procedures performed at the completion stage are no different from those performed elsewhere in the audit process. The only difference is that by this time the auditor should know enough about the client to be able to point to evidence explaining the issues highlighted by the analytical review.

Analytical procedures are a very useful tool at this stage of the audit. They can be used to calculate important accounting ratios, changes in products or customers, price and mix changes, variances, trends in production and sales and variations caused by industry or economic factors. Any significant fluctuations and unexpected relationships must be investigated through inquiries with management and obtaining appropriate audit evidence relevant to **management's responses**, and **performing other audit procedures** considered necessary in the circumstances.

As at other stages, significant fluctuations and unexpected relationships must be investigated and documented.

[Award marks as follows:

1 mark for reference to ISA 520

Up to 2 marks for no difference

1 mark for enough knowledge

1 mark for useful tool

1 mark for investigation of significant fluctuations]

(b) **Factors to consider when forming an audit opinion**

When the auditors have gathered all the evidence required, the audit engagement partner will form the audit opinion as to truth and fairness of the financial statements as a whole.

When forming their opinion, there are some key matters that the auditor must consider. These can be illustrated in the form of three questions:

- Have all the procedures necessary to meet auditing standards and to obtain all the information and explanations necessary for the audit been carried out?
- Have the financial statements been prepared in accordance with the applicable accounting requirements
- Do the financial statements give a true and fair view?

[Award 1 mark for each valid point – Maximum 3 marks]

(c) **Suggested opinions**

- **Client one** – the matter is definitely material since it involves substantial borrowing costs. The question states that the capitalization is proper and therefore there is no misstatement. The suggestion by the Audit Senior for unmodified opinion with an emphasis of matter paragraph could be appropriate. However, the inclusion of an emphasis of matter paragraph does modify the audit report.
- **Client two** – the matter is material especially that it contravenes the requirement of IFRS 15 *Revenue from contracts with customers.* Hence, there is misstatement regarding disclosure. This means the disclaimer of opinion is clearly inappropriate since the evidence is available. A modified report containing

a modified opinion in the form of an adverse opinion could be appropriate especially if the matter is considered pervasive.

- **Client three** – the inconsistency between the financial statement and the directors' report could be considered material given the impact this can have on the users. The qualified opinion is inappropriate since the financial statements are correct. The inconsistency is in the directors' report. In this case, the audit opinion must be unmodified while the misstatement of the other information must appear in the other information section of the audit report. The other information section must be placed immediately after the basis for opinion section, that is, it moves up above the key audit matters.

[Award up to 3 marks for each client – Maximum 9 marks]

END OF SOLUTIONS