COMPETENCE PRACTICE EXAMINATION

AUDIT PRACTISING CERTIFICATE

DECEMBER 2022

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.

2022 FULL AUDIT COMPETENCE PRACTICE EXAMINATION (CPE)

QUESTION ONE

Introduction

Pasuka & Co. is a medium-sized accountancy firm which is duly registered with the Zambia Institute of Chartered Accountants (ZiCA). Pasuka & Co. mainly performs auditing, business advisory and accounting services. For the past four (4) years, the Finance and Administration Manager has been reporting that profits were declining. In the year 2019, Senior Management announced stringent cost reduction measures.

You are an Audit Manager in Pasuka & Co. and you are currently responsible for the following assignments:

(1) Evaluation of the ZiCA Audit Monitoring Report and Exam Malpractice.

(2) Apple Plc – Audit of the financial statements.

(3) Luyando Mining Ltd – Preparation of the financial statements.

(4) Buyantashi Multi-purpose Co-operative (BMC) – Advisory services.

Evaluation of the ZiCA Audit Monitoring Report and Exam Malpractice

The report contained the following key findings:

- **Review of the firm** – As part of the stringent cost reduction measures, the firm's training programmes for audit staff were suspended indefinitely. The manual which the audit staff currently uses for guidance on quality matters was last updated in the year 2018.
- **File no. 1** – The audit plan was reviewed by the Audit Senior, who is considered to be more than capable. He recently wrote his full audit competence practice examination (CPE) and is expected to pass.
- **File no. 2** – The audit plan on the section for "NOCLAR" stated not applicable (N/A) – Management responsibility.
- **File no**. **3 –** Revenue recognized in the statement of profit or loss was only audited using analytical procedures.
- **File no**. **4** – The only audit evidence obtained on related parties was management representation. There is a note from the Audit Senior that stated that related parties were difficult to identify.
- **File no. 5** – The audit report includes a paragraph which states that the report is not to be relied upon by any third party.

You are responsible for answering technical queries from other managers and partners in Pasuka & Co. The Staff Partner left the following note on your desk this morning:

"A complaint has been received from a whistleblower against one (1) of our Junior Auditors that he was found with foreign material during the just ended Zambia Institute of Chartered Accountants (ZiCA) examinations. I assume this does not mean professional misconduct, so kindly guide me on the way forward".

Apple Plc

Apple Plc obtained a listing on the Lusaka Securities Exchange (LuSE) on 1 January 2022. The company has been known for offering unparallel clearing and forwarding services. The company currently has six (6) offices: Lusaka (Head office), five (5) offices are situated in the major border towns of the Republic of Zambia. This allows the company to swiftly process all transactions.

You are planning the audit of the financial statements for the year ended 31 December 2022. At a recent planning meeting with the Audit Committee and the Finance Director, you established the following:

(1) A new issue of shares is planned for September 2023 to finance construction of modern offices and warehouses in Kasumbalesa and Mwami. For this reason, management would like the audit completed by 6 February 2023.

(2) During the period under review, Apple Plc received notice from the Zambia Revenue Authority (ZRA) that it is under investigation for tax evasion. If it is found guilty, significant financial penalties will be imposed on Apple Plc. In the worst case scenario, the operating licence could be withdrawn. Based on previous engagements with the Commissioner-General (CG) regarding similar investigations, management has recognized an expense of K2 million in the draft statement of profit or loss and has included a liability for the same amount in the draft statement of financial position. This is based on a repayment schedule of equal annual instalments over the next four (4) years. Management is confident that the company will be permitted to negotiate a time to pay agreement.

(3) Apple Plc has bonded warehouses which store clients' non-perishable items of inventory. Due to new customs and excise regulation, mainly as a result of the COVID-19 pandemic, each bonded warehouse is required to undergo a major health and safety inspection every three (3) years. All bonded warehouses were inspected in January 2022, at a cost of K16,500 for each inspection.

(4) The company is experiencing staff shortages and an Audit Senior from Pasuka & Co. has been seconded to Apple Plc for a period of four (4) months.

(5) Fifty-fifty percent (50%) of the audit fees for last year are still outstanding. The Finance Director has promised that this will be settled next week.

(6) In the year 2022, the company has lost twenty percent (20%) of its market share to its competitors, who have invested significantly in IT infrastructure. Unlike Apple Plc, competitors are now in a position to track clients' products more efficiently and this has impressed most of clients.

(7) Apple Plc is urgently considering the upgrade of its IT infrastructure and has suggested that Pasuka & Co. consider providing finance, in the form of a 12% Debenture, redeemable at a premium of 11%.

(8) On 31 December 2022, the Head of Corporate Planning resigned and this has had a knock on effect on strategic planning processes in the company. A replacement is scheduled to start work on 1 August 2023.

(9) Apple Plc has a policy of importing all spare parts for its fleet of vehicles and office equipment. This is meant to ensure that only genuine spare parts are bought and any unnecessary downtime is significantly reduced.

Luyando Mining Ltd

Pasuka & Co. is preparing the financial statements for Luyando Mining Ltd for the year ended 30 June 2022. Luyando Mining Ltd, an exporter of high grade copper, is a non-audit client. The Accountant-in Charge (AIC) has asked for advice on the following:

(1) Management has requested that additional line items, headings and subtotals be included in the financial statements.

(2) Proposed accounting treatments for each matter stated below:

- Management has proposed to capitalize as part of property, plant and equipment, licence costs paid in connection with a right to mine copper in an allocated area.

- Immediately prior to the year end, the company sold land to a third party at a price of K6 million with an option to purchase the land back on 1 September 2022 for K6 million plus a premium of 5%. The market value of the land is K9 million and the carrying amount was K4 million. Management has proposed to treat this as a sale, hence, eliminating the bank overdraft at the period-end.
- On 1 June 2022, the company defaulted on an interest payment on a bank loan of K5 million repayable in 2026. The loan agreement stipulates that such default leads to an obligation to repay the whole of the loan immediately, including accrued interest and expenses. Management immediately requested the bank to

provide a period of grace, citing the COVID-19 pandemic as the main reason for the default. On 8 July 2022, the bank issued a waiver postponing the interest payment until 31 December 2022. Management has proposed to treat the bond as a non-current liability.

(3) On 31 July 2022, the board proposed a dividend of K2 per share for the year ended 30 June 2022. The shareholders will approve the dividend along with the financial statements at the general meeting on 31 October 2022 and the dividend will be paid on 30 November 2022. Management has proposed the inclusion in the financial statements of the following note:

"Dividend distributions to the Company's shareholders are recognised as a liability in the financial statements in the year in which the dividends are approved by the Company's shareholders at a general meeting."

Buyantashi Multi-purpose Co-operative (BMC)

Buyantashi Multi-purpose Co-operative (BMC) is situated in a rural area which attained district status in the year 2016. The Government completed building a multi-million Kwacha water reservoir (dam) in the district on 30 November 2021. BMC, which is a profit-making entity, was formed on 1 January 2022 and is responsible for managing and maintaining the dam and works in conjunction with the Department of Water Resources Development. All customers are required to make payments in advance.

The dam is used for fish rearing (the dam has the capacity for 45,000 fish fingerlings), farming (promote irrigation farming so that crops are grown throughout the year), animal rearing (source of water for animals) and source of clean water for the community.

All co-operatives are regulated by the Government through the Ministry of Agriculture. BMC has a membership of three hundred (300) and the Board of Trustees (BOT) oversees the operations of the co-operative. You have discovered that the district is one of the strongholds for the main opposition party.

The Paramount Chief has significant interests in BMC and has power to appoint sixty percent (60%) of the trustees. The Paramount Chief is entitled to ten (10%) of the sales and there is an agreement to pay senior managers bonuses based on meeting gross profit margin of at least twenty percent (20%). The constitution of BMC requires the trustees to approve the bonuses before being disbursed to the senior managers. The Minister of Agriculture had raised serious concerns over the said bonuses when the co-operative was being registered.

BMC uses accrual basis International Public Sector Accounting Standards (IPSAS). Pasuka & Co. provides various business and financial advisory services to BMC and was instrumental in its registration. Pasuka & Co. has been engaged by the trustees to:

(1) Review the following extract from the draft financial statements of BMC for the fish segment which currently accounts for 80% of the total income:

Period ended 31.12.2022

	Actual	**Budget**
	K'000	**K'000**
Sales	16,000	8,000
Cost of sales	(12,000)	(6,400)
Gross profit	4,000	1,600

The trustees suspect the gross profit is overstated while senior management is of the view that the figures are correct. You recently met with the Minister of Agriculture at a social gathering and he said that he was aware of this conflict and the review which is due to start. He was confident that Pasuka & Co. will do a good job. The Finance Director (FD) of BMC is a member of the local traditional council. He is a CA Zambia graduate with over eight (8) years practical experience.

(2) Advise management on the auditing issues which external auditors are likely to consider in the audit of a government grant which BMC obtained in the sum of K200,000 towards the procurement and installation of an irrigation system worth K350,000. BMC is audited by the National Audit Office.

The intention of the grant, according to the Chief Executive Officer (CEO) was to support small scale farmers within the district and create jobs in the district since there is significant unemployment.

The Accountant-in-Charge (AIC) for this engagement has been shortlisted for the position of District Commissioner (DC) and has requested the District Executive Committee of the ruling party to support his candidature.

SECTION A

Required:

(1) Critically evaluate the findings contained in the Audit Monitoring Report. (19 marks)

(2) With reference to appropriate legislation and the exam malpractice:

(a) State what is meant by professional misconduct. (3 marks)

(b) Explain whether the exam malpractice may be considered to be professional misconduct and suggest any steps that may be taken now by Pasuka & Co. (5 marks)

(3) Making particular reference to Apple Plc:

(a) Discuss the importance of carrying out a risk assessment. (3 marks)

(b) Identify and evaluate eight (8) audit risks. (12 marks)

(c) Recommend appropriate responses for each audit risk identified. (8 marks)

[Total: 50 Marks]

SECTION B

(4) Using the information given in respect of Luyando Mining Ltd:

(a) Explain the professional guidance regarding additional line items, headings and subtotals. (5 marks)

(b) Evaluate the proposed accounting treatments for each matter. (15 marks)

(c) Discuss whether you feel the proposed accounting note to be included in the financial statements is appropriate. (3 marks)

(5) Using the details in respect of Buyantashi Multi-purpose Co-operative (BMC):

(a) Identify and explain four (4) ethical and professional issues raised and suggest appropriate safeguards. (12 marks)

(b) Explain the possible reasons for any overstatement of gross profit and suggest one (1) procedure to be performed for each reason. (9 marks)

(c) Explain six (6) audit issues to consider in the audit of the grant. (6 marks)

[Total: 50 Marks]

QUESTION TWO

Introduction

Messrs Old & Young Associates is an old accountancy firm which was registered with the Zambia Institute of Chartered Accountants (ZiCA) in the year 1986. Messrs Old & Young meets all the requirements of the Anti-money laundering/countering terrorism and proliferation financing (AML/CTPF) legal framework in Zambia.

You are an Audit Manager, and you are responsible for the following engagements:

(1) Anti-money laundering/countering terrorism and proliferation financing (AML/CTPF).

(2) Audit of the financial statements for Lake Ltd.

(3) Review of the CSR report for Swamp Plc.

(4) Audit of the financial statements for River Plc for the year ended 31 August 2021.

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

Anti-money laundering/countering terrorism and proliferation financing (AML/CTPF)

The Managing Partner of Messrs Old & Young Associates is concerned with the level of ignorance in respect of AML/CTPF matters. He has directed you to:

(1) Prepare briefing notes on AML/CTPF matters which will be used at the next staff meeting.

(2) Provide guidance to the Accountant-in-Charge (AIC) of the engagement involving Kafue Ltd. Kafue Ltd is a private limited company which sells secondhand vehicles. Messrs Old & Young Associates provides bookkeeping and treasury services to Kafue Ltd. The directors for Kafue Ltd have directed the AIC to make a payment of $700,000 from the company's bank account by electronic transfer to an overseas supplier. However, they want the narration on the electronic transfer documents to state that this transaction is a loan repayment. This will enable the exporter to avoid the tax liability which could arise given that the country has no double taxation agreement with the Republic of Zambia.

You are aware that the Zambia Institute of Chartered Accountants (ZiCA), in consultation with various enforcement agencies has issued elaborate guidelines on Anti-money laundering/countering terrorism and proliferation financing (AML/CTPF).

Lake Ltd

The financial statement audit for Lake Ltd for the year ended 30 September 2022 is almost complete and you are currently reviewing the following summary of material matters, prepared by the Audit Senior for your consideration:

(1) Lake Ltd is involved in a court case with the former Managing Director (MD) for constructive dismissal. The evidence obtained is a written confirmation from Lake Ltd's lawyers. A brief note has been put into the audit working papers stating that in management's opinion supported by legal advice from the company's lawyer, the accounting treatment not to make any provision regarding this case is correct and no further audit work is necessary.

(2) The audit team reliably inspected a sample of Lake Ltd's non-current assets and agreed the findings to the non-current assets register. A few misstatements were identified and these were discussed with management. A manual journal to correct the identified misstatements was prepared by the Financial Accountant and it was arithmetically checked by a Junior Auditor. The audit team has concluded that non-current assets are fairly stated.

(3) Since Messrs Old & Young Associates also provides tax services to Lake Ltd, the audit team consulted the tax department for the firm as to the company's future tax plans, to ascertain whether they expect a deferred tax liability to arise. This assisted analytical procedures which were carried out on deferred tax provision.

(4) On 5 October 2022, one (1) of the customers with a balance of K200,000 as at 30 Septembers 2022, was dissolved by the courts of law and this matter was discussed with the management of Lake Ltd. The liquidator has verbally assured management that 60% of the outstanding amount will be paid and hence only 40% has been written off. The audit team noted the details and has updated the working papers on the current audit file.

(5) Management has provided a written representation to confirm that capitalized development costs are technically feasible and no further audit procedures on technical feasibility have been performed.

Swamp Plc

Messrs Old & Young Associates has been engaged to perform an assurance engagement on Swamp Plc's corporate social responsibility (CSR) report. Swamp Plc is not an audit client.

You recently attended a four (4)-week intensive specialized course on social and environmental assurance in the United Kingdom (UK). The Managing Partner has given you responsibility to ensure that the assurance is competently conducted.

The following comment was made by the Finance Director (FD) in relation to the assurance on the CSR report:

"I am hoping the assurance report on the CSR report will impress the various stakeholders, especially the shareholders and potential investors. The company is spending huge sums of money".

An extract from the draft CSR report is shown below.

CSR objective	CSR target	Performance in 2022
(1) Support primary healthcare, maternal and childcare and HIV/AIDS education, treatment and care.	Make direct charitable cash donations to local primary healthcare providers.	Charitable donations in the sum of K1.4 million were made directly to local healthcare providers.
(2) Continue to support the staff development fellow (SDF) programme at the University of Zambia.	Offer full sponsorship to at least two (2) lecturers on the staff development fellow (SDF) programme.	K1.6 million was spent on the staff development fellow (SDF) programme for three (3) lecturers.
(3) Promote a safe working environment in all company's operations.	Reduce employee fatalities in work-related incidents to zero.	K4 million was spent on various health and safety matters and there were no fatalities.
(4) Assist in the provision of various community services.	Allowing employees paid time off to provide community services.	1,800 man hours were used by various employees to provide community services and the total cost to the company was K2,860,100.

River Plc

River Plc is the sole national distributor of industrial and domestic cleaning products, manufactured by Business Queens Plc. It is a long standing audit client of Messrs Old & Young Associates.

The audit of River Plc's financial statements for the year ended 31 December 2022, is nearly complete, and the audit report is due to be issued after next week. The final draft financial statements recognize profit before tax of K8 million (2021 – K6 million), and total assets of K76 million (2021 – K52 million)

The Audit Senior has given you a schedule of proposed adjustments to uncorrected misstatements included in River Plc's audit working papers shown below, including notes to explain each matter included in the schedule. The Engagement Partner is holding a meeting with management tomorrow, at which the uncorrected misstatements will be discussed. He wants you to review the schedule and advise him on the matters to consider.

	Statement of profit or loss		Statement of financial position	
Proposed adjustments to	Debit	Credit	Debit	Credit
uncorrected misstatements:	K	K	K	K
1. Borrowing cost		250,000	250,000	
2. Contingent asset		75,000	75,000	
3. Change in fair value		320,000	320,000	
4. Depreciation	50,000			50,000
Totals	50,000	645,000	645,000	50,000

Notes

1. Management has recognized the borrowing cost as an expense in the financial statements during periods when substantial technical work was taking place. However, the audit conclusion is that the borrowing cost should be capitalised.

2. Management has failed to recognize a contingent asset representing the amount claimed under the company's insurance policy in respect of damage to office equipment caused by floods. Documentation show that receipt of the insurance proceeds is virtually certain.

3. Management has incorrectly taken the change in fair value on investment property to equity.

4. It was discovered that depreciation was omitted on one of the company's new delivery van.

Evaluation of suggested audit opinions for five (5) clients

Assume the financial statements for all clients are for the year ended 31 December 2022 and that management for each client is not willing to amend the financial statements. The Quality Control Review Partner has requested you to evaluate the suitability of the suggested audit opinions regarding the following clients:

- **Client one** – This is a Government Business Enterprise (GBE), which uses International Financial Reporting Standards (IFRS) in the preparation of financial statements. Management has included a loan of K53,425 to the Chief Executive Officer (CEO) in cash and cash equivalents as it is repayable on demand. The Audit Senior has suggested an unmodified audit opinion.

- **Client two** – The draft financial statements show a profit before tax of K1 million (2021:K3 million) and total assets of K19 million (2021:K15 million). Non-current assets include financial assets recognized at K2 million. A note to the financial statements describes these financial assets as investments classified as at 'fair value', and the investments are described in the note as 'held for trading'. The investments are all shares in listed companies. A gain of K600,000 has been recognized in net profit in respect of the revaluation of these investments. The Audit Senior has suggested an adverse audit opinion.

- **Client three** – The client is a public sector company based in a country where the cumulative inflation rate has averaged 140% over the past three years. It prepares its financial statements under accruals basis International Public Sector Accounting Standards (IPSAS). The gain on restatement of the net monetary position has not been included in surplus and disclosed separately in the financial statements. The Audit Senior has suggested a disclaimer of opinion.

- **Client four** – A major customer with a very material balance has not replied to the receivables' confirmation letter. The receivables population mainly consists of a large number of small, homogeneous account balances and a very low exception rate is expected. 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. The Audit Senior is not aware of circumstances or conditions that would cause customers to disregard the requests. The Audit Senior has suggested a qualified audit opinion supported by an emphasis of matter paragraph.

- **Client five** –Management has recognized an immaterial deferred tax asset in respect of the tax loss. Forecasts indicate that the client will continue making tax losses for the next six (6) years. The Audit Senior wants this to be included in the key audit matter section and has suggested an unmodified audit opinion.

SECTION A

Required:

(1) Prepare briefing notes for the training session clearly explaining the following:

(a) Money laundering, terrorist financing and proliferation financing. (9 marks)

(b) Four (4) services in the Accounting and Audit Sector which are vulnerable to abuse by criminals. (2 marks)

(c) The AML/CTPF legal framework in Zambia. (4 marks)

(2) Advise the Audit Senior on the actions to take regarding the transaction in Kafue Ltd. (9 marks)

(3) Using details provided in Lake Ltd, comment on the sufficiency and appropriateness of the audit evidence obtained, and recommend two (2) further audit procedures for each matter to be performed by the audit team. (20 marks)

(4) Describe one (1) procedure you will carry out on the performance data for each CSR objective. (6 marks)

[Total: 50 Marks]

SECTION B

(5) Making particular reference to the information given in respect of River Plc:

(a) Explain the matters which should be discussed with management in relation to *each* of the uncorrected misstatements and clearly explain the impact on the financial statements *NOT* the impact on audit report. (16 marks)

(b) For each uncorrected misstatement, state any two (2) audit evidence you should expect to find during your review. (4 marks)

(c) Using an appropriate auditing standard, advise the Engagement Partner whether he should request management to adjust the financial statements. (6 marks)

(6) Evaluate the suitability or otherwise of the suggested audit opinions, and make appropriate recommendations where necessary. (24 marks)

[Total: 50 Marks]

END OF PAPER

2022 FULL AUDIT COMPETENCE PRACTICE EXAMINATION (CPE)

<u>SOLUTION ONE</u>

<u>SECTION A</u>

(1) Evaluation of the findings contained in the Audit Monitoring Report

- **Review of the firm** – In 2019, the firm's training programmes for audit staff were suspended indefinitely due to poor business. All businesses, including audit firms need to be profitable in order to survive. Hence, the identification of areas of expenditure where savings can be made is important.

  However, suspension of training programmes for audit staff in an audit firm is definitely inappropriate given the dynamic nature of the auditing profession. The audit firm should immediately restore training programmes and look for savings in other areas of expenditure. In fact, some training programmes are required by law, regulation and the profession e.g. training on money laundering matters.

  The manual which the audit staff currently uses for guidance on quality matters was last updated in the year 2018. It is important to note that towards the end of 2020, the IAASB issued two new quality management standards (ISQM 1 and ISQM 2) and a revision of ISA 220. This means the manual is non-complaint with the new quality management standards. The aim of the project was to 'raise the bar' for quality management across the profession. The project took place against the backdrop of high-profile audit failures, and the need to ensure that audits are conducted to the required standard of quality in order to restore public trust in the profession. Hence, the manual must updated immediately to ensure compliance with the new quality management standards.

[Award marks as follows:

½ mark for business decision

½ mark for suspension inappropriate

Up to 2 marks for new quality management standards

1 mark for valid conclusion]

- **File no. 1** – The audit plan was reviewed by the Audit Senior who has not yet passed the full audit competence practice examination (CPE). Under ISA 220 *Quality Management for an Audit of Financial Statements*, the Engagement Partner must take overall responsibility for the audit quality.

It is not appropriate for the Audit Senior to review the audit plan as he may not have the required knowledge, skill and experience. The Audit Senior could have prepared the audit plan but the Audit Manager and the Engagement Partner should have reviewed the audit plan.
It is therefore possible that the audit plan was not sufficient enough to ensure the audit was completed adequately and competently. This could have led to inappropriate audit conclusions being made. It will advisable to seriously review the work performed by the audit team and ensure this does not happen again. Pasuka & Co. must always ensure adherence to the requirements of the auditing standards.

[Award marks as follows:

½ mark for reference to ISA 220

½ mark for inappropriate

1 mark for any possible consequence

1 mark for valid conclusion]

- **File no. 2** – The audit plan on the section for "NOCLAR" stated not applicable (N/A) – Management responsibility. The auditor needs to consider the requirements of ISA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements* and IESBA Code of Ethics. It is management's responsibility to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulation. However, the auditor does have some responsibility, especially where Non-Compliance with Laws and Regulations (NOCLAR) is identified or suspected.

  In addition, the auditor is required by ISA 315 *Identifying and Assessing the Risks of Material Misstatement* to obtain an understanding of the legal and regulatory framework in which the audited entity operates. This will help the auditor to identify NOCLAR and to assess its implications. Therefore, the auditor should obtain a full knowledge and understanding of the laws and regulations relevant and the implications of NOCLAR. Hence, the audit plan clearly misled the audit team.

  ISA 250 requires that when NOCLAR is identified or suspected, the auditor shall obtain an understanding of the nature of the act and of the circumstances in which it has occurred, and further information to evaluate the possible effect on the financial statements. Therefore, procedures should be performed to obtain evidence about the suspected non-compliance, and to identify any further instances of NOCLAR in the client. ISA 250 requires the matter to be discussed with management, and, where appropriate, with those charged with governance. Pasuka & Co. must as a matter of urgency organize an elaborate training programme on auditing standards to avoid such serious lapses in future.

[Award marks as follows:

1 mark for reference to ISA 250

½ mark for reference to IESBA Code of Ethics

½ mark for reference to ISA 315

1 mark for valid conclusion]

- **File no**. **3 –** Revenue recognized in the statement of profit or loss was only audited using analytical procedures. Admittedly, revenue is commonly audited using analytical procedures. This is because revenue should be predictable, and because there are good grounds on which to base analytical procedures, such as:
    - Plenty of information, for example last year's accounts, budgets, monthly analyses (companies tend to keep a lot of information about sales).
    - Logical relationship with items such as inventory and receivables.

  However, analytical procedures may be less reliable where controls' testing indicates that revenue controls are deficient. In addition, ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* states that the auditor should presume that there is a risk of fraud in relation to revenue recognition, and should obtain an understanding of the controls related to these risks. It is clearly evident that this audit was poorly conducted and measures must be put in place to avoid a recurrence.

[Award marks as follows:

1 mark for any reason for use of analytical review

1 mark for deficient controls

½ mark for reference to ISA 240

1 mark for valid conclusion]

- **File no**. **4** – The only audit evidence obtained on related parties was management representation. There is a note from the Audit Senior that stated that related parties were difficult to identify. Although, related parties are difficult to audit, ISA 550 *Related Parties* gives detailed guidance to assist auditors. It is possible that the Audit Senior may be ignorant of the standard's requirements.

ISA 580 *Written Representations* states that a written representation is not of itself sufficient appropriate audit evidence. Therefore further evidence should have been obtained. ISA 550 recommends a number of audit procedures such as reviewing prior year working papers for names of known related parties, reviewing minutes of the shareholders and directors and other relevant statutory records such as the register of director's interests, reviewing accounting records for large or unusual transactions or balances, in particular transactions recognized at or near the end of the financial period etc.

If the auditor is unable to obtain sufficient appropriate audit evidence concerning related parties and transactions with such parties or concludes that their disclosure in the financial statements is not adequate, the auditor should modify the audit report appropriately. In addition, ISA 260 requires that significant difficulties encountered during the audit should be communicated, of which this could be an example.

Pasuka & Co. should re-appraise the competences of its Audit Seniors and those found wanting must be retrained, demoted or dismissed. There is a possibility of the firm being sued for professional negligence.

[Award marks as follows:

½ mark for reference to ISA 550

½ mark for reference to ISA 580

½ mark for reference to ISA 260

1 mark for valid conclusion]

- **File no. 5** – The audit report includes a paragraph which states that the report is not to be relied upon by any third party. This paragraph is an example of a disclaimer. In an increasingly litigious environment, disclaimers may help audit firms, like Pasuka & Co., to manage their risk exposure. There is a danger, however, that the use of disclaimers could have encouraged a low quality audit if the auditor took the disclaimer into account when assessing the audit risk. The auditor might have considered that the use of a disclaimer meant that detection risk was higher, and may not have obtained sufficient appropriate audit evidence. Disclaimers are not a requirement of any auditing standards and therefore have no specifically prescribed content.

In contrast, there should be no need for a disclaimer if the audit is of a high enough quality. Generally, ZiCA discourages the use of liability disclaimer paragraphs, as these could have the effect of devaluing the auditor’s report in the eyes of many. In addition, the effectiveness of a disclaimer will depend on the view which a court may subsequently form of its reasonableness.

Pasuka & Co. should urgently develop appropriate quality management policies and procedures in order to promote quality performance and avoid the unnecessarily use of disclaimers.

[Award marks as follows:

½ mark for disclaimer

½ mark for danger of low quality

1 mark for ZiCA position

1 mark valid conclusion]

(2) Exam Malpractice

(a) **Professional misconduct**

Professional misconduct has the meaning assigned to it under section 72, of the Accountants Act No. 13 of 2008. Section 72 states that a member commits professional misconduct if the member:

- Contravenes the provisions of this Act;
- Unlawfully discloses or uses to the Member’s advantage any information acquired in the course of professional work on behalf of a client;
- Engages in conduct that is dishonest, fraudulent or deceitful;
- Commits an offence under any other law;
- Engages in any conduct that is prejudicial to the accountancy profession or is likely to bring it into disrepute, or

- Breaches the Code of Ethics or the accounting or auditing pronouncements or encourages another member to breach or disregard the principles of the Code of Ethics or accounting or auditing procedures.

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

(b) **Exam Malpractice and steps to take**

Exam Malpractice is against most of the provisions under section 72, especially engaging in conduct that is dishonest, fraudulent or deceitful. Hence, Exam Malpractice is professional misconduct according to the Accountants Act No. 13 of 2008.

The steps to take must be in line with the firm's disciplinary code to avoid Pasuka & Co. being sued for wrongful dismissal. Pasuka & Co. must get more information from the whistleblower and the Zambia Institute of Chartered Accountants (ZiCA). If the allegation is true, then the firm must institute necessary disciplinary proceedings based on the firm's disciplinary code.

There is high chance that the Junior Auditor will be dismissed given that dishonest behavior should not be condoned. It is, however, worth noting that the ZiCA Disciplinary Committee usually orders a three (3) year suspension period for the registration as a student.

[Award marks as follows:

1 mark for Exam Malpractice is professional misconduct

1 mark for getting more information

1 mark for wrongful dismissal

1 mark for necessary disciplinary proceedings

1 mark for possible disciplinary action]

(3) Apple Plc

(a) **Importance of carrying out a risk assessment**

Carrying a risk assessment is important mainly because of the following:

- Auditors are required to carry out risk assessment by ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement.*

- A risk assessment carried out under the ISAs helps the auditor to identify financial statement areas susceptible to a material misstatement (risky areas)
- It provides a basis for designing and performing further audit procedures.
- It helps to minimize detection risk.

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

(b) & (c)

Audit risks	Evaluations	Audit responses
(1) Apple Plc obtained a listing on the Lusaka Securities Exchange (LuSE) on 1 January 2022.	Management may be under significant pressure to report strong financial performance, and the risk of earnings management is high. This can lead to a range of inappropriate accounting treatments including early recognition of revenue and other income and deferral of expenses. Hence, profit and assets may be overstated.	The auditor must apply professional skepticism and focus on and increase testing on judgemental areas in the financial statements such as provisions, revenue recognition, accounting policies etc.
(2) Disclosure for companies listed on the Lusaka Securities Exchange (LuSE)	There is a risk of incomplete or inaccurate disclosures in respect of any listing rules and other regulations.	Obtain listing rules and other regulations and check whether Apple Plc has complied with these.
(3) Planned new issue of shares	Management would like the issue to be a success and may therefore be under pressure to report favourable results. The risk of management manipulation of the accounts is therefore high.	The auditor must apply professional skepticism and focus on and increase testing on judgemental areas in the financial statements such as provisions, revenue recognition, accounting policies etc.
(4) The audit must be completed by 6 February 2023	This represents a tight deadline, given the size of the client. The time pressure will mean that both financial statement risk and detection risk may be high. There is a high	Pasuka & Co. must engage management (and possibly those charged with governance aswell) and agree on an appropriate timetable. If the matter remains unresolved, Pasuka

	scope for errors in the financial reporting processes and failure on the part of the auditors to detect material misstatements either due to fraud or error.	& Co. must consider withdrawing from this engagement.
(5) Investigation for tax evasion	The auditor may have challenges when auditing the provision of K 2 million given that it is based on management's judgement. This difficulty is compounded by IAS 37 *Provisions, Contingent liabilities and Contingent Assets* requirements to measure the provision at present value. The measurement process requires management to predict the payment dates and the discount rate.	Obtain a copy of ZRA's notice and critically review the details. Review the board minutes for evidence of discussion of the provision. Obtain relevant details on previous engagements with the Commissioner-General Discuss with management the need to comply with requirements of IAS 37 *Provisions, Contingent liabilities and Contingent Assets.*
(6) Possibility of withdrawal of operating licence	This has going concern implications for Apple Plc. The auditors may fail to carry out additional procedures on going concern to address this issue. The financial statements could be incorrectly prepared on a going concern basis.	Inspect any latest correspondence with ZRA and discuss the issue with management and those charged with governance. Seek legal advice and obtain written management representations confirming to the best of its knowledge, the going concern status of Apple Plc.
(7) All bonded warehouses were inspected in January 2022, at a cost of K16,500 for each inspection	IAS 16 *Property, Plant and Equipment* require that the cost of the health and safety inspections be capitalised and then depreciated over their useful life. There is a risk that the K16,500 for each inspection has been recognized during the period as an expense in full, understating both	Review the schedule on non-current assets to ensure inspection costs have been included and depreciated accordingly.

	profit and non-current assets.	
(8) Loss of significant market share to its competitors	The loss of significant market share may be an indication of impairment of assets of the company. There is an audit risk that an impairment review has not been conducted or has been conducted wrongly.	Discuss with management regarding the impairment review and ensure all computations are in line with the guidelines given in IAS 36 *Impairment of assets.* Obtain written representations from management regarding the reasonableness of the assumptions used in the calculations.
(9) Foreign exchange transactions – importing all spare parts for its fleet of vehicles and office equipment.	The risk is that an incorrect exchange rate is used for the translation and retranslation, or that retranslation does not happen at the year-end, in which case trade payables and profit could be over-or understated, depending on the movement in the exchange rate.	Check that management has complied with the requirements in IAS 21 *The Effects of Changes in Foreign Exchange Rates.* Transactions should initially be recorded using the spot rate, and monetary items such as trade payables should be retranslated at the year-end using the closing rate. Exchange gains and losses should be recognized within profit for the year. Any hedging arrangements should be identified and accounted for as derivatives according to IFRS 9 *Financial Instruments.*

[Award marks as follows:

½ mark for identification of audit risk – Maximum 4 marks

Up to 1 mark for evaluation – Maximum 8 marks

1 mark for audit response – Maximum 8 marks]

SOLUTION ONE

SECTION B

(4) Luyando Mining Ltd

(a) **Additional line items, headings and subtotals**

IAS 1 *Presentation of Financial Statements* provides little guidance on the presentation of line items in the financial statements, such as the level of detail or number of line items that should be presented in the financial statements. Furthermore, IAS 1's objective is to set out 'the overall requirements for presentation of financial statements, guidelines for their structure and minimum requirements for their content'. In doing so, IAS 1 sets out minimum levels of required items in the financial statements by requiring certain items to be presented on the face of, or in the notes to, the financial statements and in other required disclosures.

The absence of specific requirements arises from the fact that the guidance in IAS 1 relies on management's judgement about which additional line items, headings and subtotals:

- Are relevant to an understanding of the entity's financial position/financial performance; and
- Should be presented in a manner which provides relevant, reliable, comparable and understandable information.

Hence, IAS 1 allows entities to include additional line items, amend descriptions and the ordering of items in order to explain the elements of financial performance due to various activities, which may differ in frequency and predictability.

[Award marks as follows:

1 mark for reference to IAS 1

1 mark for minimum requirements

1 mark for management judgement

1 mark for relevant, reliable, comparable and understandable information

1 mark for valid conclusion]

(b) **Evaluation the proposed accounting treatments for each matter**

- **Licence costs** – the appropriate accounting standard is IAS 38 *Intangible Assets* not IAS 16 *Property, Plant and Equipment.* IAS 38 applies to intangible assets such as licence costs, provided that the appropriate conditions are satisfied: it must be probable that future economic benefits will flow from the licence, and the costs of the licence must be measured reliably. It seems these conditions have been met and hence the licence costs paid in connection with a right to mine for copper can be capitalized as an intangible asset and amortized over the term of the licence once the legal right to perform mining activities has been acquired, unless the directors conclude that a future economic benefit is more likely than not to be realized. It should not be capitalised as part of property, plant and equipment. The amortization expense must be included in the line item, administration expenses in the statement of profit or loss.

[Award marks as follows:

1 mark for reference to IAS 16

2 mark for reference to IAS 38

1 mark for capitalization as intangible asset

1 mark for amortization]

- **Sale of land** – ethical behavior in the preparation of financial statements, and in other areas, is of paramount importance. This applies equally to preparers of accounts, to auditors and to accountants giving advice to directors. Financial statements may be manipulated for all kinds of reasons, for example, to enhance a profit-linked bonus. In this case, the purpose of the sale and repurchase is to present a misleading favourable picture of the cash position, which hides the fact that the company has severe liquidity problems.

  Company accountants act unethically if they use 'creative' accounting in the accounts preparation to make the figures look better. To act ethically, the directors must put the interests of the company and its shareholders first, and must also have regard to other stakeholders such as potential investors or lenders. If a treatment does not conform to acceptable accounting practice, it is not ethical. Acceptable accounting practice includes conformity with the qualitative characteristics set out in the *Conceptual Framework* particularly fair presentation and verifiability. Conformity with the Conceptual Framework precludes window-dressing transactions such as this, and so the land needs to be reinstated in the accounts and a current liability set up for the repurchase.

[Award marks as follows:

1 mark for reference to ethical behavior

1 mark for reference to creative accounting

1 mark for reference to substance over form

2 marks for Conceptual Framework

1 mark for treatment as a loan not sale]

- **Classification of loan** – Under IAS 1 *Presentation of Financial Statements,* a long-term financial liability due to be settled within twelve months of the year-end date should be classified as a current liability. Furthermore, a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the year-end even if the lender has agreed after the year-end, before the financial statements are authorized for issue, not to demand payment as a consequence of the breach.

  However, if the lender has agreed by the year-end to provide a period of grace ending at least twelve months after the year-end within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current.

  In this case, however, the bank only issued the waiver on 8 July 2022, which is after the period-end. The bank loan should therefore be classified as a current liability.

[Award marks as follows:

1 mark for reference to IAS 1

1 mark for current liability if waiver issued after period-end

1 mark for non-current liability if waiver issued before period-end

1 mark for treat as current liability]

(c) **Proposed note**

The dividend was proposed after the end of the reporting period and therefore IAS 10 *Events After the Reporting Period* applies. This prohibits the recognition of proposed dividends unless these are declared before the end of the reporting period. The directors did not have an obligation to pay the dividend at the period end and therefore there cannot be a liability. Although the proposed dividend is not recognized it was approved before the financial statements were authorized for issue and should be disclosed in the notes to the financial statements. Hence, the proposed note is appropriate.

[Award marks as follows:

1 mark for reference to IAS 10

1 mark for no obligation

1 marks for note appropriate]

(5) **Buyantashi Multi-purpose Co-operative (BMC)**

(a) **Ethical and professional issues**

Ethical and professional issues	Explanations	Safeguards
(1) Regulation by Government through the Ministry of Agriculture.	The Minister of Agriculture was against the bonus from the outset. He may want to use the engagement to push his agenda and settle political scores. This political interference may give rise to an intimidation threat and as such Pasuka & Co.'s objectivity may be impaired.	Clear terms of reference must be agreed between BMC and Pasuka & Co. These must be explained to all key stakeholders, including the Minister of Agriculture.
(2) The Paramount Chief has significant interests in BMC and has the power to appoint sixty percent (60%) of the trustees.	This may create an intimidation threat as the Paramount Chief may abuse his powers and encourage manipulation of the financial statements. This is further worsened by the fact that the Finance Director (FD) of BMC is a	Pasuka & Co. should have a serious meeting with the Paramount Chief at which the terms of reference should be explained. Independence for Pasuka & Co. in both mind and appearance should also be emphasized at this

	member of the local traditional council. Although, he is a qualified accountant, he may be under extreme pressure to do the wrong things and satisfy the interests of the Paramount Chief. The FD's integrity could be questioned.	meeting.
(3) The Paramount Chief is entitled to ten (10%) of the sales and there is an agreement to pay senior managers bonuses based on profitability.	This could represent a significant self-interest threat to both the Paramount Chief and senior managers. Hence, senior managers may manipulate the financial statements. This will bring into question the integrity of senior managers. It is possible that the Paramount Chief may directly or indirectly exert enormous pressure on Pasuka & Co. to authenticate the figures without carrying out any meaningful work.	Pasuka & Co. should exercise appropriate levels of professional skepticism and work must be independently reviewed.
(4) BMC uses accrual basis International Public Sector Accounting Standards (IPSAS).	Pasuka & Co. may not have appropriately qualified and experienced persons with required knowledge in IPSAS. This will result in a poor quality review.	Pasuka & Co. must ensure appropriately qualified and experienced persons are put on this assignment, and if necessary consider outsourcing.
(5) The Accountant-in-Charge (AIC) shortlisted for the position of District Commissioner (DC) and has requested the District Executive Committee of the ruling party to support his candidature.	This brings about lack of political neutrality on the part of the AIC which is crucial in such politically sensitive engagements. This may further cause the AIC to lack the required levels of integrity. He will most likely wish to please the District Executive Committee of the ruling party. This will adversely affect independence and	The AIC must be replaced with a more independent person.

	objectivity. The self-interest threat created could be significant.	

[Award marks as follows:

½ mark for each identified issue – Maximum 2 marks

Up to 1 ½ marks for each relevant explanation – Maximum 6 marks

1 mark for each safeguard – Maximum 4 marks]

(b) **Overstatement of gross profit**

The possible **main reasons** for any overstatement of gross profit include the following:

- **Wrong accounting for advance payments** – the sales are 100% above budget. It is possible that some of the advance payments have been recognized as sales contrary to the guidelines given in IPSAS 9 *Revenue from Exchange Transactions* as it is unlikely that all the items of revenue have met the stated criteria in the standard. The sales could therefore be overstated.

- **Purchases cut-off errors** – the purchase transactions may be recorded in a wrong accounting period, resulting in the understatement of both purchases and cost of sales. From the accounts, the actual cost of sales is 75% of sales against a budgeted figure of 80% of sales. There is a high possibility that some of the purchases have not been accounted for in the current period.

- **Over-valuation of closing inventory** – this may be as a result of flawed inventory counting and/or valuation of closing inventory not being in line with IPSAS 12 *Inventories.* The standard requires that inventories shall be measured at the lower of cost and net realizable value (NRV).

The **procedures** to be performed could include the following:

- **Sales cut-off errors** – obtain a list of advance payments, especially for the month of December 2022 and review the accounting treatment. For those accounted for as revenue, agree details to relevant dispatch notes.

- **Purchases cut-off errors** – select a sample of goods received notes (GRNs) for the goods received, especially in December 2022 and check that either the purchase invoice has been posted to the purchase ledger before 31 December 2022 or a purchase accrual has been included in the financial statements.

- **Over-valuation of closing inventory** – review the inventory count sheets for any unusual items and confirm that the inventory was measured at the lower of cost and net realizable value (NRV).

[Award marks as follows:

Up to 2 marks for each reason – Maximum 6 marks

1 mark for each valid work – Maximum 3 marks]

(c) **Audit issues regarding the grant**

- All relevant grant documentation, especially the signed grant agreement.

- Materiality of the grant considering both quantitative and qualitative factors.

- Accounting treatment which should be in line with IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers).*

- Changes in the accounting method. This must comply with IPSAS 3 *Change of Accounting Policy* and must be adequately disclosed

- The sufficiency and appropriateness of the evidence available. ISSAI 1500 *Audit Evidence* gives detailed guidance in this area.

- The impact on the audit report. Auditor's reports are covered mostly by the following ISSAIs: ISSAI 1700 *Forming an Opinion and Reporting on Financial Statements,* ISSAI 1701 *Communicating Key Audit Matters* in the Independent Auditor's Report, ISSAI 1705 *Modifications to the Opinion in the Independent Auditor's Report* and ISSAI 1706 *Emphasis of Matter Paragraph and Other Matter Paragraph in the Independent Auditor's Report.*

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

SOLUTION TWO

SECTION A

(1) Briefing notes

To: Managing Partner

From: Audit Manager

Subject: Anti-money laundering/countering terrorism and proliferation financing (AML/CTPF)

Introduction

These briefing notes explains what is meant by money laundering, terrorist financing and proliferation financing (AML/CTPF), and the services in the Accounting and Audit Sector which are vulnerable to abuse by criminals, and the AML/CTPF legal framework in Zambia.

[Award professional marks as follows:

2 marks for format and 1 mark for introduction]

(a) **Money laundering, terrorist financing and proliferation financing**

Money laundering refers to the process of concealing the true origin and ownership of proceeds of crime.

Terrorism financing refers to an act by which a person, directly or indirectly funds a terrorist act.

Proliferation financing refers to an act by which a person, directly or indirectly funds the proliferation of any weapon that can cause mass destruction.

[Award up to 2 marks for correct definition – Maximum 6 marks]

(b) **The services in the Accounting and Audit Sector which are vulnerable to abuse by criminals**

The following are some of the services that are susceptible to abuse by criminals:

- Financial and tax advice
- Company and trust formation
- Buying and selling of property
- Performing financial transactions
- Audit and assurance

- Book keeping and preparation of accounts
- Gaining introduction to financial institutions

[Award ½ marks for each service – Maximum 2 marks]

(c) **The AML/CTPF legal framework in Zambia.**

The AML/CTPF legal framework in Zambia includes the laws listed below:

- Financial Intelligence Centre Act No. 46 of 2010 (as amended)(The FIC Act)
- Prohibition and Prevention of Money Laundering Act No. 14 of 2001
- Anti-Terrorism and Non-Proliferation Act No. 6 of 2018
- Forfeiture of Proceeds of Crime Act No. 19 of 2010

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

(2) Advise on actions to take by the Audit Senior regarding the transaction in Kafue Ltd

It has been mentioned that the suggested narration will enable the exporter to avoid the tax liability which could arise given that the country has no double taxation agreement with the Republic of Zambia. Avoidance of tax using illegal means is tax evasion. Tax evasion can result in fines and/or imprisonment. The amount involved in the sum of $700,000 and associated tax amount could be substantial and this should alert the AIC to the possibility of money laundering. Savings made by breaching tax laws are considered as money laundering.

Since Messrs Old & Young meets all the requirements of the Anti-money laundering/countering terrorism and proliferation financing (AML/CTPF) legal framework in Zambia, the Accountant-in-Charge (AIC) must report this matter to the Compliance Officer/Money laundering Reporting Officer, as soon as possible. In fact, it is also possible that the entire $700,000 could be proceeds of criminal activity. It is possible that the Kafue Ltd is being used as a vehicle for money laundering.

The Compliance Officer/Money Laundering Reporting Officer must evaluate the reported matter and quickly make a decision as to whether further enquiries are required and, if necessary, make suspicious transaction report to the appropriate authorities. However, care must be taken that no-one 'tips-off" the client that their activity is being treated as suspicious and that a report will be made by the Compliance Officer/Money laundering Reporting Officer. Messrs Old & Young may also wish to seek legal advice given the potential legal implications of dealing with Kafue Ltd, a client involved in money laundering.

[Award marks as follows:

1 mark for tax evasion

Up to 2 marks for illegal tax savings considered money laundering

1 mark for substantial

1 mark for meets all the requirements of AML/CTPF legal framework in Zambia

1 mark for report to Compliance Officer/Money Laundering Reporting Officer

Up to 2 marks for tipping off

1 mark for seek legal advice]

(3) Lake Ltd

Matters	Comments on sufficiency and appropriateness of audit evidence obtained	Further audit procedures
(1) Written confirmation from Lake Ltd's lawyers	IAS 37 Provisions, Contingent Liabilities and Contingent Assets requires that a provision be recognized where it is probable that there would be an outflow of resources embodying economic benefits. The auditor needs to obtain sufficient and appropriate audit regarding the existence of a present obligation and whether it is probable that transfer of economic benefits will be required to settle the obligation. The written confirmation alone is not sufficient and appropriate audit evidence. The company lawyer may not be objective since he is conflicted.	• Obtain details of the legal case • Seek legal advice from an independent lawyer • Discuss with management and those charge with governance the existence of a present obligation and whether it is probable that there would be an outflow of resources embodying economic benefits • Check whether any payments have been made after the year-end in respect of the case.
(2) Inspection of a sample	IAS 16 *Property, Plant and*	• Select a sample of

of Lake Ltd's non-current assets and agreeing the findings to the non-current assets register, and arithmetical check of the manual journal by a Junior Auditor	*Equipment* gives the recognition criteria for non-current assets. Inspection of non-current assets and agreeing the findings to the non-current asset register would only be sufficient evidence as to the completeness of the non-current assets register. There is need to also get audit evidence on other financial statement assertions such as existence, rights and obligations, accuracy, valuation and allocation, classification and presentation. In addition, the work by the Junior Auditor was not checked by a senior auditor. Hence, the evidence obtained cannot be considered to sufficient and appropriate.	non-current assets from the non-current assets register and physically inspect them to confirm existence • Recalculate the depreciation which should have been charged on a sample of non-current assets and agree to the statement of profit or loss for the year. • Inspect documents of title for a sample of non-current assets e.g. title deeds, motor vehicle registration certificates, purchase invoices • A senior auditor must review the work done by the Junior Auditor.
(3) Consultation of the tax department for the firm	Deferred tax is accounted for under IAS 12 *Income Taxes.* Consultation of the tax department may provide sufficient appropriate evidence needed for any analytical procedures performed on the deferred tax provision.	No further audit procedures recommended.
(4) Verbal assurance from the liquidator	IAS 10 *Events After the Reporting Period* deals with the accounting treatment for events occurring after the period end. Customer being dissolved is an adjusting event. However, the verbal assurance from the liquidator is not	• Obtain written assurance from the liquidator. • Read minutes of board meetings regarding the dissolution of the customer • Review latest

	sufficient appropriate evidence. Verbal representations can be retracted. ISA 560 *Subsequent Events* requires auditors to do much more than simply obtaining a verbal assurance. Hence, verbal assurance is not sufficient and appropriate audit evidence.	accounting records and financial information. • Discuss the matter with management and where appropriate those charged with governance, and ensure the accounting treatment is in line with IAS 10.
(5) Written representation	IAS 38 *Intangible Assets* provides accounting guidance for intangibles. The standard states that development costs should be recognized as an asset (capitalized) only when all the stated criteria are met. One of the criteria is technical feasibility. The written representation provided by management is not sufficient appropriate audit evidence. In fact, ISA 580 *Written Representations* states that a written representation is not of itself sufficient appropriate audit evidence. Therefore, further evidence must be obtained.	• Obtain technical reports regarding the development from technical experts • Use an auditor expert to review the technical reports for any adverse results and corrective action taken • Review correspondence with regulatory authorities for indication of problem areas. • Enquiry of management whether appropriate licences have been applied for/granted and reviewing correspondence in relation to such licences.

[Award marks as follows:

Up to 2 marks for sufficiency and appropriateness of audit evidence – Maximum 10 marks

1 mark for each further audit procedure – Maximum 10 marks]

(4) Swamp Plc

CSR objectives	Performance in 2022	Procedures
(1) Support primary healthcare, maternal and childcare and HIV/AIDS education, treatment and care.	Charitable donations in the sum of K1.4 million were made directly to local healthcare providers.	• Obtain a summary of K1.4 million donated and agree the details to the cash book • Review correspondence with charities for confirmation of the amounts paid
(2) Continue to support the staff development fellow (SDF) programme at the University of Zambia.	K1.6 million was spent on the staff development fellow (SDF) programme for three (3) lecturers.	• Obtain payment vouchers for the K1.6 million and agree the amounts to the relevant cash book and bank statements. • Request for confirmation from the University of Zambia and the three (3) lecturers.
(3) Promote a safe working environment in all company's operations.	K4 million was spent on various health and safety matters and there were no fatalities.	• Obtain a schedule of the various health and safety matters and the amounts involved • Agree a sample of the payments to the relevant cash book and bank statements.
(4) Assist in the provision of various community services.	1,800 man hours were used by various employees to provide community services and the total cost to the company was K2,860,100.	• Obtain specific details of the 1,800 man hours from Human Resource Department and get confirmation from a sample of employees. • Agree the K2,860,100 to the payroll and cash book. • Interview selected community members to confirm the provision of services.

[Award 1 ½ marks for each procedure – Maximum 6 marks]

SOLUTION TWO

SECTION B

(5) River Plc

Borrowing cost

(a) Matters to be discussed with management

- Materiality – The borrowing cost of K250,000 is 3% (K250,000/K8,000,000 X 100%) of the profit before tax and is 0.3% (K250,000/K76,000,000 X 100%) of total assets and is therefore immaterial to both the statement of profit and loss and the statement of financial position.
- Relevant accounting standard – IAS 23 *Borrowing Costs* states that suspension of capitalization of borrowing costs is not necessary for periods for temporary delays or for periods when substantial technical or administrative works is taking place. The suspension of capitalization is therefore is incorrect.
- Impact on the financial statements – Both profits and assets are understated.

(b) Evidence

- Copy of loan agreement
- Details of the substantial technical works
- Workings for the interest amount

Contingent asset

(a) Matters to be discussed with management

- Materiality – The contingent asset of K75,000 is 0.9% (K75,000/K8,000,000 X 100%) of the profit before tax and is 0.1% (K75,000/K76,000,000 X 100%) of total assets and is therefore immaterial to both the statement of profit and loss and the statement of financial position.
- Relevant accounting standard–Under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets,* contingent assets must not be recognized, unless the realization of the related economic benefits is virtually certain. In this case, the receipt is virtually certain and therefore ought to be recognized as a contingent asset.
- Impact of financial statements – Both the profits and the assets are understated.

(b) Evidence

- Copy of relevant correspondence with the insurance company
- Copy of the insurance policy
- Copy of relevant post year bank statement for any receipt from the insurance

Change in fair value

(a) Matters to be discussed with management

- Materiality – The change in fair value of K320,000 is 4% (K320,000/K8,000,000 X 100%) of the profit before tax and is 0.4% (K320,000/K76,000,000 X 100%) of total assets and is therefore immaterial to both the statement of profit and loss and the statement of financial position.
- Relevant accounting standard – IAS 40 *Investment Property* states that a gain or loss arising from a change in the fair value of an investment property should be recognized in net profit or loss for the period in which it arises.
- Impact on financial statements – Profit is understated while equity is overstated.

(b) Evidence

- Copy of the valuation report
- Copy of the financial statements

Depreciation

(a) Matters to be discussed with management

- Materiality – The depreciation of K50,000 is 0.6% (K50,000/K8,000,000 X 100%) of the profit before tax and is 0.07% (K50,000/K76,000,000 X 100%) of total assets and is therefore immaterial to both the statement of profit and loss and the statement of financial position.
- Relevant accounting standard – IAS 16 *Property, Plant and Equipment* requires that depreciation charge for each period should be recognized as an expense.
- Impact on financial statements – Both profit and assets are overstated.

(b) Evidence

- Details of the new delivery van
- Copy of the depreciation schedule

[Award marks as follows:

Up to 2 marks for materiality – Maximum 8 marks

1 mark for relevant accounting standard and treatment – Maximum 4 marks

1 mark for impact on financial statements – Maximum 4 marks

½ mark for each audit evidence – Maximum 4]

(c) **Advise to the Engagement Partner**

ISA 450 *Evaluation of Misstatements Identified during the Audit* requires that auditors shall consider whether the aggregate of uncorrected misstatements in the financial statements is material. If material, auditors shall request management to make the necessary corrections.

The aggregate (net effect) of the misstatements is K595,000 (K645,000 – K50,000). This is 7% (K595,000/K8,000,000 X 100%) of the profit before tax and is 0.8% (K595,000/K76,000,000) of the total assets. The statement of profit or loss is therefore materially misstated.

The Engagement Partner must therefore request management to make the corrections.

[Award marks as follows:

1 mark for IAS 450

1 mark for aggregation

1 mark for appropriate calculation

1 mark for material

2 marks for correct advice]

(6) Suggested opinions

Client one – There is no specific prohibition against the inclusion of loan which is repayable on demand in cash and cash equivalents. However, in obscuring the nature of the transaction, it is possible that the directors are motivated by personal interest, and are thus failing in their duty to act honestly and ethically. If one transaction is misleading, it may cast doubt on the credibility of the financial statements as a whole.

The loan needs to be disclosed separately in the interest of comparability, relevance, understandability and reliability.

Since the matter is material by nature, the audit opinion ought to be modified. The appropriate audit opinion is a qualified audit opinion as the matter is not likely to be pervasive. Hence, the suggested unmodified audit opinion by the Audit Senior is inappropriate.

[Award marks as follows:

1 mark for no prohibition

1 mark for personal interest

1 mark for disclosed separately

1 mark for correct audit opinion]

Client two – The gain is 60% (K600,000/K1,000,000 X 100%) of the profit before tax and is 3% (K600,000/K19,000,000 X 100%) of the total assets. It is therefore material to both the statement of profit or loss and statement of financial position. The accounting treatment for the gain is in line with the guidance given in IFRS 9 *Financial Instruments*. The appropriate audit opinion is an unmodified audit opinion. Hence, the suggested adverse audit opinion by the Audit Senior is inappropriate.

[Award marks as follows:

2 marks for materiality

1 mark for reference to IFRS 9

1 mark for correct audit opinion]

Client three – One of the indications of hyperinflation is where there is a cumulative inflation rate of one hundred per cent (100%) or more over three years. In this case, cumulative inflation rate has averaged 140% over the past three years. Hence, the client is in a country where there is hyperinflation. IPSAS 10 *Financial Reporting in Hyperinflationary Economies* requires the primary financial statements of an entity that reports in the currency of a hyperinflationary economy to be expressed in terms of the measuring unit which is current at the end of the reporting period. The restatement applies to both the current year and to comparative information presented. A gain or loss on the net monetary position should be included in surplus/deficit and disclosed separately. Hence, the accounting treatment is against the IPSAS 10 recommendation. The amount of the gain on restatement of the net monetary position has not been mentioned. If it is material and considered pervasive, then the appropriate audit opinion will be an adverse opinion. However, if it is material but not pervasive, then the audit opinion will be qualified audit opinion. If the gain is considered to be immaterial, then the audit opinion will be unmodified. Hence, the suggested disclaimer of opinion by the Audit Senior is clearly inappropriate.

[Award marks as follows:

1 mark for cumulative inflation rate of over 100%

2 mark for reference to IPSAS 10

1 mark for materiality

1 mark for pervasiveness

1 mark for correct audit opinion]

Client four – When confirmation is undertaken the method of requesting information from the customer may be either positive or negative. The scenario mentions all the conditions required for a negative confirmation, the confirming party responds directly to the auditor only if they disagree with the information in the request. If negative confirmation was used, then there was no need to respond if in agreement. The Audit Senior should have checked the type of confirmation used. If positive confirmation was used, then non-response should have meant auditors performing alternative audit procedures to obtain relevant and reliable audit evidence. These could have included reviewing subsequent cash receipts. The suggested modified report containing qualified audit opinion supported by an emphasis of matter paragraph is premature. More audit work is required. Hence, the opinion to be issued will depend on additional evidence which will need to be obtained by carrying additional audit procedures, if necessary. It is important to note that a qualified opinion cannot be supported by an emphasis of matter paragraph.

[Award marks as follows:

1 mark for method of confirmation

1 mark for negative confirmation

1 mark for alternative audit procedures

1 mark for opinion will depend on additional evidence

1 mark for valid comment on emphasis of matter paragraph]

Client five – According to IAS 12 *Income Taxes*, a deferred tax asset is recognized for an unused tax loss carry-forward or unused tax credit if, and only if, it is considered probable that there will be sufficient future taxable profit against which the loss or credit carry-forward can be utilized. In the Republic of Zambia, tax losses can only be carry-forward for a maximum of five (5) years (ten (10) years for mining losses). Hence, the deferred tax asset should not be recognized if the loss is not a mining loss. The suggested unmodified audit opinion is appropriate given that the deferred tax asset is immaterial. However, the inclusion of an immaterial matter in the key audit matter is totally misplaced. Key audit matters are those that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period. They do not provide a separate opinion.

[Award marks as follows:

1 mark for reference to IAS 12

1 mark for maximum period of carry-over

1 mark for immaterial

1 mark for valid comment on key audit matter

1 mark for unmodified audit opinion]

END OF SUGGESTED SOLUTIONS