



COMPETENCE PRACTICE EXAMINATION
AUDIT PRACTISING CERTIFICATE
JUNE 2023

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 2¹/₂ 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.

QUESTION ONE

DBO & CO

You are a manager in the audit department of DBO & Co, a firm of Chartered Accountants registered with ZICA. The managing partner of the firm is Dan Bwali seconded by Mr. Milos Chimba. Mr. Charles Daka has recently been appointed as a junior partner working closely with Mr. Milos Chimba. Mr. Daka is presently only on a salary and is not yet eligible to participate in profit sharing of the firm.

In addition to being allocated a portfolio of client, you have also been given responsibility for quality management review of selected clients. In the next five years, DBO intends to promote you to assume full responsibility for the monitoring of quality management in the firm as a whole.

Between 2022 and 2023, you have been involved with five clients, including

- 1) MemChem Cleaning Limited - Quality control management
- 2) Dotv Limited – Planning
- 3) Ministry of Health – Management and Supply of drugs

1) MEMCHEM

Memchem is a well-established regional based company that specializes in the cleaning and hygienic industry currently operating in four countries in the region, including Zambia. Memchem's principal customers include supermarkets, hotels and industrial plants. DBO accepted to take over the audit of MemChem from the previous auditors – ProBE and Associates.

Professional etiquette procedures revealed that the outgoing auditors did not want to accept re-appointment because of a number of disagreements with directors, especially those relating to the need to write down inventories to net realizable amounts. In the response to the etiquette letter, ProBe Associates hinted that it was likely that the audit for the year ended 31st March 2023 would detect errors committed in the previous years.

This is the first time that DBO is being involved with a client in the cleaning and hygienic industry. An expert in this industry (drawn from within the wider DBO family of associated firms) was arranged to be available during the audit.

The draft accounts for the year ended 31 March 2023 show turnover K19.8 million (20X1 K 13.8 million) and total assets K6.1 million (20X1 K4.2 million).

As part of your review of quality management, you visited the audit team at the head office of Memchem on two occasions. The audit team comprised

Engagement Partner	:	Milos Chimba
Audit Manager	:	Martha Bunga
Audit Supervisor	:	Thresa Lunda
Audit senior	:	Dean Saka
Trainee Auditor 1	:	Laban Sinyangwe
Trainee Auditor 2	:	Lulu Nyambe

You have summarized the findings of your visit and review of the audit working papers relating to the financial statements for the year to 31 March 2023 as follows:

- (i) On instruction from the engagement partner, Martha Bunga was responsible for the planning and direction of the audit of MemChem Limited, including taking full responsibility for the overall quality management of the audit.
- (ii) Laban and Lulu attended the annual inventory count which was held on 31st march 2023. The inventory count and procedures were completed within two hours. You are now aware that ProBe Associates took almost the whole day for the same activity in the previous year. Memchem stocks a large variety of chemicals, some which of are very susceptible to strict environmental laws and regulations relating to storage and usage. The closing inventory included in the financial statements for the year ended 31 March 2023 was valued at K1.8 million
- (iii) In addition to MemChem, Thresa was assigned to three other assignments at the same time and spent most of her time working from DBO's office. The time sheets indicated that she had visited MemChem only twice between the start and end of the field work
- (iv) Audit work relating to the determination of the net realizable of material inventory values of some cleaning detergents was still outstanding at the final stages of the audit. These were specialized detergents subject to strict storage and usage laws and regulations
- (v) MemChem had computerized its supply chain management system during the year ended 31st March 2023 integrating it with the existing Sage accounting software. This affected the processing of inventories and payable balances. Being not so competent in information technology, Dean experienced challenges in auditing inventories and payables
- (vi) The working papers reviewed that there was a lot of work outstanding because the audit team had to end the field work at the end of the appointed three-week planned duration.

APPOINTMENT OF AN ENGAEMENT QUALITY REVIEWER

Mr. Chimba recommended that the new partner, Mr. Charles Daka should be appointed as the Engagement Quality Reviewer on the MemChem audit.

2) Dotv Zambia Limited

Dotv Zambia Limited has a financial year ending 31st March 2023. Dotv offers an internet television network, with over 1 million subscription members in Zambia

Background information

Dotv started to offer an internet streaming service for films and TV programmes ten years ago. Dotv's business model is to acquire licences for films and TV programmes and customers pay a monthly subscription fee to access them and watch online. Nigerian and Indian films are particularly popular

Matters relevant to audit planning

Following a discussion between DBO's audit engagement partner and a representative of Dotv audit committee, several matters were noted as being relevant to the audit planning:

i) Annual incentive scheme

For several years, Dotv has operated an annual incentive scheme for staff, under the terms of which employees are eligible to receive an annual incentive payment linked to the achievement of selected targets. The scheme operates across all different categories of staff, with some employees' targets linked to profitability, while others are aligned to non-financial measures including customer satisfaction. Participants in the scheme are entitled to earn a maximum annual incentive payment of 5% of their salary. Approximately 90 employees, including the senior executive directors, are entitled to participate in the annual incentive scheme. Last year the average bonus payment was K10,000 per participant.

ii) Legal case

In June 2022, a legal case was initiated against Dotv by Nollywood Films, a film production Company based in Nigeria. Nollywood claimed that Dotv had infringed copyright by streaming a film for which a licence had not yet been approved. Dotv insists approval of the use of the licence had been granted. Dotv finance director is not willing to recognise the legal claim within the financial statements as he is confident that the claim against Dotv will not be successful, and he does not want to discuss it further with the audit-team, emphasising that there is no relevant documentation available for evaluation at this time. Nollywood Films were seeking K500,000 compensation

Selected financial information

	Note	Projected to 31st march 2023 K' million	Actual 31st march 2022 K' million
Revenue	1	98.00	78.00
Operating profit		7.84	7.02
Profit before tax		6.01	5.87
		-----	-----
Total assets		78.00	60.00
Included in total assets:			
Intangible assets	2	58.00	42.00
Number of subscription customers		1,050,000	807,000

1. Dotv's main source of revenue is from monthly membership fees. Members are billed in advance of the start of their monthly membership and revenue is recognised when the bill is sent to the customer. Payments are paid through various channels including mobile money, debit and credit cards. The price of a regular subscription has remained at K90 per month throughout 2022 and 2023. Occasionally, Dotv offers a free trial period to new customers. This year, Dotv also introduced a new premium subscription package, which allows customers to add two family members to their subscription for an additional fee of K65 per month.
2. Dotv acquires content licences per title in order to stream film and TV content to its subscribers. The content licences are each for a fixed time period, varying between three and five years. Dotv capitalises the cost per title as an intangible asset. Dotv policy is to amortise licences over a five-year period, the finance director justifies this as being 'the most prudent' accounting treatment.

Due to improved performance during the year, the finance director of Dotv has not provided any impairment on any of the existing licences

During the year an additional amount of K16 million was spent on acquiring additional licences from Mollyhood Films, based in India. Evidence seems to suggest that the interest in Mollyhood content is not as high as anticipated

3. MINISTRY OF HEALTH

Procurement of Drugs and Other Medical Supplies

Your firm is aware of widespread concern in government and the general public about the condition of drugs and other medical supplies in public health facilities. It has been reported that people were dying of treatable diseases such as malaria because of lack of medicines in public health facilities. At the same time drugs worth billions of Kwacha expire in the Central Medical Stores (CMS), two regional medical stores, stores of referral hospitals, district health offices and other health facilities.

As part of monitoring of government funded projects, the Government of the Republic of Zambia has decided to engage private audit firms to assist in carrying out audits on various projects as a way of promoting transparency, probity and accountability. DBO has been selected to carry out audits on some of the projects within the Ministry of Health

You are now planning to carry out a financial audit of the Central Medical Stores (CMS) for the year-ended 31 December 2022, including a review to establish whether procurement procedures were followed in the awarding of contracts for the supply of drugs and other medical supplies.

You are aware that procurement procedures should follow the requirements of the Public Procurement Regulations, including the need for having a procurement plan for the awarding of contracts, and their estimated cost. The recent internal audit report highlighted increased incidences of expired drugs mainly as a consequence of unplanned procurements

During the process of obtaining an understanding of the CMS and related centres, the audit team has discovered that in Regional offices of the CMS, there is no segregation of duties between the stores and accounting functions. Accounting officers are responsible for payments for stores items, and receipts and issues of stores items. The audit team is aware of the absence of some documentation for award of procurement contracts and related contracts.

There have been accusations in the media of widespread corruption in the management of drugs and other medical supplies, and calls for a forensic audit into the alleged corruption and theft

REQUIREMENTS

1) In relation to the MemChem audit for the year ended 31st March 2023

- a) Evaluate the adequacy of the quality management policies and procedures implemented during the audit of MemChem for the year ended 31st March 2023 (18 marks)
- b) Evaluate whether the audit of should include the appointment of an engagement quality reviewer (EQR) (6 marks)
- c) Comment on the eligibility of Mr. Janis Tembo's appointment as the engagement reviewer for the audit (6 marks)
- d) State and justify THREE areas of focus for the Engagement Quality Reviewer (8 marks)

2) In relation to the audit of Dotv Limited

- a) Compute FIVE relevant performance ratios (10 marks)
- b) Using the ratios computed in (a) above and other information provided evaluate **TEN** audit risks, including indicating where appropriate whether the risk is material (20 marks)
- c) Recommend FIVE substance procedures that should be performed on the content licences acquired from Mollyhood during the year (12 marks)

3) In relation to the audit of CMS

- a) Identify and explain FOUR risks of fraud in accounting and stores management at the Regional Offices of the CMS (8 marks)
- b) Explain how the absence of documentation affects audit risk, and suggest procedures that should be taken in conducting the audit to obtain sufficient appropriate evidence (12 marks)

QUESTION TWO

SWAN ASSOCIATES

You are a manager in the audit department of Swan Associates, a firm of Chartered Accountants, responsible for a portfolio of audit assurance and related assignments

For the 2023, you have been assigned on three engagements

- 1) Lusaka Lime Company (LLC) – Evaluation of Ethics and Audit Strategy
- 2) Choc Chips Company (CCC) - Audit completion and going concern
- 3) ChangLin Construction Plc (CCP) – Audit reporting and Key Audit Matters (KAM)

1) LUSAKA LIME COMPANY (LLC)

LLC Co was established only two years ago, but has grown rapidly, and this will be the first year that an audit is required. In previous years a limited assurance review was performed on its financial statements by an unrelated audit firm. The company extracts and processes lime for sale to industrial companies and the general public. The extraction of lime is a process that is strictly monitored by the Zambia Environmental Agency because of its potential impact on the public. There seem to be reasonable prospects for the company to grow rapidly.

LLC Co has one full-time accountant who uses an off-the-shelf accounting package to record transactions and to prepare financial information. The company has a financial year ending 31 March 2023. LCC is in the process of recruiting another more qualified and experienced accountant.

One of Swan Associates's audit managers, Laura Bowa, is being interviewed for the role of financial controller at LCC. Laura is a good candidate for the position, as she developed good knowledge of LCC's business during the process of planning and managing the audit before she was removed from the audit.

At LCC's most recent board meeting, the audit fee was discussed. The board members expressed concern over the size of the audit fee, given the company's loss for the year. The board members would like to know whether the audit can be performed on a contingent fee basis.

The following comment was made by Bruuno Chez, the company's founder and owner-manager, in relation to the audit proposal and potential audit fee:

'I am looking for a firm of auditors who will give me a competitive audit fee. I am hoping that the fee will be quite low, as I am willing to pay more for services that I consider more beneficial to the business, such as strategic advice. I would like the audit fee to be linked to LLC Co's success in expanding within SADC as a result of the audit firm's advice. Hopefully the audit will not be too disruptive and I would like it completed within four months of the year end.'

The audit of LCC was already under way when it was discovered that the manager on the audit, Laura Bowa had applied for a position of financial controller at LCC. Laura has since been removed from the audit. The engagement partner is now concerned that the process of evaluating ethical and other professional issues and the determination of the audit strategy may have been compromised

The engagement partner has now requested you to evaluate the ethical issues arising from the audit and also evaluate the audit strategy proposed by Laura Bowa to ensure that objectivity of the firm is not exposed

You have also become aware of a recent visit from ZEMA in relation to suspected breach of required regulations. There is a significant amount of carbon emission in lime processing.

AUDIT STRATEGY

	ISSUE	AUDIT APPROACH /procedures
1	Overall Approach Although the LCC audit is new, there are no significant risks that have been noted. I also consider that it would not be cost effective to test the internal controls for possible reliance on them	A substantive approach will be adopted where tests of detailed will be performed on all transactions and balances
2	Sale of motor vehicle to Bruuno, owner manager of LCC A van was sold to Mr Chez on 23 rd May 2022 at K112,500. The amount is still outstanding and is included in receivables	A confirm K112,500 is included in receivables within current assets. No further audit procedures are considered necessary because the transaction is not material to the financial statements as the total assets are K 15 million
3	Valuation of inventories of lime LCC employs a management expert to assist in the valuation of inventores of lime. During the year ending 31 March 2023, the management expert was in attendance during the inventory count which our two auditors attended. The management expert is a resident chemical engineer who is one of the senior managers in LCC	Reliance will be placed on the work of the management expert in the process of valuing the lime inventories. Accordingly, no further work is required
4	Use of Analytical Reviews As the audit is new, it will not be possible to carry out meaningful analytical procedures at any of the stages of the audit.	In carrying out substantive work, other testing procedures will be applied and not analytical review procedures

2) CHOC CHIP COMPANY (CCC)

Choc Chips Company (Choc) manufactures a wide range of chocolate products. The audit of the financial statements for the year ended 31 March 2023 is nearing completion and you are reviewing the working papers of the going concern section of the audit file. The draft financial statements recognize:

- A loss of K1,500,000 (2022 – profit of K1,760,000), and
- Total assets of K13.8 million (2022 –K14.4 million).

The audit senior computed the following ratios

- The current ratio is 0.8 (2022 – 1.2),
- The quick ratio is 0.5 (2022 – 1.6).

The latest management accounts show that ratios have deteriorated further since the year end, and the company now has a cash balance of only K250,000. Choc has a long-term loan outstanding of K800,000 with a covenant attached, which states that if the current ratio falls below 0.75, the loan can be immediately recalled by the lender. The loan was provided to Choc three years ago by Afri Finance Bank (AFB)

You are also aware that one of Choc's best-selling chocolate brand, the Heavenly, has become technically obsolete during 2023 as customers now prefer less sweetened products. Historically, the Heavenly has generated 45% of the company's revenue. In response to customers' preference, K1.3 million has been spent on developing a new product, the HealthyChoc, due for launch in August 2023, which will be marketed as a wellness product.

A cash flow forecast has been prepared for the year to 31 March 2024, indicating that based on certain assumptions, the company's cash balance is predicted to increase to K2.5 million by the end of the forecast period.

Assumptions include:

- i) The successful launch of the HealthyChoc product,
- ii) The sale of plant and machinery which was used to manufacture the Heavenly, generating cash proceeds of K950,000, forecast to take place in July 2023,
- iii) A reduction in payroll costs of 15%, caused by redundancies in the Heavenly manufacturing plant, and
- iv) The receipt of a grant of K800,000 from a government department which encourages innovation in wellness products, scheduled to be received in August 2023.

Having completed the file review, you have concluded that the use of the going concern assumption is appropriate, but that there is significant doubt over Choc's ability to continue as a going concern. You have advised the company's audit committee that a note is required in the financial statements to describe the significant doubt over going concern. The audit committee is reluctant to include a detailed note to the financial statements due to fears that the note will highlight the company's problems and cause further financial difficulties, but have agreed that a suitable note will be included.

POSSIBLE LITIGATION

Your firm has just received a letter from the lawyers representing Afri Finance Bank, indicating a possible litigation case against Chic Choc and your firm in the event that Choc fails to pay the K800,000 loan contending that the bank partly relied on the unmodified opinion issued by your firm at the time the loan was disbursed

3) CHANGLIN CONSTRUCTION PLC

CHANGLIN CONSTRUCTION PLC (CCP)

The home page on the website of CCP states

*"We ChangLin **Construction** are the leading name to reckon in the construction industry. Since its inception in 2007, we have been devoting our best approach to exceed our clients' expectations by creating significant infrastructure in order to emerge as the Best & Top construction company. A full-service providing construction company Serving On-time and on budget We Can Deliver All Types of Construction and Renovation Projects like Residential Construction, Commercial Construction, Engineering construction and Projects Management Consultancy"*

CCP is one of the construction companies approved by the government of the republic of Zambia to be contracted for construction and related projects.

The company typically works on several construction contracts at a time.

CCP 's financial year ended on 31 March 2023, and the draft financial statements recognise

- Revenue K 1,050 million (2022 – K865 million)
- Profit before tax of K220.5 million (2022 – K200 million) and
- Total assets of K3,700 million,
- Including cash of K30 million.

You are now reviewing the extract report to those charged with governance in order to extract Key Audit Matters to be included in the audit report. You are also aware that during discussions with the chairman of the audit committee, he expressed reservations on the usefulness of the key audit matters, contending that the additional inclusion merely extended the length of the audit report

EXTRACT REPORT TO THOSE CHARGED WITH GOVERNANCE

1. The Auditor's Responsibilities in Relation to the Financial Statement Audit

Our responsibility is to carry out an independent examination of the financial statements for the year ended 31st March 2023 and express an opinion as to whether the financial statements give a true and fair view

Management have acknowledged their responsibility to prepare financial statements that comply with the agreed reporting framework

2. Planned Scope and Timing of the Audit

The audit included the review of corporate governance, internal controls and compliance with applicable laws and regulations

For the current year, an interim audit was planned and performed as our due diligence action to ensure the report was issued earlier than the previous years

3. Significant Findings from the Audit

a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

The construction industry is characterised by the need to make estimates relating to revenue recognition and related receivables. Included in revenue of K1,050 million is approximately K574 million generated from construction projects not yet completed. The K574 million was estimated based on various stages of completion using a variety of complex methods of estimating the cost and value involved at different stages of projects

b) Material audit adjustments

The following matters gave rise to adjustments made to the financial statements for the year ended 31 March 2023

- i) CCP is working on a major contract relating to the construction of a number of flying over bridges for the Lusaka District Council. Work started in October 2022, and it is estimated that the contract will be completed in September 2023. The contract price is K200 million, and it is estimated that a profit of K50 million will be made on completion of the contract. The full amount of this profit has been included in the statement of profit or loss for the year ended 31 March 2023. CCP 's management believes that this accounting treatment is appropriate given that the contract was signed during the financial year, and no problems have arisen in the work carried out so far.
- ii) A significant contract was completed in September 2022 for the Ministry of Works. This contract related to the construction of a 20-mile highway in Mongu district. In November 2022, several large cracks appeared in the road surface after a period of unusually heavy rain, and the road had to be shut for ten weeks while repair work was carried out. The Ministry paid for these repairs, but has taken legal action against CCP to recover the costs incurred of K400 million. Disclosure on this matter has been made in the notes to the financial statements.
- iii) An explosion occurred at the largest of the ten offsite storage locations on 20 May 2023. This resulted in some damage to inventory and property, plant and equipment.

CCP 's management have investigated the cause of the explosion and believe that they are unlikely to be able to claim on their insurance. Management of CCP has estimated that the value of damaged inventory and property, plant and equipment was K329.5 million and it now has no scrap value.

c) Significant internal control deficiencies

During the audit, we noted that capital expenditure authorisation forms for capital acquisitions amounting to K4.5 million had not been completed for this expenditure.

4. Auditor independence

We carried out our ethical procedures for this ongoing audit and are satisfied that, apart from our ten year-long association with CCP, no other significant threats existed that would have affected our independent position as auditors of CCP. Our ten-year long association with CCP is perceived to create significant familiarity and self-interest threats. However, this issue has been extensively discussed with the audit committee and concluded that our policies relating to audit engagement partner and team rotation are sufficient to mitigate against these perceived threats

REQUIREMENTS

1) In relation to the audit of the Lusaka Lime Company (LCC)

- a) Evaluation
 - i) SIX ethical and other and other professional issues arising from the audit of LCC (12 marks)
 - ii) For each issue, recommend the appropriate action that should have been taken (12 marks)
- b) Evaluate the audit strategy proposed by Laura Bowa and recommend any further procedures that should be undertaken (8 marks)

2) In relation to the audit of Choc Chips Company (CCC)

- a) Identify and explain FOUR matters which cast doubt on the going concern status of Choc. (10 marks)
- b) Explain the audit evidence you should expect to find in your file review in respect of the cash flow forecast. (10marks)
- c) In respect of the note on going concern to be included in Choc's financial statements. You have since reviewed the note and you are satisfied that it is adequate
 - i) State the minimum contents of the note (6 marks)
 - ii) discuss the implications of the disclosure on your audit report (4 marks)

3) In relation to the possible litigation case against your firm

- a) Comment on how this litigation case may be connected to the concept of the "expectation gap" (6 marks)
- b) Discuss the matters that should be considered in determining whether your firm should be held liable in this matter (6 marks)

4) In relation to the audit of CCP and the extract of the report to those charged with governance

- a) Identify and justify FOUR issues that should be classified as Key Audit Matters (12 marks)
- b) For each of the FOUR KAMs identified, explain the evidence you should expect to find in your review of the audit conducted on these matters (8 marks)
- c) Describe the perceived advantages and disadvantages of the inclusion of Key Audit Matters in the auditor's report (6 marks)