FULL AUDIT – December 2015

QUESTION ONE

QS Associates is a firm of ZICA accountants. It was formed by Henry Mwenya on 1 January 2000, and now has two offices in Lusaka and Kitwe. The establishment has grown from three to eighteen. The firm has four partners. Henry Mwenya is the Managing Partner.

The firm performs auditing, tax, accounting, treasury and other business advisory services. However, the firm has suffered from increased competition due to new firms setting up in both Lusaka and Kitwe. Large and medium audit firms are seriously questioning the regulatory role of ZICA. Most of the new firms lack credible systems to ensure ethical behavior and a level playing field for all.

At a planning meeting held at the end of 2013 for the whole firm, in Siavonga, one of the partners felt that the budget for the coming year (2014), was too ambitious. He was aware that the firm had failed to deliver what had been planned in the past two years.

Mr. Henry Mwenya, however, defended the budget stating that profitability in the past had fallen short of the original budget for a number of reasons, including:-

1) Poor cost control especially by audit managers,
2) Low productivity, mainly due to high labour turnover,
3) Poorly designed organization structure, and
4) Lack of an effective marketing strategy.

Henry Mwenya expressed confidence that the measures contained in the 2014 budget were enough to enable the firm deliver on its targets. A number of responsibilities were redefined and some reallocated.

Your name is Francis Mande, and you are one of the senior mangers in QS Associates. Henry Mwenya has just given you the responsibility to undertake annual reviews and any specific assignments for the following audit clients:

1) Mumana Ltd
2) Kafue Plc
3) Chamboli Ltd
4) Riverside Ltd

These are crucial to the attainment of the targets contained in the 2014 budget. QS Associates boasts of the best policies and procedures on ethics.

MUMANA LTD

Mumana Ltd is a well established company providing advertising and other marketing services. It was established over six years ago and QS Associates has been auditing the company since 2011.

At the beginning of 2014, Mumana Ltd entered into an agreement to provide marketing services to QS Associates. The managing director for Mumana Ltd, Luka Zebron was extremely excited about the agreement.

The following matters arose during the audit of the financial statements for the year ended to 31 March 2014, which is nearing completion:-

a) During the year, Henry Mwenya was appointed as a member of Mumana Ltd's board. He has already attended six board meetings. Other partners are not happy with the development and strongly feel Henry Mwenya's independence may be compromised.
b) QS Associates made an advance payment of K25,000 to Mumana Ltd for various marketing campaigns three months ago but nothing has happened up to now. The other partners are contemplating cancelling

the agreement and demanding a refund. However, the current liquidity position of Mumana Ltd is so poor that it may take a few months to get the refund.

c) Last month, one of the junior members of staff at QS Associates was the guest of honour at the wedding ceremony of the daughter to Luka Zebron who got married to Mumana Ltd's senior accountant in charge of receivables. The audit team's responsibilities were structured in a way that the junior member did not deal with receivables. The junior member is a close friend of the senior accountant.

d) During the year, QS Associates was engaged to assist in the resolution of tax disputes. Mumana Ltd insisted that QS Associates act as advocates, since the matter at hand was material to the financial statements. The engagement letter for this assignment is yet to be finalized, and work is just about to start.

e) QS Associates was also engaged to carry out a SWOT analysis of Mumana Ltd and assist in the formulation of a business strategy. This assignment has just been completed. The payment has been transferred from Luka Zebron's account to QS Associates' account. The new strategy will be implemented next year. QS Associates have already been told by management that they will continue as auditors next year.

f) At the beginning of 2014, Mumana Ltd engaged QS Associates to assist in the recruitment of a financial reporting accountant. This was a new position created by Mumana Ltd to enhance the financial reporting systems within the company. Mumana Ltd provided the criteria for selection. QS Associates recommended three candidates based on the criteria set by Mumana Ltd. None of the staff who were involved in the recruitment participated in the audit. The person who was finally recruited by the management of Mumana Ltd has played a key role in the current audit.

KAFUE PLC

Kafue Plc is a multinational company which makes and sells computer accessories. The company maintains a diverse customer base and this has had a positive impact on both liquidity and profitability.

You have just received the following email from Henry Mwenya:-

To: Francis Mande <francis@rocketmail.com>
From: Henry Mwenya <henry@rocketmail.com>
Date: 6th June 2014
Subject: Kafue plc audit

Francis,
I had a planning meeting with Kelvin Muyunda, the finance director of Kafue Plc yesterday. A number of issues regarding the audit for the year ended 30 June, 2014 were discussed.

I made the following notes from the Meeting:-

1) The company is experiencing an increase in cases involving theft of inventories especially computer chips,

2) Management is concerned that almost all employees in the technical department own more than one car. There is no evidence of any employee internal or external indebtedness in terms of loans.

3) A number of invoices and receipts are cancelled each month.

4) Large amounts of cash are held every day.

5) The morale among senior management appears low.

6) Instances of massive collusion between managers and juniors have been uncovered.

7) Some senior managers collude with offenders and deliberately lay wrong charges or simply turn a blind eye to wrong doing.

8) Significant related party transactions exist.

I have called a meeting of the audit team next week to consider the findings and suggest a way forward. Kindly prepare briefing notes for my use, in which you explain the issues to be discussed at the meeting.

I need your response before the close of business tomorrow.
Thanks,

Henry Mwenya

CHAMBOLI LTD

Chamboli Ltd is a well-established company involved in mining activities in Kitwe. The company is proposing to establish copper recovery and processing plants in Wusakile, north of Luangwa Surburb.

The anticipated total output is over 6,000 tonnes of copper ore per month, which will produce 200 tonnes of copper concentrates per month. The copper concentrate is expected to have a grade in the range of 88% to 93% of copper.

Chamboli Ltd intends to purchase a new concentrator at a cost R20,000,000 from the Republic of South Africa. A South African bank is willing to finance the transaction and has therefore requested financial forecasts for the next twelve months. The bank insists that the forecasts should be accompanied by an assurance report by a ZICA recognized firm.

QS Associates has been asked to provide the assurance report. The management of Chamboli Ltd has even sent a copy of the cash flow forecast and the supporting forecasted income statement and statement of financial position.

You have received the following email from Agness Mwewa, one of the partners in QS Associates.

To: Francis Mande < Francis@rocketmail.com >
From: Agness Mwewa < Agnmwewa@rocketmail.com >
Date: 8th June, 2014
Subject: Chamboli Ltd's forecast

Hello,
We have received the financial forecasts for Chamboli Ltd, although we are yet to make a decision on whether to accept the assignment or not. However, given our ambitious targets for 2014, I am sure we will accept. A preliminary review of the forecasts has revealed the following:-

1) An analysis of sales show that sales will increase by 30%. This is based on the assumption that overall profit margins will increase by 45% and the Kwacha will depreciate against the Dollar by more than 6%. Bad debts are estimated at 2%. The receivable collection days has reduced by 15 days to 45 days. Management intends to engage an overseas factor on a non-recourse basis. All the copper is sold abroad.
2) The labour cost has remained the same. Management has already successfully concluded negotiations with the union officials on a one year "Wage Freeze". This is contained in the latest collective agreement.
3) The forecast income statement shows that cost of sales is expected to fall by 18%. The payables payment period has increased by 10 days.
4) Overheads have increased by 7% in line with the inflation level. They are mainly property rentals, utility bills, insurance premiums and general

office expenses.

5) The supplier of the concentrator will be paid after a 60 day credit period.
6) The interest on the loan is 15%.

I would like you to recommend procedures to be performed on the forecast information given above. Oscar Phiri, the manager in charge of the Chamboli Ltd audit has also given me an outline of the suggested report on the assignment. The outline report is provided in the attachment below. I would like you to consider its suitability. You are not required to draft a new report. Your quick response will be highly appreciated.

Regards,

Agness Mwewa

Attachment: Draft report from Oscar Phiri

INDEPENDENT AUDITOR'S REPORT

We have examined the accompanying forecasted statement of financial position, statements of income and cash flows of Chamboli Ltd as of 30 September, 2015 and for the year then ending.

Our examination provides an absolute basis for the opinion given.

In our opinion, the financial statements for the year ended 30th September give a true and fair view.

(Signature)

(Date)

RIVERSIDE LTD

Riverside Ltd is one of oldest clients for QS Associates. It deals in motor spares but the board, at its meeting last month decided to diversify into the production and sell of aggregates to leverage on the opportunities in the Zambian market and respond to the growing sophistication in the needs of the construction sector. The project development anticipates environmental, social, and economic impacts.

The company has submitted an Environmental Impact Assessment (EIA) Report to the Zambia Environmental Management Agency (ZEMA). ZEMA has put up the following notice in the press:

ZEMA

This notice serves to inform members of the general public, interested and affected parties that an Environmental Impact Assessment (EIA) Report for Riverside Ltd's aggregates plant has been received by ZEMA for review , in line with the provisions of the Environmental Management Act (EMA), number 12 of 2011 as read with the EIA Regulations; SI. № 28 of 1997 and is available for scrutiny at the following places:

1. ZEMA Information and Documentation Centre in Lusaka.
2. ZEMA website : www.Zema.org.zm
3. Riverside Ltd's offices
4. Lusaka municipal council, civic centre

Kabeto Zimba who is the engagement partner has raised a few concerns which he would like you to address.

He is confident that the impact on the audit will be manageable.

SECTION A

1. a) Discuss the key functions of ZICA and briefly state how these could encourage ethical behavior.

[5 Marks]

b) Identify and explain the ethical and other professional issues relating to the matters raised in Mumana Ltd.

[18 Marks]

c) Suggest actions which might be taken by QS Associates in relations to matters indentified in Mumana Ltd.

[9 Marks]

2. a) Briefly discuss the key responsibility of an auditor as set out in one of the international standards on auditing (ISA) which you think might be relevant to the issues raised in Kafue plc.

[4 Marks]

b) Respond to Henry Mwenya's email.

[8 Marks]

c) Using an appropriate ISA, suggest three risk assessment procedures relevant to Kafue plc.

[6 Marks]

[**TOTAL 50 MARKS]**

SECTION B

3. a) Describe in as much detail as possible, the general matters QS Associates should consider before accepting to report on Chamboli Ltd's forecast financial information.

[10Marks]

b) Respond to Agness Mwewa's email.

[10 Marks]

c) Evaluate the suitability of the report prepared by Oscar Phiri.

[8 Marks]

4. a) Discuss why it is important for auditors to consider environmental law and regulations.

[7 Marks]

b) Advise Kabeto Zimba on the possible areas in the financial statements for Riverside Ltd which might be susceptible to the risk of material misstatements.

[10Marks]

c) Describe the main contents of social and environmental reports

[5 Marks]

[Total 50 marks]

QUESTION TWO

BACKGROUND

AFM Accountants is a firm of ZICA accountants. It was formed in 2002 and prides itself on the personal service it provides. The close contact it has with its clients means AFM Accountants receives a significant amount of repeat business. The firm now employs 40 staff, and has an annual income of K5,000,000.

The firm has good policies, especially in respect of training, quality and risk assessment. All policies are reviewed annually.

Last year, the firm spent K20,000 on training all audit staff in modern risk assessment procedures. This has had an immediate impact, with costs on almost all audits carried out so far, this year, decreasing by 5% on average. The managing partner is happy and has promised members of staff a higher bonus this year. He is now focusing more attention on the application of computer assisted audit techniques, especially in the conduct of forensic audits.

You are the manager in charge of the following audits:-

ii) MKC Ltd,

iii) CKM plc,

iv) KMC Ltd.

The modern risk assessment procedures have also had an impact on the efficient verification of financial statement assertions.

MKC LTD

MKC Ltd was incorporated in the Republic of Zambia in 2006. It is wholly owned by Elizabeth Mukoloma, who is the company's chairperson and chief

executive officer. She does not believe in failure. The company is wholly financed by her through equity and short-term loans.
MKC Ltd is a farming business with 30 permanent and pensionable staff. All the workers stay on the farm (situated in Lilayi), while Elizabeth Mukoloma stays in Kalundu, some 25 kilometres, north of Lilayi. It is a requirement that farming business organize agro insurance covers with reputable insurance companies.
In 2009, Elizabeth Mukoloma and her senior management team decided to concentrate on poultry farming, which was fairly predictable in terms of cash flows. The strategy resulted in improved profitability and liquidity over the past 4 years. However, the recent results for 2014 have been disappointing.

MKC Ltd procure its feed from Lion feeds Ltd. Lion feeds Ltd controls almost 70% of the market share for feed, and charges premium prices.

The feed is bought on a Just In Time (JIT) basis, since MKC Ltd has no proper storage facilities. MKC Ltd runs a backflush accounting system and no inventory records are maintained.

The day old broiler chicks are also bought from Lion feeds Ltd. MKC Ltd orders 10,000 chicks every 4 weeks and has a 10 chicken runs. Each chicken run has a capacity of 2,000 birds. The chicks are recorded on a piece of paper on arrival. The paper is handed over to Elizabeth Mukoloma. She gives the paper to the farm manager, who records the details in a note book. The farm manager is given details on mortality every week.

The employees are trained in daily operations and health matters. 3 employees are assigned to each chicken run and they work in shifts (Day and Night), for 7 days a week. There is a high labour turnover mainly due to long hours of work.

Chickens are ready for sale after six weeks, and most of them are sold in batches at Soweto market. A few sales are conducted at the farm by the farm manager. He is trusted by Elizabeth Mukoloma and is given authority to use the money for any business transactions. The sales at Soweto market are conducted by an agent who earns a commission of 30 ngwee per bird sold. The agent banks all the cash in an MKC Ltd's account at BFN bank. Any unsold birds after 3 days are sold at 20% of their selling price, and this money goes towards the commission for the agent.

An unqualified part-time bookkeeper prepares accounting records and management accounts on a monthly basis. He uses the note book from the farm manager and any information provided by Elizabeth Mukoloma. Elizabeth Mukoloma is generally impressed with the quality of the accounting records and has promised to employ the accountant on a permanent basis. Elizabeth Mukoloma is a surveyor by profession.

At the moment, the financial statements are prepared and audited by AFM Accountants. You have been the manager on the audit for the past 5 years. Your team now includes two junior auditors.

You are currently preparing a memorandum for the engagement partner setting out the audit and business risks relating to MKC Ltd, and the kind of audit strategy you feel should be adopted during the audit.

At one of the planning meetings for the audit of MKC Ltd, one of the junior auditors asked you to comment on the impact on the nature, extent and timing of audit procedures, if materiality was assessed as low at MKC Ltd.

CKM PLC

CKM plc is one of the 3 major oil marketing companies in Zambia and it is listed on the Lusaka Stock Exchange (LUSE). Since the liberalization of the economy in the late 1990s, CKM plc, like other oil marketing companies, has been facing increasing competition, especially from new entrants who have started developing new and modern infrastructure. Management is worried about the impact of these developments on the company.

The draft financial statements for the year ended 30 June 2014, show revenue of K628 million (2013 – K542 million), profit before taxation K125 million (2013 - K119 million) and total assets of K437 million (2013 - K361 million).

The following issues arising during the final audit have been noted on a schedule of points for your attention.

a) CKM plc abandoned one of its old lubricant manufacturing plant in Kitwe 6 years ago. The tests carried out by the Zambia Environmental Management Agency (ZEMA) during the year, revealed that the land is contaminated. The current legislation does not provide any clear penalties but the CKM plc has made a provision of K14 million in the financial statements for the year ended 30 June 2014.

b) To counter the aggressive marketing activities especially by new entrants, CKM plc incurred K60 million in advertising. This has been expensed, but the chief financial officer believes this is wrong. He has requested AFM Accountants to reconsider this treatment since the company recently approved the use of Economic Value Added (EVA) as a measure of performance. Under EVA, K45 million is treated as an investment for the future since the advertising cost is expected to benefit CKM plc for 4 years.

c) During the year, the Managing Director attended a workshop on "finance for non – finance managers". He was extremely impressed with a presentation by the ZICA Technical Director on statement of cashflows. He believes the direct method is easier to understand.

The statement of cashflows for the year ended 30 June 2014 reports net cash flows from operating activities under the direct method instead of the usual indirect method. All the corresponding figures have been restated.

KMC LTD

KMC Ltd is an insurance company, which was the second private wholly Zambian owned Insurance Company to enter the liberalized insurance sector. It is now among the leading insurers on the Zambian market. The company boasts of a branch network spread to almost all parts of the country.

The audit work for the year ended 31 March 2014 is nearing completion, and you are reviewing the draft audit report which has been prepared by the Accountant –In-Charge (AIC).

You are aware from the press, that a lawsuit was filed against the company by one of its major client. This material uncertainty which has affected the going concern status of KMC Ltd is adequately explained in note 13 in the financial statements. AFM accountants agrees that the disclosure is adequate. KMC Ltd is being sued for K260 million for wrong advice. The Managing Director has mentioned that the company's advisors have been having discussions with the company lawyers.

An extract from the draft audit report is shown below:

Basis for adverse opinion

As explained in Note 13, the company is being sued for K260 million for wrong advice. According to the International Financial Reporting Standards, the company should have prepared the accounts on a break-up basis, since the company's future going concern may be threatened if it was to lose the case.

Adverse opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse opinion paragraph, the financial statements present fairly, in all material respects the financial position of KMC Ltd as at 31 March 2014, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and comply with the companies Act, 1994.

Management of KMC Ltd has been debating whether an audit is value adding. They want to try a review engagement next year since they believe it is cost effective and offers better value.

One of the audit trainees on this engagement, would like you to explain what is meant by modified opinions in auditor's reports.

SECTION A

1. a) Discuss why it is important for AFM Accountant to understand the business risks facing MKC Ltd.

[4 Marks]

b) Identify and explain the key audit risks and business risks in MKC Ltd.

[27 Marks]

c) Recommend an appropriate audit strategy for MKC Ltd.

[9 Marks]

2. a) Explain the importance of planning in the performance of the MKC Ltd's audit.

[4 Marks]

b) Discuss the implications of materiality for the MKC Ltd's audit.

[3 Marks]

d) Advise the junior auditor on the impact on the nature, extent and timing of audit procedures if materiality at MKC Ltd is assessed as low.

[3 Marks]

[TOTAL 50 MARKS]

SECTION B

3. a) Using an appropriate International Standard on Auditing (ISA), discuss the relevance of financial statement assertions in risk assessment.

[3 Marks]

b) Suggest actions which auditors must undertake if evidence from one source is inconsistent with that from another.

[2 Marks]

c) In relation to each of the issues raised in CKM Ltd:-

i) Comment on the matters that you would consider,

[15 Marks]

ii) State the audit evidence that you should expect to find, in undertaking your review of the audit working papers and financial statements for the year ended 30 June 2014.

[3 Marks]

iii) Where appropriate recommend further audit procedure that should be carried out.

[3 Marks]

4. a) Discuss the types of Modified opinion.

[3 Marks]

b) Critically appraise the draft audit report of KMC Ltd for the year ended 31 March 2014, prepared by the AIC.

[6 Marks]

c) Comment on whether a review is appropriate for KMC Ltd

[5 Marks]

5. a) Compare and contrast a statutory financial statement audit and a forensic audit.

[4 Marks]

b) Explain, with reasons, how a member of ZICA should respond to a request to provide a forensic audit.

[3 Marks]

c)Recommend any six major steps to be undertaken by AFM Accountants in the application of a CAAT.

[3 Marks]

[Total 50 Marks]

FULL AUDIT

SOLUTION TO QUESTION ONE

SECTION A

1. a) According to section 5(1) of the Accountants Act, 2008, the functions of ZICA are to do all such acts and things as are necessary to foster the advancement of the accountancy profession.

   Some of the relevant functions mentioned under section 5 (2) are:-

   i) Regulate and govern the conduct of its members in the practice of their business and profession.
   ii) Promote the integrity and enhance the status of the accountancy profession including the declaration of any particular business practice to be undesirable for all or a particular category of accountants.
   iii) Develop, promote and enforce internationally comparable practice standards in Zambia.
   iv) Protect and assist the public in all matters relating to the practice of accountancy.

The functions contained in the law require world class standards. Since, ZICA is also an educator, the standards are well articulated, especially in the auditing papers. Hence, ethical behavior is encouraged from the time one registers as a student. Stringent disciplinary measures apply where one is found wanting. According to section 77(5), where the disciplinary Committee, after due inquiry, finds a chartered accountant or a member, guilty of professional misconduct, it may impose one or more of the following penalties:

- Order the cancellation of the chartered accountants or Member's practicing certificate, non –audit practicing certificate or certificate of registration;
- Censure the chartered accountant or Member;

- Caution the chartered accountant or member;
- Impose a fine, not exceeding one hundred thousand penalty units to be paid to the institute;
- Order the chartered accountant or Member to pay to the institute or to any other party of the hearing any costs of or incidental to the proceedings;
- Order the chartered accountant or Member to pay to the institute or to any other party to the hearing any costs of or incidental to the proceedings
- Order the chartered accountant or Member to pay any party to the hearing or other person, as restitution, the amount of loss caused by that person's negligence; or
- Impose any reasonable conditions for the suspension, for a period not exceeding one year of, the chartered accountant's membership, certificate of registration, practicing certificate or a non-audit practicing certificate.

1. (b) 1.(c)

Issue	**Explanation**	**Suggested Action**
i) Partner on client board	Henry Mwenya must be independent and be seen to be independent. He is faced with a self-interest threat since he is likely to be involved in board or managerial decision-making. He is unlikely to question the decisions he participated in making.	He should resign or ensure his role is essentially administrative e.g. company secretary.

ii) Close business relationship	The agreement regarding marketing services exposes QS Associates to a self-interest threat. The relationship is already proving problematic. Mumana Ltd has not done any marketing campaigns for K25,000 received from QS Associates. Indications are that, there could already to be a breakdown in the relationship. This is likely to impact negatively on the audit.	The agreement must be cancelled and a schedule of payment for K25,000 agreed. If an acceptable payment plan is not reached, QS Associates should consider resigning as auditor for Mumana Ltd, and also consider engaging a factor to recover the money.
iii) Personal relationships	Personal relationships do result in self-interest threat. The junior auditor may not want to jeopardize the friendship. He is unlikely to exercise the required professional skepticism.	There is no further action required since the firm has already acted appropriately.
iv) Resolution of tax disputes	QS Associates is faced with a self-review threat and an advocacy threat. This is likely to inappropriately influence the professional judgment and behavior. The matter is material to	QS Associates must not accept assignment.

	the financial statements	
v) SWOT analysis and assistance in the formation of business strategy	QS Associates is faced with a self-review threat. ISA 315 require an auditor to understand and assess an organisation's strategies. It is unlikely that QS Associates will be objective in their assessment of Mumana Ltd's strategy.	QS Associates should ensure a different team is used in the audit of next year's financial statements.
vi) Recruitment of the Financial Reporting Accountant	Recruitment of staff able to affect the financial statements create a self-interest threat. There is a temptation to make managerial decisions, which QS Associates may fail to question during the audit. In addition, QS Associates may not want to report any identified deficiencies as recommended by ISA 265	The work should be reviewed to ensure that: a) It has been conducted in accordance with the plan. b) Sufficient evidence has been obtained to support conclusions drawn. c) Conclusion drawn are reasonable given the evidence obtained.

2. a) The relevant standard is ISA 240 "The auditor's responsibilities relating to fraud in audit of financial statements. The auditor's responsibility is to obtain reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. He is responsible for maintaining professional skepticism throughout the

audit, considering the possibility of management override of controls, and recognizing that audit procedure effective for detecting errors may not be effective for detecting fraud.

b) Briefing notes

To: Henry Mwenya

From: Francis Mande

Re: Kafue plc audit

Date: 7th June 2014

The following notes explain matters to be discussed at the meeting. According to ISA 240, the discussion should include the following:-

1) An exchange of ideas between the engagement team about how fraud could be perpetrated.
2) A consideration of circumstances that might be indicative of aggressive earnings management.
3) A consideration of known factors that might give incentive to management to commit fraud.
4) A consideration of management's oversight of employees with access to cash/other assets.
5) A consideration of any unusual/unexplained changes in lifestyle of management/employees.
6) An emphasis on maintaining professional skepticism throughout the audit.
7) A consideration of the types of circumstances that might indicate fraud.
8) A consideration of how unpredictability will be incorporated into the audit;
9) A consideration of what audit procedure might be carried out to answer any suspicions of fraud.

10) A consideration of any allegations of fraud that come to the auditor's attention.
11) A consideration of the risk of management override of controls.

I am sure discussions regarding the above-mentioned matters will enable our firm meet the following objectives:-

- To identify and assess the risks of material misstatement of the financial statements due to fraud;
- To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses.
- To respond appropriately to fraud or suspected fraud identified during the audit.

c)Using ISA 315 "Identifying and assessing the risks of material misstatement through understanding the entity and its environment", the relevant risk assessment procedures to Kafue plc include:-

- Inquires of management and those charged with governance;
-Consideration of when fraud risk factors are present;
-Consideration of results of analytical procedures;
-Consideration of any other relevant information.

SECTION B

3 a) According to ISAE 3400 "The examination of Prospective Financial Statements", QS Associates should consider the following general matters before accepting to report on Chamboli Ltd's forecast financial information:-

i) QS Associates should not accept, or should withdraw from, the engagement when the assumptions are clearly unrealistic or when QS Associates believes that the prospective financial information will be inappropriate for its intended use.

ii) QS Associates and Chamboli Ltd should agree on the terms of the engagement.

The ISAE also lists the following factors which QS associates should consider:-

i) The intended use of the information.

ii) Whether the information will be for general or limited distribution.

iii) The nature of the assumptions, that is, whether they are best estimate or hypothetical assumptions:

v) The elements to be included in the information.

vi) The period covered by the information.

QS Associates should also have sufficient knowledge of the business to be able to evaluate the significant assumptions made. QS Associates must also consider practical matters, such as the time available to them, their experience of the staff member compiling the information, any limitations on their work, and the degree of secrecy required beyond the normal duty of confidentiality.

b) To: Agness Mwewa < Agnmwewa@rocketmail.com >

From: Francis Mande < francis@rocketmail.com >

Date: 10th June, 2014.

Subject: Chamboli Ltd's forecast

Madam,

I have looked at the information you sent, and wish to recommend the following:-

a) Appropriate procedures

i) The forecast increase in sales and the overall profit margin should be checked for reasonableness. A review of the recent past performance should be done.

ii) Performance of analytical procedures on historical information to confirm reasonableness of forecast sales, taking into account knowledge of the business.

iii) Ensure the expected depreciation of the Kwacha is consistent with market expectation.

iv) Review the adequacy of bad debts through discussion with management.

v) Enquire as to the reasons for engaging an overseas factor and investigate the decrease in receivable collection days.

vi) Obtain the latest collective agreement and confirm the wage freeze.

vii) Enquire as to the reasons for the fall in cost of sales and the increased payables payment period.

viii) Verify overhead figure to supporting documentation e.g. latest invoices, utility bills etc.

ix) Review correspondence with the supplier of the concentrator to confirm that the supplier of the concentrator has given Chamboli Ltd a 60 day credit period.

x) Agree the interest rate to the correspondence with the bank.

xi) Ensure the cash forecast are consistent with the forecast income statement.

xii) Ensure the timing of the interest payments are consistent with the draft agreement.

b) <u>Suitability of report</u>

i) The title must be "INDEPENDENT ACCOUNTANT'S REPORT" not "INDEPENDENT AUDITOR'S REPORT", since this assignment is not an audit.

ii) The report must include the responsibilities for management and the accountant. For example, a clear statement must be included which states that management is responsible for the prospective financial information including the assumptions on which it is based.

iii) There should also be a reference to the ISAE or relevant national standards or practices applicable to the examination of prospective financial information:

iv) The reference to absolute basis is totally wrong. ISAE 3400 suggests that the accountant express an opinion, including:

- A statement of negative assurance as to whether the assumptions provide a reasonable basis for the prospective financial information.

- An opinion as to whether the prospective financial information is properly prepared on the basis of the assumptions and the relevant reporting framework.

- Appropriate caveats as to the achievability of the forecasts.

v) Prospective financial information must not be referred to as financial statements, and the period quoted is also wrong, i.e, year ended 30th September (no year mentioned).

vi) Reference to true and fair view is also wrong. A negative assurance must be used.

I hope the following will assist.

Thanks,

Francis Mande

4 a) It is a requirement of ISA 250 "Consideration of laws and regulations in an audit of financial statements". "The auditors must be alert to the possibility of the nature of a client's business having potentially harmful environmental impacts (Past, present and future)".

It is an area of great public interest. According to the Accountant's Act 2008, ZICA shall maintain appropriate practice standards among members that are consistent with the principle of self-regulation and the public interest.

It is also an important part of risk assessment and internal control auditors should consider information concerning existing and proposed regulations and the respective fines or penalties incurred must also be considered.

b) Environmental issues may have a direct Impact on the following:

i) Provisions e.g. for site restoration.

ii) Contingent liabilities e.g. arising from pending legal action.

iii) Actual liabilities e.g. fines and penalties imposed.

iv) Non-current asset values e.g. property situated on or near a contaminated site.

v) Inventory valuation.

vi) Capital or revenue expenditure on clean-up operations.

vii) Product redesign costs.

viii) Going concern e.g. where new or more stringent environment legislation (such as that on emissions) threatens product viability, or where withdrawal of an operating licence is "life threatening".

The following are also important:

- The risk of non-compliance with laws/regulation,
- The risk of compliance costs arising,
- The possible effects of customers' preference.

c) There is no guidance in issue as to the contents of such a report. The items listed below should be included as a minimum:

   i) Note of the objectives of the review,
   ii) Opinions,
   iii) Basis on which those opinions have been reached,
   iv) Work performed,
   v) Limitations to the work performed, and
   vi) Limitation to the opinion given.

FULL AUDIT

SOLUTIONS TO QUESTION TWO

SECTION A

1.a) Business risk is related to the company as a whole. It has implications at all stages of an audit assignment. It is therefore particularly important for AFM Accountants to understand the business risks facing MKC Ltd because:

i) It is a requirement under ISA315 “Identifying and assessing the risks of material misstatement through understanding the entity and its environment”.

ii) It will promote greater knowledge of the business of MKC Ltd.

iii) It will provide more focus for the audit of MKC Ltd, as it will help AFM Accountants to identify financial statement areas susceptible to material misstatements and provide a basis for designing and performing further audit procedures.

iv) It will aid understanding of MKC Ltd’s directors motives.

b)

AUDIT RISKS	
Audit Risks	**Explanation**
Inherent Risks i) Dominant chairperson and CEO–Elizabeth Mukoloma	There is a greater potential for her to override internal controls, and her dominance may impact negatively on going concern
ii) Poultry Industry	The risk of disease (e.g. bird flu)

	is particularly high. This can transform what initially appear to be a profitable business into loss making.
iii) High Regulated Environment	Possibility of non – compliance with various regulation is high
Control Risks i) Lack of proper books of accounts (use of backflush system)	There is no mention of proper books of accounts being maintained apart from the farm manager's note book. The accounting information is likely to be incomplete.
ii) Use of unqualified part time bookkeeper.	The unqualified book keeper is unlikely to know acceptable financial reporting frameworks. His competence may be questionable. Elizabeth Mukoloma's praise may be out of ignorance, since she is not an accountant.
iii) Lack of Segregation of duties	The farm manager keeps the note book and is also responsible for sales at the farm. No one seems to be checking on the activities of the farm manager.
Detection Risks	These may be inexperienced to

i) Use of junior auditors	be able to competently carryout various assignments without proper supervision.
ii) Preparation of financial statements by AFM Accountants	It is likely that AFM Accountants may be complacent when examining financial statements prepared by them. The level of professional skepticism is likely to be low. AFM Accountants will be faced with a self – review threat.
iii) Audit manager for the past 5 years	Using the same senior personnel in an audit team over a long period may create a familiarly threat to objectivity. The audit manager may take a more sympathetic view in this audit and fail to carry out all the required audit procedures.
BUSINESS RISKS	
Business Risks	**Explanation**
Operational Risks i)Reliance on one supplier for chicks and feed	The supplier has more bargaining power which can adversely affect business operations. If the supplier decided to increase prices

	significantly or stop supplies, the impact will be felt by MKC Ltd immediately.
ii)Use of JIT system	Any disruption in supplies can impact on business negatively since MKC Ltd has no storage facilities
iii)Poor human resource management and inefficiency in working practices	There is no mention of any human resource management system in MKC Ltd. This is common in most farming enterprises, and usually results in increased labour turnover and unnecessary disputes, including strikes
Financial Risks i)Cash business	Cash receipts are sensitive and therefore prone to theft
ii)Use of an agent	Possibility of manipulation of sales to boost the commission in high.
iii)Single source of finance- Elizabeth Mukoloma	MKC Ltd is likely to experience a funding gap especially that the recent results are disappointing
Compliance Risks i)Non compliance with the employment Act	MKC Ltd has no human resource expert
ii) Non – compliance with health	The recent disappointing results

and safety laws and regulations	may reduce the funds available for training and health and safety matters.
iii) Lack of the required insurance covers	It is likely that MKC Ltd may be operating without the necessary insurance covers, since they may view this as non value adding

c) The main risks faced by MKC Ltd are:

i) Dominant chairperson and Chief Executive Officer (CEO)

ii) Poor financial reporting framework

iii) Poor control environment.

iv) High possibility of fraud

In view of the aforementioned main risks, the appropriate audit strategy is an audit risk approach, with substantive testing.

2)a) Planning generally entails developing an overall strategy and a detailed plan for the expected nature, timing and extent of the audit. ISA 300 **"**Planning an audit of financial statements" states that the auditors shall plan the audit so that the engagement is performed in an effective manner. Hence, planning in the performance of the MKC Ltd audit is important mainly because of the following:

i) It will help AFM Accountants to devote appropriate attention to important areas of the audit.

ii) It will help AFM Accountants to identify and resolve potential problems on a timely basis.

iii) It will help AFM Accountants to properly organize and manage the audit of MKC Ltd so that it is performed in an effective manner.

iv) Assist AFM Accountants in the selection of appropriate team members and assignment of work to them.

v) Facilitate the direction, supervision and review of the audit work of MKC Ltd.

b) The implication of materiality for the MKC Ltd audit are as follows:

i) AFM accountants are required to consider materiality and its relationship with audit risk when conducting the MKC Ltd audit.

ii) AFM Accountants should plan and perform the audit of MKC Ltd to be able to provide reasonable assurance that the financial statements are free of material misstatements.

iii) The amount (quantity) and nature (quality) of misstatements in the financial statements of MKC Ltd need to be considered.

iv) The possibility of small errors in the financial statements of MKC Ltd should be considered cumulatively.

v) Materiality should be considered at both the overall financial statement level and in relation to an individual account balance.

c) The Impact on the nature, extent and timing of audit procedures if materiality at MKC Ltd is assessed as low can be summarized as follows:

ITEM	**IMPACT**
i. Nature	• This will mean AFM Accountants should increase substantive testing
ii. Extent	• AFM Accountants should increase sample sizes
iii. Timing	• AFM Accountants should ensure that more testing is carried out on period end balances

SECTION B

3. a) ISA 315 "Identifying and assessing the risks of material misstatement through understanding the entity and its environment", states that the auditor must use assertions for classes of transactions (i.e. income statement), account balances (i.e. statement of financial position), and presentation and disclosures in sufficient detail to form the basis for the assessment of risks of material misstatement and design and performance of further audit procedures.

b) If audit evidence from one source is inconsistent with that from another, the auditor must determine what modifications as additions to audit procedures are necessary to resolve the issues and must consider the effect on other aspects of the audit.

c)i) MATTERS TO CONSIDER INCLUDE:

Contaminated land

- **Materiality**
  - The provision represents 23% ($\frac{14}{628}$ x 100%) of turnover, 11.2% ($\frac{14}{125}$ x 100%) of profit before taxation and 3.2% ($\frac{14}{437}$ x 100%) of total assets.

    This issue is therefore material.

- **Accounting treatment**
  - According to IAS 37 “Provisions, contingent liabilities and contingent assets”, a provision is a liability of uncertain timing or amount.
  - A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
  - In case of CKM plc, there seems to be no liability and as such a provision should not be recognized unless there is:

    i) A constructive obligation to clean up the land (since there does not appear to be any legal obligation to do so), and

    ii) A reliable estimate of the obligation can be made.

There will not be a constructive obligation, unless for example, CKM plc has a published policy for cleaning up sites and honouring its published policy (i.e. creating a valid expectation).

- **Risk**
  - Provisions may be materially overstated
  - Income for the year may be understated

Advertising cost

- **Materiality**
  - Advertising cost represents 9.6% ($\frac{60}{628}$ x 100%) of turnover, 48% ($\frac{60}{125}$ x x100%) of profit before taxation and 13.7% ($\frac{60}{437}$ x 100%) of total assets.
  - This issue is therefore clearly material.

- **Accounting treatment**
  - According to IAS 38 "Intangible assets", internally generated intangible assets such as advertising costs, which are not capable of being recognized as assets should not be recognized.
  - Advertising cost is indistinguishable from internally generated good will.
  - The standard states that advertising costs should be expensed in the income statement.

- The current financial accounting treatment in CKM plc's financial statements is correct and should not be confused with the management accounting treatment.

- **Risk**
  - There is no risk, unless the current accounting treatment is changed, in which case income will be overstated and intangible assets overstated also.

Statement of cashflow

- **Materiality**
  - Change is material by nature, since, in practice the indirect method is more commonly used.
  - Users are therefore used to statements of cash flows based on the indirect method.
- **Accounting treatment**
  - IAS 7 "Statement of Cash Flows" encourages reporting under the direct method because it provides information which is not available under the indirect method.
  - Hence the use of the direct method is clearly permitted.
- **Risk**
  - Inadequate or non – disclosure of the reason for the change.
  - Wrong restatement of corresponding figures

ii)AUDIT EVIDENCE

Contaminated land

- ZEMA Report
- Board minutes on relating to the contaminated land

- Report on site visitation by audit staff
- Written representations covering management's intentions

Advertising cost

- Supporting Invoices
- Board Minutes relating to Advertising costs
- Draft Financial Statements

Statement of cashflow

- Schedules of cash receipts
- Schedules of cash payments
- Copy of statement of cash flow

iii) RECOMMENDED FURTHER AUDIT PROCEDURES

Contaminated land

- Inquiry of management why the site has not been cleared for 6 years.
- Discuss with management how the K14 million was arrived at.
- Ask what has prompted the provision now.

Advertising costs

- Advise management that the current treatment is correct. They should not confuse financial accounting treatment with management accounting treatment.
- Enquire if there are any prepaid advertising costs since these must recognized in the statement of financial position.

Statement of cashflow

- Ensure the provisions of ISA710 'Comparative information – corresponding figures and comparative financial statements" have been followed.
- Verify the restated figures.

4.a)Modified opinions are covered by ISA 705 "Modifications to the opinion in the independent auditor's report", which identifies three types of possible modification.

i) A qualified opinion – this must be expressed in the auditor's report in the following two situations:

   -The auditor concludes that misstatements are material, but not pervasive, to the financial statements

   -The auditor cannot obtain sufficient appropriate audit evidence on which to base the opinion but concludes that the possible effects of undetected misstatements, if any, could be material but not pervasive.

ii) Adverse Opinion – This is expressed when the auditors having obtained sufficient appropriate audit evidence, concludes that misstatements are both material and pervasive to the financial statements.

iii) Disclaimer of Opinion – An opinion must be disclaimed when the auditors cannot obtain sufficient appropriate audit evidence on which to base the opinion and concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

   i. The opinion must also be disclaimed in situations involving multiple uncertainties when the auditor concludes that despite having obtained sufficient appropriate audit evidence for the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statement.

b) i) The facts do not require an adverse opinion.

ii) Therefore the basis for adverse opinion and the adverse opinion paragraphs should not be in the report.

iii) Even if we were to assume that the two paragraphs were relevant, the contents of the two paragraphs are wrong. The level of incompetence exhibited by the AIC is unacceptable. He needs training or he must be relieved of his duties.

iv) The contents of the so called adverse opinion, is infact an unmodified opinion.

v) The company is faced with a material uncertainty that may cast doubt on the entity's ability to continue as a going concern.

vi) This material uncertainly is adequately explained in note 13 in the financial statements, and AFM Accountants agree that the disclosure is adequate.

vii) The opinion must be unqualified, since the material uncertainty is adequately explained.

viii) An emphasis of matter paragraph should be included in the audit report, after the opinion paragraph. This should draw the users attention to note 13.

c) A review is a limited assurance engagement. ISRE 2400 "Engagement to review financial statements", contains guidance on review engagements. It is another form of assurance that can meet the needs of some small and medium – sized entities (SMEs), without putting an undue strain on time and other resources.

KMC Limited, however is not an SME. It is among the leading insurers in the Zambia market. ISRE 2400 (revised), states that a review may not be appropriate for complex entities such as insurance companies, for which inquiry and analytical procedure alone may not reduce engagement risk sufficiently. Hence a review may not be appropriate for KMC Ltd.

5.a)Forensic auditing is the process of gathering, analyzing and reporting data, in a pre-determined context, for the purpose of finding facts and/or evidence in the context of financial, legal disputes and/or irregularities and giving preventative advice in this area.

A statutory financial statement audit is a type of assurance engagement that is carried out by an auditor to give an independent opinion on a set of financial statements. It is required by law.

A statutory financial statement audit therefore focus on financial statements, while the scope for a forensic audit is wide. Many of the techniques used in a forensic audit will be similar to those used in the audit of financial statements, but the different objectives and risks of the assignment require some differences in approach e.g. in a forensic audit, there may be no materiality threshold.

b)It is important to note from the outset that the fundamental principles, in the code of ethics for professional accountants apply in all professional assignments. Hence, the response will depend on the evaluation of these principles. For example:

i) Integrity – Forensic accountants are often, by definition, working in an environment and dealing with individuals who are dishonest and lack integrity. If there is any risk that their own integrity may be compromised, they should decline.

ii) Objectivity – Any perceived threats to objectivity will undermine the credibility of the accountant's opinion.

iii) Professional competence and due care – Forensic assignments may require very specialized skills. For example, where evidence gathering requires specific I.T skills. A member of ZICA should consider very carefully whether they have adequate skills and resources before accepting the assignment.

iv) Confidentiality – Forensic accountants will often be working for one party to a dispute, and have access to very sensitive information, subject, of course, to legal rules of disclosure in court cases, it is clearly essential to maintain the strictest confidentiality.

v) Professional behaviour - fraud cases and other situations such as takeover disputes can be very much in the public eye. Any lapse in the professionalism of say, an expert witness, could do serious damage to the reputation of the profession as a whole.

c)The major steps to be undertaken by the auditors in the application of a CAAT are as follows:

i) Set the objective of the CAAT application.

ii) Determine the content and accessibility of the entity's files.

iii) Define the procedures to be performed on the data.

iv) Define the output requirements.

v) Identify the audit and computer personnel who may participate in the design and application of the CAAT.

vi) Refine the estimates of costs and benefits.

vii) Ensure that the use of the CAAT is properly controlled and documented.

viii) Arrange the administrative activities, including the necessary skills and computer facilities.

ix) Execute the CAAT application.

x) Evaluate the results.