



## **COMPETENCE PRACTICE EXAMINATION**

### **AUDIT PRACTISING CERTIFICATE**

**JUNE 2024**

**TIME ALLOWED: 5 HOURS**

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#### **INSTRUCTIONS TO CANDIDATES**

1. This paper has Two Questions.
2. You are required to attempt ALL the two questions
3. Each question has Sections:  
Question one has two sections: A and B  
Question two has two sections: A and B
4. All the two questions carry equal marks.
5. The Examination is divided into sessions of 2<sup>1</sup>/<sub>2</sub> hours each. There will be a 30 Minutes break in between the sessions.
6. Please use your Membership number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.
7. This is an open book examination.

## AUDIT

### QUESTION ONE

#### PUTA & CO

Your name is Kingsley Bene and you are a manager in Puta & Co, a firm of chartered accountants registered with the Zambia Institute of Chartered Accountants (ZICA). You are aware that your firm has been selected for quality review assessment by ZICA. You are also aware that the last assessment did not go very well and your firm risk being sanctioned by ZICA

You have received the following e-mail from the Senior Partner in charge of quality management

To : Kingsley Bene  
From : Marshall Puta  
Subject : Audit Assignments for 2023/24  
Date : 2<sup>nd</sup> February 2024

Kingsley,

As you are aware I will be going to attend a partner's conference in Livingstone in the next few days. Thereafter, I am proceeding to our regional head office in South Africa for our annual senior partners' consultative seminar. In the next few weeks, I am assigning you to review the work done on Golden Key Limited (GKL)

As you know, ZICA has stepped up its reviews and have now indicated that firms achieving a below standard grade on three consecutive reviews will be censured. The recent reviews carried out on our audits which included Golden Key Limited's audit for the year ended 31 March 2021, were just above average in terms of quality management. I would therefore like you to review the work done as I need to make doubly sure that the firm is not exposed

I am also concerned that GKC has the impression that as auditors, we should be held partly responsible for the fraud thefts being experienced.

I have already alerted the engagement partner of the GKL audit that this review would be carried out and that he should fully co-operate with you

I trust that you will have made substantial progress on this assignment for my review on my return in two weeks' time.

Marshall

*Marshall Puta*

## **GOLDEN KEY**

Golden Keys Co (GKC) has been manufacturing, supplying and fitting premium bathrooms and kitchens in hotel chains throughout Zambia for the past 20 years. The company started as a small family concern, but has increased into 40% market share company over the last three years.

Although GKC has achieved this quantum leap in growth, top management still remains in the clutches of the same family members. Mr. Mainza Chanza is the founder and majority shareholder of the company and assumes the role of Chairman and Chief Executive Officer

The draft financial statements for the year ended 31<sup>st</sup> March 2024 recognize:

Revenue	:	K18 million	(2023 K17 million)
Profit before tax	:	K2 million	(2023 K3 million)
Total assets	:	K58 million	(2023 K59 million) – About 75% is made up of manufacturing plant

GKC has been your audit client for the last four years and during this year, the audit team has been offered to buy any furniture or fitting at a 50% discount.

## **INTERNAL AUDIT AND FRAUD - THEFT**

GKC recently set up an internal department headed by Ken Zimba. Ken Zimba is an engineering graduate. However, he developed interest in internal auditing and has attended a number of workshops conducted by ZICA on internal auditing. Ken is assisted by three auditors who are still studying for the ZICA CA exams.

Ken reports to the managing director, Mr. Mainza Chanza. In addition to conducting the typical appraisal function of assessing internal control policies and procedures, the internal audit team conducts monthly inventory counts covering all the storage locations. This is because of the high levels of thefts that have been experienced in the past.

## **LOCAL CONTRACTS**

On the local front, business has been slow, Golden Key has found itself accumulating a lot of products as the construction at both domestic and commercial levels have significantly reduced due to weak performance of the Zambian economy characterized by high unemployment and rising prices. The inventory holding now stands at 120 days compared to an average of 50 days in the previous periods. Receivable days have also increased from 30 days to 60 days, currently standing at K1.2 million for the year ended 31 March 2024

The manufacturing plant has been operating at below 60% capacity. Consequently, Golden Key management decided to lease out some of the equipment to third parties.

GKC employed a business development consultant who proposed that GKC should explore opportunities within the region, particularly Angola and a small island called Blaze on the Namibian Border. This proposal was presented to the Board of GKC

## **RECENT DEVELOPMENTS**

As part of its expansion strategy, the board of Golden Key Co decided it needed to enter regional markets, and in particular the island, Blaze. The reason that the Island was selected as a suitable market was because it had experienced rapid economic growth and domestic prosperity following the discovery of rich, offshore mineral deposits. Unfortunately, this small island nation has never enjoyed stable democratic government and is notorious for corrupt business practices, with customs officials regularly demanding bribes from both importers and exporters. As a result, Blaze Island has a poor international credit rating. In order to attract both domestic and foreign inward investment, the government of Blaze Island operates with very low levels of indirect tax, which has stimulated the island's tourist industry and led in turn to a significant increase in hotel building.

Following a successful tendering exercise, Golden Key Co was awarded the contract to supply all of the bathroom equipment for a 200-room hotel, currently under construction in a remote area of the island. The total value of the supply contract amounted to \$500,000 and it was to be paid in three equal instalments as the bathrooms were delivered to the hotel. The contract assigns responsibility for shipping the goods from Zambia to the island solely with Golden Key Co, and no payment will be made until an agreed volume of goods clears Blaze Island customs. In order to be more prudent, GKC has decided to account for revenue based on amounts received.

## **SYSTEMS DEVELOPMENT**

Management of GKC is greatly concerned about the increased incidences of theft of inventories. This has been assessed to be partly because the accounting and management information systems are out of date. GKC would like to develop a new system. Management has asked your firm to give advice on the new system as they have little specialist in-house knowledge in this area.

## **INVENTORY COUNT**

GKC has storage warehouses in each of the major towns, Lusaka, Ndola, Kitwe, Livingstone and Solwezi. GKC has a system of conducting inventory count at the year-end. This is normally conducted on 1<sup>st</sup> and 2<sup>nd</sup> April every year, during which time business operations are closed. Being aware that the internal audit would in attendance during the count, the firm decided to partly rely (after consultation with management of GKC) on the work done by internal audit.

However, a junior auditor was sent to attend the inventory count that was conducted in Livingstone.

## **EXTRACTS OF WORK DONE ON INVENTORIES BY THE JUNIOR AUDITOR AUDIT TEAM**

### **Before the count**

- Reviewed inventory count instruction and considered them adequate

## **During the Count**

- Observed the counting to confirm that it was being conducted in accordance with instructions
- Were surprised with the increased level of inventories and new warehouse located in another part of Livingstone
- On two occasions, the count team encountered a difference between the recorded quantities and the counted quantities. The record was adjusted to reflect the counted quantities
- Furniture included some unique ornaments (decorations) and figurines (sculptures) considered very valuable. Given the different sizes and materials used, it was not clear how to classify and count them

## **Conclusion:**

I conclude that my attendance has obtained reasonable assurance that the procedures were conducted in accordance with inventory count procedures and the resulting quantities can be relied upon for subsequent valuation

## **After the count**

- Reviewed the final stock sheets for any obvious additions and amendments
- Obtained assurance from the warehouse manager that these were the final stock sheets

## **COMPLETION OF THE AUDIT**

You have gathered the following findings from the working papers documenting procedures and conclusions on the completion of the audit:

### **a) Court case**

Legal correspondence shows that there is an on-going legal case in which an ex-employee is suing GKC and has claimed K500,000 damages against the company for unfair dismissal. The audit team obtain verbal confirmation from GKC legal advisers that the damages are probable, but not virtually certain to be paid. No provision has been recognized in the financial statements. No other evidence was obtained by the audit team

### **b) Trade receivables**

On 1 May 2024 a notice was received from administration dealing with the winding up of Furniture Zambia Limited (FZL), following its insolvency. The notice stated the company should be in a position to pay approximately 10% of the amounts owed to its trade payables. The financial statements include a balance of K1.6 million owed by FZL

### **c) Chairman's statement**

The draft statement to be included in the annual report is on file. The chairman comments on the performance of GKC include a statement to the effect that the company had exceeded its budgeted results as revenue had increase by 20% from 2023.

## REQUIREMENTS

### 1) In relation to

- a) Fraud through theft
  - i) Comment on the assertion that your firm should be partly be blamed for the theft fraud (6 marks)
  - ii) Discuss whether it was possible for your firm to have detected the incidences of theft through audit procedures (4 marks)
- b) Ethical and other professional issues
  - i) Evaluate FOUR ethical and other professional issues arising (8 marks)
  - ii) For each issue recommend appropriate action that should be taken (8marks)

### 2) In relation to Golden Keys Limited

- a) Evaluate SIX business risks (12 marks)
- b) Discuss FIVE risks of material misstatement (10 marks)

**Note: Separate marks allocated for comments on materiality**

### 3) In relation to the need to rely on the work of internal audit and work done by the junior auditor

- a) Evaluate the matters that should be considered before relying on the work done by the internal auditor (11 marks)
- b) Conclude as to whether the work done by internal auditors should be relied upon by your firm (4 marks)
- c) Evaluate the adequacy of the procedures conducted by the junior auditor (9 marks)

### 4) In respect of the completion of the audit

- a) For each of each of the three matters raised during completion:
  - Court case - (9 marks)
  - Trade receivable (9 marks)
  - Chairman's report (6 marks)
- i) Assess the implications for the completion of the audit of GKC
- ii) Explain any adjustments that may be necessary
- iii) Recommend further procedures that may be necessary

**Note: for the purpose of this part of the question, assume the draft figures in the financial statements are correct**

b) Describe the impact on the audit report if these adjustments are not made

(4 marks)

**(28 marks)**

**[Total: 50 marks]**

## **QUESTION TWO**

### **MARY BLIGE ASSOCIATES**

You are an audit manager in Mary Blige Associates, firm of chartered accountants registered with the Zambia Institute of Chartered Accountants (ZICA). The firm was registered in 2019 and is proud to have accumulated a sizeable number of clients.

You have been assigned a portfolio of assignments including

1. Easy Finance Limited – Audit Planning and Testing
2. Delight Lux Limited – Audit completion and Reporting

### **EASY FINANCE LIMITED (EFL)**

#### **Your firm has recently been appointed as auditors of Easy Finance Limited**

Mr. Washa set up Easy Finance Limited (EFL) in 2018 pursuant to Companies Act No. 10 of 2017 of the Laws of Zambia. EFL is a non-deposit taking Micro Finance Institution licensed to operate a financial business by the Bank of Zambia under the Banking and Financial Services Act CAP 387 of the Laws of Zambia. EFL is headquartered in Lusaka with branches in each of the provinces of Zambia. Its products and services include

- Pay-Day advance
- SME loans
- Cash Advance
- Agricultural Loans
- Groups Loans
- Salary Advance

Before setting up EFL, Mr. Washa had spent several years working for Suarez Bank in the United States. Following the collapse of the Bank in 1916, Mr. Washa was deported to Zambia after appearing in court for suspected involvement in money laundering in a case involving transfer of funds from Zambia to a number of missions abroad. The case attracted a lot of interest in the Zambian Media

For the year ended 31 March 2024, EFL financial statements recognize

Profit before tax	K32.2 million (2023 K24.0 million)
Revenue	K577.0 million (2023 K599.0 million)
Total assets	K349.2 million (2023 K326.0 million)

On your first visit to EFL, you made an appointment to have a discussion with Mr Washa but you were told that all queries should be addressed to Maggie Chewe the finance director. You have not been able to meet with Mr Washa. In your various discussions with Maggie, you have become aware that



- EFL's investments have included various derivatives, including crypto currencies amounting to about K5 million. EFL also maintains numerous foreign exchange accounts both locally and abroad. These are accounts record a high frequency of movement in funds of significant amounts
- During the year, EFL with the influence of Mr. Washa managed to appoint Honourable Mike Pambashe as one of the executive directors. Mr. Pambashe currently serves as Minister of Foreign affairs in the UPND government
- Between Mr Washa and Mr. Pambashe, a sum of K50 million was injected into EFL to finance the opening up of new branches in Kasama, Solwezi and Lundazi

You have been availed an internal report on the developments and significant events that have taken place during the current year. These cover governance, technology as well as revenue performance and investments as detailed below

### **Governance**

The Bank of Zambia carries out inspection visits to assess compliance with applicable regulations. During the year EFL was fined 2,000 penalty points (each point is equivalent to K500.) for failing to improve its corporate governance policies and procedures. EFL's chairman (who was non-executive director) had passed away in the previous year and had not been replaced. Mr. Washa was acting as both chief executive officer and chairperson. In addition, the audit committee had not yet been comprised.

### **Technology**

In order to comply with Bank of Zambia regulations loans management, EFL, like all other banks are required to modify or replace their existing systems to incorporate forex management systems and new money laundering laws and regulations. During the year, EFL modified some parts of its systems and replaced some parts at a total cost of K3.7 million

The modified and replaced systems were still being implemented at the year end

### **Revenue and investments**

Revenue comprises mainly interest income. EFL uses amortised cost in accounting for its loan receivables using a fixed rate agreed upon at the time when the loan is disbursed. The loan periods range from one month to 3 years. For loans of less than six-month duration, EFL recognizes the total interest receivable as income regardless of when the loan is disbursed. EFL considers that this policy makes it less expensive and avoids the costly and tedious method of daily accruals of interest.

The finance non-deposit sector of the financial services industry has become very competitive with at least 10 new entrants every year. This has put pressure on EFL to be more innovative in developing new products and services in its portfolio.

Included in total assets are intangible asset that relate mostly to software and other technological development costs. During the year K3.5 million was spent on modifying the loan management

system. A further K2.0 million was spent on research and development into new products and services, and K500,000 on developing new accounting software. These costs have been capitalised as intangible assets and are all being amortised over a 15-year useful life.

During the year EFL moved to EFL House, a newly constructed complex to be used an investment property containing a suite of offices. This is included as investment properties in the extract of financial statements. EFL has adopted the fair value model for its investment properties and a revaluation was undertaken on 31 March 2024 for the first time. The revaluation was undertaken by an external valuer employed by EFL. The construction of EFL House started in 2022 and was completed at a total cost of K6.5 million and building brought into use on 1 April 2023.

## **DELIGHT LUX LIMITED (DLL)**

### **Delight Lux Limited has been a client of your firm for the last four years**

Delight Lux Limited prides itself as being the preferred company for confectionary products. If you can imagine it, they make it. From Zambia’s biggest lollipop, the creamiest milk chews and toffees to the fruitiest flavoured chewing gums, a world of flavor awaits. Following a tradition of excellence, Delight Lux manufactures a wide assortment of lollipops chewing gums, candy and sweets. A line of products designed to be of the highest quality, without compromise, whilst offering true value for money. The cornerstone of their operations is the flagship brand Amazon, operating under a franchise agreement with Amazon Incorporated in the USA

DLL is a stand-alone subsidiary company of Mpundu Holdings plc a conglomerate company listed on the Lusaka Stock Exchange (LuSE)

The financial statements for DLL for the year ended 31 March 2024 recognise

Revenue	K530 million	(2023 -K450 million)
Profit before tax	K69 million	(2023 K46 million)
Total Assets	K130 million	K2023 K110 million)

The audit of DLL is nearly complete and the audit senior has left the following outstanding matters for your attention

List if uncorrected misstatements

Note	Account	Profit and Loss		Statement of Financial Position	
		DR	CR	DR	CR
		K'000	K'000	K'000	K'000
<b>1</b>	Other income / Bank		3,700	3.700	
<b>2</b>	Profit b/down / Asset	900			<b>900</b>
<b>3</b>	Admin / Liability	0			<b>0</b>

## Notes

1. On 31<sup>st</sup> March 2024, DLL sold one of its refrigerated trucks to ABC bank for K3.7 million and immediately leased it back. The agreement provided that DLL was to be responsible for the maintenance and insurance of the truck, including any losses to be incurred associated with the use of the truck. The truck was to be repurchased back on 1 April 2025 at pre-agreed price of K3.885 million. ABC lending rates are approximately 5% per month

The finance director debited bank and credited other income for the sale of the truck

2. During the year, DLL changed its method of computing depreciation from reducing balance method to a method that is based on expected levels of production. This was considered to be more reflective of the manner in which the plant is utilized. This resulted in additional depreciation of K900,000. The finance director considers this to be a prior year adjustment and has treated it as a prior year adjustment by debiting equity (profit and loss brought forward) and crediting the asset
3. Delight Lux Limited is being sued by an American company for alleged breach of franchise agreement. Estimated compensation is K73 million. The lawyers of DLL have assessed that it is probable but not certain that DLL will be liable for the breach of the franchise agreement. The finance director has not recognized the provision in the financial statements on the understanding that this is a case for the Holding Company and should not affect DLL.

## Reporting

Following your discussion with the audit committee of DLL regarding these outstanding issues the following actions have sincere been taken

- a) The matters relating to sale of the truck remain outstanding as the finance director insists that a sale had taken place
- b) The matter relating to depreciation has since been resolved and required adjustments have been made to charge the K900,000 to the current profits.
- c) With regard to the legal case, you have been provided with a letter from Mpundu Holdings (MH) confirming that MH will provide all the financial and other support required to ensure that DLL continues as a going concern. The finance director has also included the provision of K73 million. The audit committee have also acknowledged that in the absence of the expected support from the holding company, the going concern status of DLL is questionable
- d) On page 34 of the financial statements, a note 12 has been included stating
  - i) The directors acknowledge that following the litigation proceedings from Amazon Incorporated, the going concern status of Delight Lux Limited is threatened

- ii) However, given the assurances received from our holding company, Mpundu Holdings, we maintain that our company will continue its operational existence in the foreseeable future as a going concern
- e) You have reviewed the note 12 on page 34 of the financial statements and you are satisfied with the disclosures provided

**The audit senior has now proposed the following audit report for your review**

**Extract of the audit report**

To the Directors of Delight Lux Limited

**Going Concern**

Delight Lux Limited is being sued by an American company for alleged breach of franchise agreement. However, Mpundu Holdings, the holding company of DLL is able to provide required resources and any other support to ensure that DLL continues as a going concern.

As auditors, we are satisfied with the disclosure.

**Basis of opinion**

Mrs Jolly Lombe, the finance director refused to make the required adjustment to reverse an entry made to other income from the sale of an asset to a third party. She believes that sale had in fact taken place. As auditors, we believe her opinion is misguided and is not supported by accounting standards

Accordingly, current profits are understated by K3.7 million and retained profit brought forward is understated by the same amount

**Opinion**

Because of the significance of the matter stated above, the financial statements comprising profit or loss and other comprehensive income, statement of financial position, statement of changes in equity and statement of cash flows do not give a true and fair view

## REQUIREMENTS

### 5) In relation to EFL

- a) Recommend due diligence procedures that your firm should have undertaken in accepting to be auditors of EFL (6 marks)
- b) Identify and describe SIX indicators of money laundering suspicions (12 marks)
- c) In addition to due diligence procedures, discuss other policies and procedures that your firm is required to adopt (at the firm level) and the action that should now be taken on the suspected money laundering in EFL (6 marks)

### 6) In relation to EFL

- a) Evaluate
  - i) EIGHT audit risks to be considered in the planning of the EFL audit (16 marks)
  - ii) Assess whether each risk is material (4 marks)
- b) Recommend and justify appropriate audit strategies for the following:
  - i) Level of planning and performance materiality to be set (4 marks)
  - ii) Overall approach to be adopted (4 marks)
- c) Recommend substantive procedures to be performed on
  - i) Modification of the loan management system (5 marks)
  - ii) Investment property – EFL house (7 marks)

### 7) In relation to each of the following outstanding issues relating to the audit completion of the audit of DLL

- a) Financial liability (6 marks)
- b) Depreciation (6 marks)
- c) Provision (8 marks)

Comment on the matters to consider and recommend further action that should be taken in the finalization of the audit of DLL, **AND** state the specific adjustment to be made in each case

**8) In relation to the draft report proposed by the audit senior**

- a) Discuss the matters to consider in accepting the letter of support as being sufficient and appropriate evidence in supporting the going concern status of DLL  
(4 marks)
  
- b) Critically evaluate the suitability of the audit report proposed by the senior auditor  
(12 marks)

**[Total: 50 marks]**

**END OF PAPER**