



## **COMPETENCE PRACTICE EXAMINATION**

### **AUDIT PRACTISING CERTIFICATE**

**DECEMBER 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<sup>1</sup>/<sub>2</sub> 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.

## **2021 FULL AUDIT COMPETENCE PRACTICE EXAMINATION (CPE)**

### **QUESTION ONE**

#### **Background**

Sitali Accountants was set up in 1985 as a low cost auditing firm operating from one (1) office in Lusaka. It is now one of the largest auditing firms operating in all the ten (10) provinces of the Republic of Zambia.

The firm's founder and Managing Partner, Michael is an aggressive professional accountant ever willing to challenge the Zambia Institute of Chartered Accountants (ZiCA) and competitors wherever they impeded his firm and looking to generate positive publicity for the firm whenever possible.

Michael is now looking to develop a strategy which will secure the firm's growth and development over the next three (3) years. He can see a number of competitors and costs continuing to rise and is now prepared to use CA-Zambia graduates as a cost saving measure. However, the signals for future demand for assurance services are confusing, although much of the increased demand is expected to come from small and medium-sized enterprises who may not afford the fees now charged by Sitali Accountants. There is a suggestion that all future fees be linked to a company's profitability. This pricing model is expected to attract a lot of companies to Sitali Accountants.

Sitali Accountants has already recruited fifty (50) CA-Zambia graduates and they have been posted equitably to all the ten (10) provinces. All the CA-Zambia graduates have no practical work experience.

The firm has received an Audit Monitoring Report from the Practice Review Department of the Zambia Institute of Chartered Accountants (ZiCA). The outcome of the visit has been classified as "**Unsatisfactory**". Michael wants a detailed evaluation of the entire Audit Monitoring Report.

You are a Senior Audit Manager in Sitali Accountants and you are currently responsible for the following assignments:

- (1) Evaluation of the Audit Monitoring Report.
- (2) Mweru Plc – Review of the interim financial information.
- (3) Kariba Ltd – Audit of the financial statements.
- (4) Chambishi Plc – Business advisory services (issue of convertible securities).

(5) Zambezi Ltd – Review of Prospective Financial Information (PFI).

### **Evaluation of the Audit Monitoring Report**

The report contained key findings from the review of the firm and four (4) audit files:

- **Review of the firm** – The firm does not have a clear policy on the Audit Supervisory roles and no one wants the position of Audit Supervisor. It was evident that supervisory jobs had no explicit lines of authority and labour turnover was extremely high. The remaining few Audit Supervisors lacked the required skills and experience. In addition, they were being overworked.
- **File no. 1** – No analytical procedures were carried out. A note from the Audit Supervisor stated that since the client was new there was no need to perform analytical procedures.
- **File no. 2** – The audit programme on the section for going concern stated not applicable (N/A). This client was formed by an Act of Parliament and the Government always provided funds when necessary.
- **File no. 3** – There was no risk assessment conducted given that this is an old client. The Audit Supervisor stated that the audit team was informed that there were no major changes by the Chairperson of the Audit Committee.
- **File no. 4** – The audit evidence obtained was not sufficient and appropriate to support the unmodified opinion given.

### **Mweru Plc**

Mweru Plc was listed on the Lusaka Securities Exchange (LuSE) in 2019. The company supplies a variety of recyclable components to the electronic industry. You are planning the review of the interim financial information for the six (6) months ended 30 September 2021. At a recent planning meeting with the Audit Committee, you established the following:

(1) During the period under review, the Finance Director was unable to work due to serious illness. He was admitted to an Isolation Centre at one of the university teaching hospitals, after testing positive for COVID-19. He later developed serious chest pains which adversely affected his respiratory organs. The company had no spare staff able to fulfill the role and hence a qualified auditor of Sitali Accountants was seconded to the Mweru Plc for five (5) months. The Engagement Partner has recommended that the seconded Auditor work on this assignment as he has good knowledge of Mweru Plc and the Audit Committee is in support of this recommendation.

(2) From a review of the correspondence files you note that the Engagement Partner and the Human Resources Director are related in marriage.

(3) In an effort to strengthen the control environment, the board has promised to engage Sitali Accountants to assist with the provision of internal audit services after the review of the interim financial information.

(4) Mweru Plc is very profitable, although the non-executive directors (NEDs) seem to be ineffective in querying the actions of the Chairperson and Chief Executive (CEO).

(5) The Audit Supervisor owns a few shares in Mweru Plc.

(6) The fee for the review of the interim financial information will be based on a percentage of profit after taxation.

(7) The Engagement Partner would like his son, Wesley to be part of the audit team; Wesley is one of the CA-Zambia graduates recruited.

(8) The audit team members will receive free COVID-19 vaccines, which Mweru Plc has bought from one of the chemists.

(9) The nomination committee is headed by the Human Resources Director.

(10) The Audit Committee for Mweru Plc has decided that Sitali Accountants will continue reviewing the interim financial statements for the next ten (10) years.

### **Kariba Ltd**

The audit plan for the audit of the financial statements for the year ended 31 March 2021 is almost complete. You are in charge of the audit of Kariba Ltd, a mining company situated in Siavonga. Sitali Accountants has audited Kariba Ltd for several years. For the first time you decided to use one (1) of the CA-Zambia graduates in risk assessment as part of her practical training. She has correctly identified the following key business risks:

(1) Changes in tax legislation, adjusting the tax rates upwards.

(2) High cost of mining.

(3) New Management.

(4) Deteriorating exchange rate.

The Audit Supervisor has carried out a lot of work on audit risks. He recently joined Sitali Accountants after having worked for a medium-sized auditing firm for four (4) years. The following are some of the audit responses suggested by the Audit Supervisor in respect of the audit risks identified:

Audit risks	Audit responses
(1) Additional overheads have been included in the valuation of inventory. This follows a change in accounting policy which was approved by the board. There is a risk that inventory could be overstated.	Discuss the change in the inventory policy with management and check relevant board minutes for approval. In addition, review additional overheads included to ensure that these are of a production nature.
(2) A generous revenue-related bonus scheme has been introduced in the year. This may lead to fraudulent accounting in respect of revenue recognition.	Management should be advised to stop this generous revenue-related bonus scheme in order to eliminate the material misstatements which will result from fraudulent accounting.
(3) The working capital ratios have significantly deteriorated despite the increase of revenue. This could be evidence of overtrading which could result in going concern difficulties.	Prepare detailed 12 months' forecasts and discuss with management the assumptions used.
(4) There is a risk that Kariba Ltd may fail to comply with the loan covenants, resulting in the loan being recalled. This could then possibly lead to going concern issues.	The audit team must maintain professional skepticism.
(5) 20% of the receivables included in the financial statements could be irrecoverable. Hence, there is a risky that the receivables are understated.	Carry out appropriate confirmation of receivables, using positive confirmation.

**Chambishi Plc**

Chambishi Plc is a medium-sized company. It is a consultancy engineering company that specializes in providing engineering services to the construction industry. The directors are currently considering issuing convertible securities to finance an ambitious expansion programme. However, most of the directors do not understand what is meant by convertible securities and the board has requested Sitali Accountants for independent professional advice.

**Zambezi Ltd**

Zambezi Ltd's profitability and liquidity have been adversely affected by the COVID-19 pandemic. It is currently experiencing difficulties in paying its statutory obligations. However, the directors believe this a temporal phase. The Finance Director of Zambezi Ltd, an audit client, contacted the Managing Partner asking Sitali Accountants to review

the following profit forecast which is required by the Bank in order to support the loan application:

**Profit forecast for the year ended 31 December 2022**

	<b>K</b>
Turnover	7,980,000
Cost of sales	<u>(3,690,000)</u>
Gross profit	4,290,000
Administration costs	(2,520,700)
Selling & distribution costs	(842,300)
Finance cost	<u>(176,800)</u>
Profit before taxation	750,200
Income tax expense	<u>(213,400)</u>
Profit after taxation	<u><u>536,800</u></u>

**SECTION A**

**Required:**

- (1) Critically evaluate the findings contained in the Audit Monitoring Report. (18 marks)
- (2) Making particular reference to Mweru Plc:
  - (a) Discuss five (5) main enquiries which will be relevant when carrying out the review of the interim financial information. (5 marks)
  - (b) Explain the importance of ethical conduct in the review of the interim financial information. (3 marks)
  - (c) Identify and explain, in as much detail as possible, eight (8) ethical threats. (16 marks)
  - (d) Provide a recommendation to address each ethical threat. (8 marks)

**[Total: 50 marks]**

**SECTION B**

(3) Using the information given in respect of Kariba Ltd:

(a) Explain the business risks identified and advise the audit team members on the possible effects of the business risks on the financial statements of Kariba Ltd.

(10 marks)

(b) Evaluate any four (4) audit responses proposed by the Audit Supervisor in respect of the audit risks identified, and suggest any relevant amendments, where necessary.

(8 marks)

(4) Using the information given in respect of Chambishi Plc:

(a) Explain, for the benefit of the directors, what is meant by convertible securities and explain why they may be used.

(3 marks)

(b) Advise the directors regarding the basic procedures to be taken when issuing convertible securities using appropriate legislation.

(6 marks)

(c) Recommend four (4) audit procedures which could be performed in respect of the valuation of convertible securities.

(8 marks)

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

(a) Describe six (6) relevant procedures to be carried out by your firm when assessing the given profit forecast.

(12 marks)

(b) Suggest appropriate action(s) your firm should take if the profit forecast contains unrealistic assumptions.

(3 marks)

**[Total: 50 marks]**

## **QUESTION TWO**

## **Introduction**

Serenje Associates is a new accountancy firm which has just been registered with the Zambia Institute of Chartered Accountants (ZiCA). The firm has completed developing the quality control policy. It now intends to conduct training for staff regarding the requirements of the Financial Intelligence Centre (FIC) Act.

You were recently recruited as an Audit Manager, and you are responsible for the following engagements:

- (1) Review of guidelines developed for the Ministry of Health government intervention programme.
- (2) Audit of the financial statements for Tiger Ltd for the year ended 31 August 2021.
- (3) Financial Intelligence Centre (FIC) Act training.
- (4) Evaluation of governance structures for Chongwe Zambia Bank
- (5) Audit of the financial statements for Mwandi Ltd.
- (6) Evaluation of suggested audit opinions for five (5) clients.

## **Review of guidelines**

At the beginning of the year 2021, Parliament approved a K20 million relief fund for the Ministry of Health government intervention programme. The programme will run for three (3) years. The following guidelines have been developed:

- Unemployed parents are eligible to receive cash to cover medical bills for their children aged less than 18 years (up to a maximum of four (4) children), at approved hospitals.
- Working parents with lower incomes are also eligible. However, they can only receive certificates which they can exchange for medical services at approved hospitals.
- Most mission hospitals are among the approved hospitals.
- All approved hospitals are required to ensure they carefully screen all health workers, and they provide adequate supervision.
- All approved hospitals face significant legal liability on the basis of 'negligent hiring' or 'negligent supervision'.

Serenje Associates has been engaged by government, through the Ministry of Health to review the guidelines before approving them. Government has been criticized for not protecting the poor and uneducated populations.



## **Audit of the financial statements for Tiger Ltd**

You have received the following email from the Engagement Partner:

**To:** Audit Manager

**From:** Engagement Partner

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

I am happy that following a competitive tender, we have finally gained a new audit client; Tiger Ltd. Tiger Ltd's year-end is 30 November 2021 with a scheduled date to complete the audit of 20 January 2022. The date now is 5 November 2021.

All inventory, sales and purchasing systems are computerized. You should start planning the audit approach for Tiger Ltd. One option you should consider is to re-write our audit software to interrogate the computerized inventory systems as part of inventory valuation testing. However, any computer testing will have to be on a live basis and I hope you are aware that the month of December is a major exam period for our staff.

Tiger Ltd has a significant number of cash and bank transactions. The company also bought more non-current assets in the year under review. The company maintains a non-current asset register.

Regards

## **Financial Intelligence Centre (FIC) Act training**

The Managing Partner wants all members of staff to be reasonably knowledgeable on issues pertaining to money laundering. You are aware that money laundering is the generic term used to describe the process by which criminals disguise the original ownership and control of the proceeds of criminal conduct by making such proceeds appear to have been derived from a legitimate source. Therefore, it is the process of transforming the proceeds of crime into ostensibly legitimate money or other assets.

You recently heard at a workshop jointly organized by ZiCA and FIC that in response to mounting concern over money laundering, the Financial Action Task Force on money laundering (FATF) was established by the G-7 Summit in Paris in 1989 to develop a coordinated international response in order to implement effective anti-money laundering programmes. Formation of Financial Intelligence Units (FIUs) whose role was to monitor,

assess and analyze suspicious transaction reports and contracts was one of the major recommendations.

The Managing Partner has requested you to prepare briefing notes in which you clearly state the risk management systems requirements for reporting entities under the Finance Intelligence Centre (FIC) Act. He has informed you that he will also use the same briefing notes to decide whether to accept an offer which has just been received for Serenje Associates to be auditor for a company owned by a senior government official.

### **Evaluation of governance structures for Chongwe Zambia Bank**

Chongwe Zambia Bank was formed in 2008 and has two (2) branches in Lusaka and one (1) branch in Solwezi. The head office is in Lusaka. It provides a wide range of banking services and holds an appropriate licence.

The board consists of experienced former bank managers of reputable international banks. These are appointed by the majority shareholder of Chongwe Zambia Bank and, given their background, require no induction. The board has several committees which act as an aid to assist the board of directors in discharging its duties and responsibilities more effectively and efficiently. Management is not included on these committees, but is usually invited to provide input on any matter that is of interest to the board.

Over the years, there has been serious arguments among the various stakeholders regarding the above mentioned governance issues. The independent non-executive Chairperson has now engaged your firm to evaluate the governance structures based on the information given above.

### **Mwandi Ltd**

The final audit for the year ended 31 December 2021 is nearing completion and you are **reviewing** the audit working papers. The draft financial statements recognize total assets of K255 million (2020 – K216 million), revenue of K136 million (2020 – K120 million) and profit before tax of K52 million (2020 – K38 million). The following three (3) issues, which are summarized below, have been brought to your attention:

- Audit tests on the valuation of investment property indicate a deficiency in the relevant internal control system used by management to make accounting estimates. There is a potential overstatement regarding the valuation included within the financial statements in the region of K250,000.
- A provision of K7 million has been treated as a contingent liability.
- An impairment loss on a non-current asset of K1 million has been written off against profit or loss for the year.

## Evaluation of suggested audit opinions for five (5) clients

As part of your training, the Engagement Partner has requested you to evaluate the suitability of the suggested audit opinions regarding the following five (5) clients:

- **Client one** – The client reclassified research costs as administrative expenses rather than its previous classification as cost of sales. They believe this classification will ensure the information in the financial statements is more reliable and relevant. This has been treated as a change in accounting policy. The amount involved is material but not pervasive. The Audit Senior has suggested a modified audit report containing an unmodified opinion with an emphasis of matter paragraph, since the treatment is acceptable and the comparative results have been correctly restated.
- **Client two** – The client is a subsidiary of a multinational company. The parent company has provided a comfort letter in support of the client's going concern status. The Audit Senior has suggested an unmodified audit report containing a unmodified opinion.
- **Client three** – The client has strong controls in place to ensure that all liabilities are recorded. The Auditor responsible for the audit of payables sent confirmation letters to suppliers with large balances. Some suppliers disputed the amounts and the reasons given were verified as correct by the Auditor. However, the directors have refused to make the required adjustments. The total amount of the understatement is immaterial. The Audit Senior has suggested a modified audit report containing a modified opinion in the form of a qualified opinion.
- **Client four** – The client's legal advisor has not replied to a request for information on a pending legal case. The Audit Senior has obtained sufficient appropriate audit evidence on the operating effectiveness of the relevant controls and has assessed the risk of material misstatement as low and obtained alternative advice from the firm's legal advisor. The Audit Senior has proposed an unmodified audit report containing a modified opinion in the form of a disclaimer of opinion.
- **Client five** – During the audit of non-current assets, one of the company's motor cars was found to be located at the house of one of directors. This motor car has been included in the non-current assets balance in the statement of financial position. The audit team was unable to obtain sufficient appropriate audit

evidence. Informal enquiries indicated that the motor car was used by the wife to the director. The Audit Senior has proposed a modified audit report containing a modified opinion in the form of an adverse opinion.

One of the Junior Auditors is interested in knowing how an auditor critically appraises an audit opinion and when it is necessary to critically appraise an audit opinion.

## **SECTION A**

### **Required:**

(1) Using the information in respect of the guidelines developed for the Ministry of Health government intervention programme:

(a) Explain six (6) main risks associated with the programme. (12 marks)

(b) For each of the risks identified in (a) above, recommend appropriate controls which can be introduced to mitigate the risks. (6 marks)

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

(a) Explain five (5) problems that may be encountered in the audit of Tiger Ltd and for each problem, explain how that problem could be overcome. (10 marks)

(b) Explain the procedures to obtain a bank report for audit purposes from the company's bank. (4 marks)

(c) Describe two (2) audit procedures you will carry out to determine whether non-current assets in the financial statements exist. (4 marks)

(3) Prepare briefing notes to the Managing Partner in which you clearly state the basic risk management systems requirements for reporting entities under the Finance Intelligence Centre (FIC) Act, and how the offer from the company owned by a senior government official should be handled. (10 marks)

Professional marks available on this question (4 marks)

**[Total: 50 marks]**

## **SECTION B**

(4) Evaluate the governance structures for Chongwe Zambia Bank, based on the information given. (9 marks)

(5) In undertaking your review of the audit working papers and financial statements of Mwandi Ltd for the year ended 31 December 2021, for each of the issues:

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

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

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

(a) Explain, for the benefit of the Junior Auditor, how an auditor critically appraises an audit opinion and when it is necessary to critically appraise an audit opinion. (8 marks)

(b) For each client, evaluate the suitability or otherwise of the suggested audit opinions, and make appropriate recommendations where necessary. (15 marks)

**[Total: 50 marks]**

**END OF PAPER**