

DELTA & CO

CPE AUDIT QUESTION ONE

SUGGESTED SOLUTIONSS

1) In relation to the review of the Misebo Plc audit

a) Evaluate any SIX issues in total relating to the quality management, ethical and other professional issues that ZICA is likely to have raised regarding the audit of Misebo Plc (18 marks)

b) For each issue raised in (a) above, recommend appropriate actions to be taken as part of the responses to be provided to ZICA (12 marks)

The objective of the firm is to establish and maintain a system of quality management to provide it with reasonable assurance that:

- The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and
- Reports issued by the firm or engagement partners are appropriate in the circumstances

The applicable auditing standards are:

- ISA 220 (Revised)– Quality Management for an Audit of Financial Statements
- International Standard on Quality Management (ISQM) 1 – QM policies and procedures at the individual audit level
- International Standard on Quality Management (ISQM) 2 – Need for quality review and appointment of an engagement quality reviewer

	ISSUE	ACTION / SAFEGUARD
1	Long association – self-interest and familiarity threats Bob Lukozu has been acting as audit engagement partner for eight years. As Misebo Plc is a listed company this goes against the requirements of the ZICA <i>Code</i> which requires that an individual shall not act as the engagement partner for more than seven years. The problem is that long association of the engagement partner with the client leads to a self-interest threat to auditor objectivity, whereby the audit firm's judgement is affected by concern over losing the long-standing client. There may also be a familiarity threat due to close relationships between the audit engagement partner and management of Misebo Plc, meaning that the partner ceases to exercise sufficient professional scepticism, impacting on	• Bob Lukozu should be replaced as soon as possible by another audit engagement partner. • This matter should also be discussed with those charged with governance and included in report to those charged with governance

	audit quality. This is especially the case given that Bob Lukozu is performing additional non-audit services for the client.	
2	Monitoring – policies and procedures – ISQM 1 The fact that Bob has been allowed to continue as audit partner for longer than the period allowed by the ZICA <i>Code</i> indicates that Delta & Co does not have appropriate policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, as required by ISQM 1	The firm should review whether its monitoring of the length of time that audit engagement partners act for clients is operating effectively and make any necessary improvements to ensure compliance with ISQM 1
3	Leadership Responsibilities for Managing and Achieving Quality on Audits ISA 220 According to ISA 220, the engagement partner is required assume overall responsibility for managing and achieving quality on the audit engagement, including taking responsibility for creating an environment for the engagement that emphasizes the firm’s culture and expected behavior of engagement team members. In doing so, the engagement partner shall be sufficiently and appropriately involved throughout the audit engagement such that the engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the engagement. Bob Lukozu has booked only two hours for audit work performed on Misebo Plc. This is not sufficient time for the audit partner to promote adequate leadership and management of the audit	As part of panning, adequate time and should be allocated for leadership responsibilities that should include monitoring and reviews
4	Supervision and review – planning / allocation of staff – ISA 220 It appears that most of the final review was performed by a newly promoted audit supervisor who would not have the necessary experience to perform the review and the supervision. There is also a related issue regarding the delegation of work. Possibly some of the detailed review of the working papers could have been delegated to someone other than the audit partner, in which case the senior audit manager Mwaka Lishebo would be the appropriate person to perform this work. However, Mwaka only recorded six hours of work on the audit. Thus, confirming that too much of the review has been delegated to the new audit supervisor, especially given that going concern was identified as	- As part of panning, responsibilities for supervision and review should be specified and allocated to staff with requisite qualifications and experience - Also, adequate time should be allocated for this purpose - In the context of the Misebo audit, the audit manager and the audit partner should have been allocated more time for reviews

	a significant audit risk, meaning that the audit manager and partner have even more reason for involvement in the final review of audit work. It is possible that there is insufficient evidence to support the audit opinion which has been issued, or that inappropriate evidence has been obtained.	
5	Fees – self-interest threat There is also a possible a self-interest threat due to the monetary value of the service provided meaning that Bob Lukozu’s attention seems to have been focussed on the special investigation rather than the audit, leading to the problems of inappropriate delegation of this work as discussed above. His additional involvement with Misebo Plc by providing this work compounds the familiarity threat also discussed previously. A self-interest threat is created as the value of the services provided is substantial (K890,000) compared to the audit fee (250,000). The fact that non-audit fees are so high would create a proportionately bigger intimidation threat because they would form a larger part of the firm’s income and the audit firm may not be objective for fear of losing the client.	• The fees expected to be earned from the provision of other non-audit services should also be reviewed to reduce the perceived threat of undue dependence on one client
6	Special investigation – self-review/advocacy threats There is insufficient documentation as to the nature of this non-audit work, and it could relate to the provision of a non-audit service which is not allowed for a public interest entity. Misebo Plc is a listed company, and the <i>Code</i> prohibits the audit firm from providing certain non-audit services, for example certain internal audit services, valuation services and tax services. The lack of documentation means that Delta & Co could have provided a prohibited service and therefore be in breach of the <i>Code</i>. The fact that K890,000 was charged for this special investigation indicates that it was a substantial engagement and just the matter of inadequate documentation is a cause for concern. There is also a possibility that in fact no work has been performed, and the firm has accepted this money from the client but provided no service. This would be a very serious issue, could be perceived as a bribe, and it should be investigated with urgency. Depending on the nature of work involved in the special investigations, there may also be other threats to objectivity including self-review and advocacy.	• Delta & Co should ensure that its policies and documentation on engagement acceptance, especially in relation to additional services for existing audit clients, are reviewed and made more robust if necessary. • Potential ethical threats and other professional considerations should be taken into account in accepting to provide non-audit services as well.
6	Engagement quality review – ISQM 2	• Delta & Co should implement policies and procedures as required by ISQM 2.

	As this is a listed audit client, an Engagement Quality Management Review should have been performed in accordance with ISQM 2. It is not clear whether this took place or not, but no time has been recorded for this review.	- As part of planning, the engagement partner and audit manager should have identified Misebo Plc as a type of company requiring an engagement quality review - Additionally, If a pre-issuance review was carried out then it should have picked up these problems prior to the audit opinion being issued.
7	Going Concern – performance engagement/ planning and allocation of resources – ISA 220 The audit work on going concern has been inappropriately delegated to an audit assistant who would not have the necessary skill or experience. This is especially concerning given that going concern was identified as a significant audit risk, and that the work involves using judgement to evaluate information relating to contract performance. It is concerning that the audit work appears to have been based on a review of contracts which were selected by management. First, only five contracts were reviewed but the company is typically working on 20 contracts at one time. So it is likely that the coverage of the audit work was insufficient, and more contracts should have been subject to review. Second, management may have selected the better performing contracts for Mary to review. This would create a false impression of the performance of the company as a whole, leading to an inappropriate conclusion on going concern being reached. Finally, the work performed by Mary on this small selection of contracts appears insufficient and inappropriate. The lack of further audit procedures means that the audit evidence is not likely to be sufficiently robust in this significant area.	- The work should have been performed by a more senior member of the team, probably the audit manager or supervisors, who is more able to exercise professional scepticism and to challenge management where necessary on the assumptions underpinning the forecasts. - Given the risk attached to going concern perhaps all the contracts currently being carried out should have been reviewed, or the sample selected based on the auditor's evaluation of the risk associated with each contract and their materiality. - Assumptions should not just be agreed as consistent with the previous year, especially in a situation of increasing economic uncertainty as applies in this case. Assumptions should be challenged and other work performed as required by ISA 570 <i>Going Concern</i>.

2) In relation to the finalization of the audit of Chinyama plc

a) State the matters to consider and further action you should take regarding the:

i) Disclosure of the FMD event

(8 marks)

Matters to consider

i) Issue

The issue is potential overstatement of biological assets

ii) Justification

According to IAS 10, an adjusting event is an event that provides additional information relating to the conditions existing at the reporting date. The problem relating to possible exposure of the cattle to the FMD was identified at the reporting date, evidenced by the death of the twenty-three cows. Therefore, the declaration of Mazabuka area as a high risk area for FMD and the requirement by the department to destroy all animals exposed to the FMD should be regarded as an adjusting event as it provides additional information relating to the conditions at the reporting date

iii) Materiality

The total value of the animals exposed to the FMD is estimated at K40,05 million (90% X K44.5 million). This is 8% of total assets and is material. The amount is also 101% of profit before tax and is also material.

iv) Possible impact on report

This issue would have an impact on the audit report

Further action to take

- Discuss with management regarding their accounting treatment of the subsequent event as a non-adjusting event – with reference to the provisions of IAS 10 – Events after the Reporting Date
- Request management to recognise the loss of K40.05 million by crediting the inventories of biological assets and debiting the profit and loss
- Obtain further evidence by reviewing the pronouncement by the department of Veterinary Services, including the basis of the estimate of 90% of the cows suspected to have been exposed to the FMD
- Discuss issue with those charged with governance (TCWG) and include in report to TCWG
- If the adjustment is not made, a qualified except for opinion should be issued

ii) Netting of the loss against insurance recovery (6 marks)

Matters to consider

v) Issue

The issue is potential understatement of loss expected from effects of FMD and overstatement assets and profit

vi) Justification

According to IAS 1 – Presentation of Financial Statements, offsetting, otherwise known as netting, takes place when an entity presents its rights and obligations to each as a net

amount in the statement of financial position. However, this is only allowed when there is a contractual right or intention to set off two or more contracts.

In the case of Chinyama, the loss of the assets through PMD is a separate contract from the insurance against such losses and therefore cannot be set. The loss and the recoverable/receivable from the insurance company should be presented separately

vii) Materiality

The potential receivable based on the animals to be destroyed is estimated at K40,05 million (90% X K44.5 million). This is 8% of total assets and is material. The amount is also 101% of profit before tax and is also material. This does not include the twenty-three animals that had died before the year end.

viii) Possible impact on report

This issue would have an impact on the audit report

Further action to take

- Discuss with management
- Request for adjustment to be made – separate recognition of receivable if assessed to be certain – DR receivable and CR other income
- Obtain further evidence such insurance cover and correspondence from Ladson Insurance to confirm type of cover
- Discuss issue with those charged with governance (TCWG) and include in report to TCWG
- If the adjustment is not made, a qualified except for opinion should be issued

b) Evaluate whether the FMD event should be regarded as a key audit matter (KAM)

The term 'key audit matters' is defined in ISA 701 as:

'Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance

There are three matters which the ISA requires the auditor to take into account when making this determination:

1. Areas which were considered to be susceptible to higher risks of material misstatement or which were deemed to be 'significant risks' – high risk of material misstatement

2. Significant auditor judgments in relation to areas of the financial statements that involved significant management judgment such as estimates.
3. The effect on the audit of significant events or transactions that have taken place during the period.

The auditor must determine which matters are of most significance in the audit of the financial statements and these will be regarded as KAM.

In the context of Chinyama Plc, the decision to designate Mazambuka and the regulation to destroy animals exposed to FMD should be regarded as both a significant event and significant risk as it material and the impact has the potential of converting the profit into the loss. Additionally, this may also have going concern implications, especially if the losses expected are not recovered.

(4 marks)

c) Assuming that this is regarded as a key audit matter, state your firm's reporting responsibility relating to the KAM (3 marks)

Once the auditor has determined which matters will be included as KAM, the auditor must ensure that each matter is appropriately described in the auditor's report including a description of:

1. The Description of the Key Audit matter
2. Why the matter was determined to be one of most significance and therefore a key audit matter, and
3. How the matter was addressed in the audit (which may include a description of the auditor's approach, a brief overview of procedures performed with an indication of their outcome and any other key observations in respect of the matter). In th

3) In relation to the audit of Bola Football club

a) Comment on the implications of the previous year's qualified report on your current audit and state further procedures you should now take. Assume that the matter is material but not pervasive (6 marks)

Implications

- The previous year's audit report was qualified on account of impairment of players not having been taken into account. This implies that the misstatement is still included in the opening balance of assets of players, and if not corrected would the affect the opinion for the current audit
- In addition, in accordance with IAS 8, Accounting policies, Accounting Estimates and Errors – an error discovered in the current year but committed in the previous year should be treated as a prior year adjustment by restating the opening retained profits

Further procedures

- Obtain permission from BPF to contact the previous auditors – HLP – to arrange to review their working papers relating to the impairment, including having discussions with them
- Obtain the impairment policy relating to players and ensure that it is in accordance with IAS 36 – impairment
- Re-compute the impairment in question, taking into account carrying value, fair value and value in use of the affected players
- Review and discuss the issue of impairment with ABF to come to a conclusion as to the correctness of the accounting treatment to be applied
- Request management to make adjustment as appropriate

b) SEVEN business risks affecting Bola football club**(14 marks)****i) Resources - Age of players**

It appears that ABF has at least ten players that are over 30 years of age. As this age group struggles to cope with demands of professional football, this reduces the capacity and capability of ABF to win football matches. This also implies that the players being planned to be sold may be sold at a loss

ii) Resources – The stadium

ABF's stadium was built 20 years ago, with an average attendance of about 80% of its capacity. This has reduced from previous high level of over 96%. High maintenance costs and recent collapse of part of the wall suggests that the stadium is not operating at the required capacity and risk closure with the threats of litigation from fans and the local council. This has resulted in reduced revenue.

iii) Exchange losses

Players are bought and sold in foreign currency – US \$ dollars – and the players remuneration is designated in dollars. Without any hedging strategies, this exposes ABF to potential foreign exchange losses, which can be significant – judging from the recent movements of the Kwacha against the dollar

iv) Poor performance – position, profitability, revenue

ABF has not won a competition in the last five years and currently occupies position 8 on the Division 1 FAZ table. The most important driver of profitability for professional clubs is the performance of their men's first team in the Zambia football league and international competitions. If this poor performance continues, ABF may be relegated into the lower division with much reduced income potential. Attendance has already reduced from 96% to 80%

v) Governance structure

The ABF governance board structure is not effective as it comprises only 2 non-executive directors, against 7 other directors and the chairman. This implies that the non-executive are not able to successfully object to any decision that may not be in best interest of ABF. This may adversely affect the achievement of operational and resource objectives of ABF

Additionally, FAZ recommends that clubs follow generally accepted corporate governance best practice. Breach of any of these regulations results in significant fines (2% of revenue) and penalties being imposed, including deduction of points and relegation. ABF is at risk of incurring these fines which will further adversely the already dropping revenues

vi) Dwindling support

The reduction in the stadium capacity is partly attributed to dwindling fans' support due to poor results in the recent past. This results in loss of revenue from sale of tickets, loss of loyalty within Zambia and the region.

vii) Laws and regulations – barriers

Additionally, following the collapse of part of the fence, the local council have issued a warning to ABF for potential of breach of stated healthy and safety regulations. This may result in fines and penalties and ultimate closure of the stadium

c) Evaluate EIGHT risks of financial statement misstatement (20 marks)

i) Opening Balances

ABF has taken over this audit from HIP Associates. The previous years' report was modified on accounting of impairment of players not being taken into account. There is a risk that the assets and profit are still overstated if this is not rectified. Against this background, other opening balances may also be misstated

ii) Stadium – IAS 36 – capacity

ABF's stadium was constructed more than 20 years ago and it requires regular and costly maintenance. Further, the stadium capacity has reduced from 96.3% the previous year to 80%. These are indicators of impairment

According to IAS 36 – Impairment- ABF should have carried out an impairment review and compute any impairment by comparing the carrying value of the stadium and its recoverable amount, being the greater of its fair value and value in use. Therefore, there is risk that the

stadium may be overstated and profit overstated by the amount of impairment that may be required

iii) Barrier improvement

Following the collapse of parts of its fence ABF now plans to construct a new barrier in 2025 within the VIP (Very Important Persons) sitting area estimated to cost around K250,000. This amount has been included as part of the provisions balance included in the financial statements for the year ended 31st December 2024.

According to IAS 37, a provision is an existing liability except that the amount and the timing of the payment is not known for certain. A liability results from a past obligating event that cannot be avoided by ABF. Therefore, the provision of K250,000 is not allowed. Provisions and assets are overstated

iv) Revenue recognition – IFRS 15

75% of the seats are typically occupied by seasonal ticket holders who buy tickets in advance at the beginning of the season. ABF treats all advance purchases of tickets as revenue on the grounds that they are not refundable.

According to IFRS 15 – Revenue from Contracts with Customers – revenue should only be recognised once related performance obligation is satisfied. Accordingly, revenue is overstated by the amounts relating to future football matches

v) Translation – IAS 21

Players are bought and sold in foreign currency – US \$ dollars – and the players remuneration is designated in dollars. According to IAS 21 – the effects of differences in exchange rates, monetary assets and liabilities should be retranslated at rates prevailing at reporting date and any exchange differences transferred to the profit and loss. It is possible that IAS 21 was not properly complied with resulting in potential misstatement of assets and liabilities

vi) Players – IAS 36 – poor performance. Age

ABF has at least 10 players that 30 years and above. The market value of players that are 30 years and above is relatively lower as the performance of players in the age group are not able to sustain the demands of the professional game. This is an indicator of impairment.

According to IAS 36 – Impairment- ABF should have carried out an impairment review and compute any impairment by comparing the carrying value of these affected players and their recoverable amount, being the greater of its fair value and value in use. Therefore, there is risk that the stadium may be overstated and profit overstated by the amount of impairment that may be required

vii) Laws and regulations – IAS 37 - FAZ

The ABF governance board structure is not effective as it comprises only 2 non-executive directors, against 7 other directors and the chairman.

The ZFL is governed by the Football Association of Zambia (FAZ). The FAZ enforces the playing and other regulations of the ZFL. Other regulations include financial fair play regulations. The FAZ recommends that clubs follow generally accepted corporate governance best practice. Breach of any of these regulations results in significant fines (2% of revenue) and penalties being imposed, including deduction of points.

Accordingly, there is a risk that fines and penalties related to the governance structure have not been recognised in accordance with IAS 37 – Provisions, Contingent Assets and Contingent Liabilities. This may result in provision being understated and profit being overstated.

viii) Purchase of players – IAS 38

ABF buys and sells players. According to IAS 38 – Intangible assets – such players should be capitalised if they are assessed to be economic resources and should be amortised over an appropriate period. It is not easy to determine the basis of amortisation for players, given the unpredictable nature of their availability and performance. This may result in amortisation being misstated.

ix) Laws and regulations – Council

Following the collapse of parts of its ABF's fence, the local council have issued a warning to ABF for potential breach of stated health and safety regulations. It is possible that the ensuing provision or contingent liability has not been accounted in accordance with IAS 37 – Provisions, Contingent Liabilities and Contingent Assets.

d) Recommend principal substantive procedures relating to the

i) Lease of the basic infrastructure of the stadium

(4 marks)

- Inspect the lease agreement to verify relevant details relating to period, lease rentals and rights and obligations to verify that ABF is the lessee
- Re-compute the depreciation of the basic infrastructure of the stadium based on the lease term and agree with client calculations and amounts recorded in the financial statements
- Re-compute the liability using amortisation cost as per IFRS 16 and verify with management calculations and amounts recorded in the financial statements
- Visit the Kapwepwe mall and inspect the infrastructure for existence and condition

ii) Treatment of players held for sale

(6 marks)

- Inspect board minutes for the meeting held on 14 November to verify the decision to sale the five players
- Discuss with management to confirm whether the players were immediately available for sale from that date as required by IFRS 5 – Assets held for sale
- Inspect player contracts to ascertain any information relating to release and sale clauses
- Discuss with management their commitment to sale the five players by considering whether (As required by IFRS 5)
 - An active program to locate the buyers and complete the plan must have been initiated
 - The prices must be reasonable in relation to its current fair value
- It appears that as at 31st December 2024, no active negotiations had started
- Review the entries made to restate these players at the lower of carrying value and net realizable
- Discuss with management to reverse these entries as the requirements of IFRS 5 have not been met

SUGGESTED SOLUTIONS

CPE – FULL AUDIT QUESTION TWO

A+ ASSOCIATES

Requirements

1) In relation to money laundering

- a) Discuss the responsibility of A+ Associates with respect to money laundering
(6 marks)

a) Money Laundering

Money Laundering is defined as the process in which criminals attempt to conceal the origin and ownership of proceeds of their criminal activities, allowing them to maintain control of their proceeds, and ultimately, obtaining legitimate cover for the sources of income

A+ Associates are required to

- perform customer due diligence, i.e. procedures designed to acquire knowledge about the firm's clients and prospective clients and to verify their identity as well as monitor business relationships and transactions
- Create channels for internal reporting within the audit firm including appointment of a money laundering reporting officer (MLRO) to receive the money laundering reporting in which audit staff report suspicions of money laundering activities
- Keep records, including details of customer due diligence and supporting evidence for business relationships, which need to be kept for five years after the end of the relationship and records of transactions, which also need to be kept for five years
- Take measures to make relevant employees aware of the law relating to money laundering and terrorist offences and to train those employees in how to recognise and deal with transactions which may be related to money laundering or terrorist financing
- Put in place ongoing monitoring procedures to ensure that policies are up to date and being followed

The MLRO will be responsible for reporting incidents to the relevant authorities. Auditors must be careful to avoid tipping off a party suspected of money laundering

b) Money Laundering Indicators

Cash transactions

Mukwa Limited received dollar cash which is invested in Europe. This makes the company an ideal environment for cash acquired through illegal activities to be legitimised by adding it to the cash paid genuinely by customers and passing it through the financial statements. This is known as placement

Outside investments

Outside investments, particularly those in jurisdictions with weak regulatory oversight, pose a significant money laundering risk due to the ease of concealing illicit funds, the potential for generating profits from illicit sources, and the difficulty in tracing the origins of investments. The secrecy offered by offshore financial centers, coupled with the complex nature of some investment vehicles, makes it challenging for authorities to identify and track money laundering activities.

Frequent trips abroad

Mr. Mokola makes monthly trips abroad. Frequent trips abroad can be a money laundering risk because they provide opportunities to move illicit funds across borders, making it harder to track and seize them. This is particularly true for cash, which can be transported physically and may not be easily traceable. Additionally, travel agents and businesses involved in international transactions can be used as conduits for laundering money.

Politically exposed person

The chairman of the company is Mr. Neto Lasha, who is also the minister of tourism. As a government official, M. Lasha is a politically exposed person. Politically Exposed Persons (PEPs) are considered a money laundering risk because their positions often provide access to public funds and influence, increasing the likelihood of corruption, bribery, and the misuse of public resources. This heightened risk stems from the potential for PEPs to exploit their positions to conceal illicit wealth, launder money, or finance terrorism.

Access to senior management

Mr. Mokola has indicated that he prefers not to be disturbed, implying restricted access to him. Restricted access to senior management can pose a money laundering risk because it limits oversight and accountability for high-risk activities. This can make it easier for individuals to engage in illicit transactions without proper scrutiny, potentially facilitating money laundering and other financial crimes.

2) Compute the following ratios for 2024 and forecast 2025

	Forecast 2025	2024
a) Increase in Turnover	3.6%	
b) Gross profit margin	26%	20%
c) Operating margin	7%	11%
d) Receivable days	67 days	40 days

3) **Using the ratios computed above and other information,**

a) Describe EIGHT audit risks

(16 marks)

b) For each risk, suggest an appropriate response to reduce the audit risk

(8 marks)

	AUDIT RISK	SUGGESTED RESPONSE
1	First year of audit This is the first year A+ Associates is carrying out the audit of Mukwa Limited. As a result, there will be a lack of knowledge regarding the company's accounting policies and transactions which could lead to a misinterpretation of audit evidence or the performance of inappropriate procedures. This will increase detection risk and specifically non-sampling risk. There is also less assurance over opening balances as A+ Associates did not perform the audit last year.	Allocate additional time in the audit timetable to enable the audit team to research the client, its business and its systems. Ensure a comprehensive planning meeting is held with all audit staff to enable this information to be shared and allocate more experienced staff than usual to the audit. Increase audit procedures over opening balances.
2	Management pressure – self interest Mike Mokola is planning to sell his shares in the company. There is a risk that he may want to manipulate the financial statements to improve the performance and position of the company so as to increase the value of his shares. There is a risk that profit and assets are overstated.	Assign more experienced staff to the audit. Brief all audit staff to remain alert and exercise professional scepticism, especially in areas which require the exercise of judgement, and which would affect profit and asset valuations.
3	Capitalisation of expenditure – IAS 16 The company has spent K14.2m refurbishing the garden centres which has been recognised within non-current assets. Costs may have been included in non-current assets which do not meet the criteria of IAS® 16 Property, Plant and Equipment (PPE). There is a risk that PPE is overstated and expenses are understated.	Obtain a breakdown of the K14.2m. Review supporting documentation, such as invoices, to confirm that amounts have been correctly included within PPE. Inspect a sample of new assets to ensure that they exist and are generating economic benefits.
4	Classification and interest – IAS 1 Mukwa Limited has taken out a loan, which is to be repaid in five annual instalments commencing in September 2025. There is a risk that the amount outstanding may not be correctly classified between current and non-current liabilities, resulting in misstatement of these amounts. There is also a risk that the company may fail to include	Review the draft financial statements and agree the amounts disclosed as current and non-current liabilities to the loan documentation. Recalculate the finance charge for the year, agree the interest rate used to the loan documentation and review the draft statement of profit and loss to confirm it has been included.

	the finance charge relating to this amount resulting in understated finance costs.	
5	Capitalisation of advertising expenditure – IAS 38 K400,000 was spent on advertising in November 2024. This has been included within intangible assets and is being amortised over 24 months. Advertising expenditure does not meet the criteria for recognition in IAS 38 Intangible Assets and so it should be recorded as an expense. Failure to adjust for this will result in intangible assets and profit being overstated.	Review the invoice and the bank ledger account to ensure K400,000 was paid in November 2024. Discuss the matter with management and request that they adjust this and record the advertising costs as an expense. Review the journal for the adjustment recognising this expenditure in profit or loss.
6	Legal cost provision – IAS 37 The building authority is investigating whether Mukwa Limited has breached building regulations. Mukwa Limited could be required to remedy deficiencies and pay a fine. If it is probable that these costs could be incurred, then a provision should be made. If Mukwa Limited fails to do so, provisions will be understated. If it possible that these costs could be incurred, then disclosure should be made and if Mukwa Limited fails to do so, then disclosure would be inadequate and not in line with IAS 37 Provisions, Contingent Liabilities and Contingent Assets.	Review correspondence with the building authority to understand the alleged non-compliance and assess the likelihood of fines. Discuss the matter with the directors to assess their views as to whether Mukwa Limited complied with building regulations and any likely fines. Review correspondence with the company's lawyer on this matter. Review correspondence with surveyors or builders about remedial costs to assess the reasonableness of any amounts provided. If relevant, review any disclosures in the draft financial statements to ensure that they are adequate and meet the requirements of IAS 37.
7	Project expenditure – IAS 38 In August 2024, a project began to develop new technology to maintain the temperature and humidity in Mukwa Limited's greenhouses and K350,000 was included in intangible assets. The project may not have met the criteria in IAS 38 Intangible Assets for costs to be treated as assets. Therefore, intangible assets could be overstated and expenses understated.	Discuss the project with management and review the project files to establish at what date the criteria were met. Review a sample of costs recorded as project costs and documentary evidence such as invoices to confirm they were treated correctly as research or development.
8	Adjusting event – IAS 10 – Inventory NRV – IAS 2 A flood caused water damage to inventory and the sales price may need to be reduced.	Review invoices and other sales records to establish the sales prices of the affected plants from May until the

	There is a risk that the net realisable value (NRV) is lower than cost and, if the inventory is valued at cost, inventory will be overstated and cost of sales understated.	end of the final audit. For a sample of types of plant, review costing records to establish the cost and compare with selling price to establish if a write down is required.
9	Gross profit and operating margin change The gross profit margin has increased from 20% in 20X4 to 26% in 20X5 yet the operating profit margin has decreased from 11% to 7% over the same period. This could indicate that costs have been misclassified between cost of sales and operating expenses, leading to misstatement of amounts.	Review a breakdown of costs in comparison to the previous year. For any cost headings with large fluctuations compared to the previous year, discuss with management and perform detailed testing if required.
10	Receivables – Impairment – IFRS 9 The credit controller has been on sick leave and receivables collection period has increased from 40 days as at 31 July 20X4 to 67 days for 20X5. Control risk is increased as credit control procedures may not have been operating effectively for the last four months of the year in the credit controller's absence. There is a risk that some of these debts are not recoverable and an allowance may be required. If this is the case, trade receivables may be overstated and the allowance for receivables understated.	Select a sample of old receivables and discuss with Mukwa Limited's management as to whether an allowance is required. Review correspondence with those customers to identify any disputed balances which may require an allowance. Review payments received from those customers after the year end. Review any allowance to assess its adequacy. Discuss controls within the credit control department and the impact of the credit controller's absence with management and assess the adequacy of any alternative arrangements put in place.

4) Describe FOUR substantive procedures which A+ Associates should perform in order to obtain sufficient and appropriate audit evidence in respect of ADDITIONS to Mukwa Limited's property, plant and equipment. (8 marks)

- Obtain a schedule of additions, cast the schedule to ensure it is accurate and agree the total to the general ledger and trial balance.
- For a sample of additions, agree the cost recorded in the additions schedule to the purchase invoice and that the invoice is in the company's name.
- For a sample of items listed, review the details of the expenditure to confirm that the expenditure represents an addition to PPE rather than a repair of existing non-current assets.

- Inspect the existence of a sample of the new assets and agree serial numbers to the non-current asset register where possible.
- Discuss with management the basis for establishing the useful lives of the new assets and consider whether the useful lives of any existing assets may have changed as a result of the refurbishment.
- Recalculate depreciation for a sample of PPE and confirm the assets have been depreciated from the date the cafes were opened.
- Review expense accounts in the general ledger, particularly repairs and maintenance, and consider whether any items recorded as expenses were in fact additions to non-current assets.
- Review the draft disclosures in the financial statements and ensure that assets arising from the building of cafes are included in the total additions and that disclosures are in accordance with IAS 16 Property, Plant and Equipment.

5) In relation to laws and regulations

- a) Explain the responsibility of A+ Associates in relation to Laws and Regulations
(5 marks)

According to ISA 250 Consideration of Laws and Regulations in an Audit of Financial Statements, auditors are not responsible for preventing non-compliance with laws and regulations and cannot be expected to detect non-compliance with all laws and regulations. They have a responsibility to obtain reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error including those caused by non-compliance with laws and regulations.

A+ Associate's responsibility differs in relation to the two different categories of laws and regulations identified below:

- In relation to laws and regulations which have a DIRECT effect on the determination of material amounts and disclosures in financial statements, the auditor is required to obtain sufficient appropriate audit evidence regarding compliance.
- In relation to laws and regulations which DO NOT HAVE A DIRECT EFFECT on the determination of material amounts and disclosures in the financial statements, but may impact the entity's ability to continue to trade, the auditor is required to perform specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements. This includes inquiring with management whether the entity is in compliance with such laws and regulations and inspecting
- correspondence with relevant licensing or regulatory authorities.

A+ Associate also has a responsibility to remain alert, by maintaining professional scepticism, to the possibility that other audit procedures may bring instances of identified or suspected non-compliance with laws and regulations.

- b) Further action to take and reporting implications of Mukwa Limited's unwillingness to deal with the breach in building regulations.
(6 marks)

A+ Associate should consider whether they have a responsibility to report non-compliance to management, those charged with governance or a third party, as appropriate. On discovery of the non-compliance, the auditors should discuss the issue with management to determine implications of non-compliance and to establish the action taken or to be taken by management

As Mr. Mokola is unwilling to deal with this matter expeditiously, A+ Associates should consider:

- Reporting this matter to those charged with governance – the board
- The impact of the non-compliance implications on the audit report. If the total cost implications of K1.5 million are not taken into account, then profit will be overstated by K1.5 million and liabilities understated by the same amount
- This amount is about 24% (1.5/6.3) of operating profit and is material and is about 1.7% of revenue (1.5/88.2) and is also material in respect of revenue
- As the amount is material but not pervasive, the auditor should consider issuing a qualified, except for opinion
- The unwillingness to deal with the matter by management brings into question the integrity of management. Accordingly, A+ should also consider resigning from the audit.

6) In relation to the engagement quality review:

a) In relation to acceptance procedures

- i) Conduct a review of the information contained in the Mukwa Limited acceptance and contract assessment and to evaluate SIX weaknesses in A+ Acceptance procedures
(9 marks)

- ii) For each weakness, recommend appropriate improvements that should be implemented
(6 marks)

	Weakness	Recommendation to improve
1	Reference	No reference about the client have been obtained prior to acceptance which implies that money laundering procedures have not been complied with
2	Professional clearance	The professional clearance letter should be received in writing and reviewed to ensure that there are no matters that are relevant to accepting the engagement. This should be documented. If no letter is received, this should also be documented including action taken such as reporting to the relevant professional body
3	Legal clearance This was considered as not being applicable. However, given that the previous auditors resigned, there are specific legal procedures that should be followed. Otherwise the appointment of A+ Associates may be regarded as being null and void	Action should have taken to • Ensure that the outgoing auditors' removal or resignation has been properly conducted in accordance with the legislation • Ensure that the appointment of A+ Associates is valid from a legal perspective.

4	Intended user of financial statements This is stated as management and shareholders only	It is generally accepted that financial are primarily targeted at shareholders. However, the firm should be aware that there is a wider range of users that normally use audited financial statements for making their economic decisions. For example banks consider the credit worthiness of a borrower by partly referring to the statement of financial position
5	Due diligence Client identity confirmed Money laundering risk low Politically exposed Persons	Obtaining passport details of owner and wife is not enough. CDD should include obtaining addresses/location of key personnel in the organisation including the chairman, especially that he is a politically exposed person. This should include key roles in the organisation including anything to do with financing arrangement Apart from the cash business aspect, there are indicators of money laundering such as off shore investments with restricted access. Accordingly, the money laundering risk should be assessed as high The chairman of the company is Mr. Neto Lasha, who is also the minister of tourism. This makes him a politically exposed perso
6	Proposed partner/signature of partner	There is no partner assigned to the auditor and the acceptance checklist has not been signed. This is a failure of quality management in accordance with ISQM 1 and ISA 2 which requires that the overall leadership and management of an audit should be undertake by a partner
7	Objective of acceptance procedures	The checklist does not indicate the objective of undertaking these procedures. Stating the objectives would help the staff involved in the process to understand the importance and matters to consider in more detail

b) In relation to the Contract and Preconditions of the audit

- i) Discuss the importance of the letter of engagement being finalised and comment on the implication of this letter not being signed whilst the audit has already commenced
(5 marks)

According to ISA 210, The primary purpose of an audit engagement letter is to act as a formal, legally binding agreement between the auditor and the client, outlining the scope, responsibilities, and expectations of the audit engagement. It establishes a clear

understanding between both parties, minimizing the risk of misunderstandings or disputes.

Typical contents include:

- The scope, objectives and limitations of the engagement
- The responsibilities, rights and duties of management and the auditor/professional
- The form of communication and reports
- Practice arrangements (timing, information requirements, locations, use of experts, internal auditors etc.)
- The basis of fees

The fact the letter has not been signed opens up possible misunderstandings between the auditor and the client. The resignation of the previous auditor is probably a warning sign of possible misunderstandings across a range of issues

- ii) Evaluate the assessment that consideration of pre-conditions of an audit is not applicable for a new audit **(6 marks)**

According to ISA 210, the auditor is required to confirm that pre-conditions of an audit are in place. These:

- That an acceptable financial reporting framework is to be applied to the preparation of the financial statements
- That management understands and acknowledges its responsibilities for:
 - Preparing the financial statements What/Why
 - Providing the auditor with access to all relevant information and explanations
- If the client imposes a significant limitation of scope (leading to a disclaimer of opinion), the auditor shall not accept the engagement
- There are no threats to compliance with the fundamental ethical principles
- That the auditor has the competence to perform the engagement

It is therefore not appropriate to state that this is not applicable for new audits. If anything this is even more significant for new audits

c) In relation to engagement performance

- i) Identify and evaluate FOUR engagement performance engagement deficiencies in the approach adopted by A+ Associates **(8 marks)**
- ii) For each deficiency provide a recommendation which would have addressed it to ensure compliance with quality management requirements **(4 marks)**

	Deficiency	Recommendation to address
1	Human Resources – Qualifications and experience The audit engagement team which carried out the audit of Mukwa Limited had previously audited educational organisations rather than retail companies. As Mukwa Limited is a retail company, the audit team would not have the relevant experience to audit this type of company, especially in the area of inventory which may include a high degree of subjectivity.	A+ Associates should have selected a different audit team, which had knowledge of the relevant industry in which Mukwa Limited operates. The team should have comprised members who had audited retail companies and in particular had experience of auditing account balances such as inventory.
2	Planning and Direction - briefing Several junior members of the audit engagement team missed the planning meeting where Mukwa Limited's key audit risks were discussed. Without an appropriate briefing, team members will not fully understand the risks to be addressed during the audit of Mukwa Limited and may not gather sufficient and appropriate audit evidence to form a conclusion over the identified audit risks.	An additional team briefing should have been held with the audit engagement partner for the missing team members and all the audit risks explained in detail.
3	Supervision and Review The audit supervisor was ill for the last two weeks of the audit and during this period of absence, no other senior team members were assigned to the audit. It is important that audit assistants are able to discuss and raise questions with more experienced team members throughout the engagement so that appropriate communication can occur within the team. Without adequate supervision, audit assistants may not undertake their tasks correctly. Any misunderstandings may not be addressed on a timely basis leading to an inaccurate audit conclusion.	An alternative audit supervisor should have been allocated to the team to cover the period of illness. Alternatively, the audit manager could have been present on site more or available to answer queries during this period to address any concerns of audit assistants.
4	Planning – Allocation of staff – qualifications and experience Following absence due to illness, the audit of intangible assets was reallocated from the audit supervisor to a junior member of the audit team, who had never audited intangible assets before. The audit of intangible assets may be complex and include a degree of subjectivity. The junior team member allocated would be unlikely to have the relevant experience to audit this account balance and so may have formed inappropriate conclusions.	The audit of intangible assets should not have been reallocated to the junior team member. Other fieldwork should have been allocated to junior members so that a more experienced auditor was able to audit the subjective balance. Alternatively, an alternative auditor from A+ Associates should have been allocated to the audit of Mukwa Limited so that the audit of intangible assets was undertaken by a team member

		with appropriate competence and capabilities.