



COMPETENCE PRACTICE EXAMINATION

FULL AUDIT

JANUARY 2009

TIME ALLOWED: 5 HOURS

INSTRUCTIONS TO CANDIDATES

1. This paper has Two Questions.
2. You are required to attempt ALL the two questions
3. Each question has Sections:

Question one has three Sections: A, B and C
Question two has two sections: A and B
4. All the two questions carry equal marks.
5. The Examination is divided into sessions of 2½ hours each. There will be a 30 Minutes break in between the sessions.
6. Please use your Membership number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.
7. This is an open book examination.

QUESTION 1

Blue Steel Construction Ltd (BSC) is a medium-sized construction company engaged in the construction of both long term and short term construction works, including the provision of related maintenance and consultancy services. The company is audited by Petwe & Partners, a medium- sized firm of registered auditors where you are employed as a senior audit manager. Although you have been involved with this client for the last two years, you have been retained and assigned as audit manager for the audit of the year ended 30 September 2008.

For the audit of the year ended 30 September 2008 financial statements, it was decided to conduct an interim audit mainly to review and test internal controls. It was also expected that the audit staff would be able to attend an interim inventory count planned to be conducted at the end of June. The interim audit was conducted between June and July 2008. During the interim audit:

- a) A study of the BSC's internal controls for the purchases and payment cycle was undertaken and an assessment of control risk for each transaction-related audit objective for purchases and payment transactions was made.
- b) Tests of controls and audit procedures were designed that provided appropriate evidence for each of the controls identified.
- c) An interim inventory count was also conducted during the interim visit. However, the total time allocated to undertake and complete the interim audit was not sufficient such that the staff had to work overtime almost every day. BSC provided evening meals to staff every time they worked late. The audit staff were also invited to purchase housing units at 60% of their recommended value. One member of staff has since taken advantage of this offer.
- d) Although controls appear to be well designed and test of control deviations were not expected, previous year's results indicated that misstatements could still exist. Therefore, it was decided to perform substantive tests of transactions for purchases and payments.
- e) From the interim audit, the understanding of internal controls over purchases and payments and the related tests of controls and substantive tests of transactions support an assessment of a low control risk.

Accordingly, it was agreed that the final audit for the 2008 audit would be focused on the audit of balances. For the audit of trade accounts payable, it was agreed that substantive procedures will be performed to obtain audit evidence regarding all assertions relating to trade accounts payable.

In order to expedite the completion of the final audit, BSC requested that your firm should assist with the preparation of financial statements and the tax computations for the year ended 30th September 2008.

It is now December 2008 and you have been provided with the following audit working papers prepared by your field staff:

Work paper	Reference number
Understanding the entity and internal control systems	A2008-1
Purchases and payments cycle	A2008-2
Trial balance of trade accounts payable – 30 September 2008	A2008-3
Revenue recognition	A2008-4
Matters arising from the audit	A2008-5

Client: BSC	Year-end: 30/09/2008	A2008-1
Prepared by: K Nchimunya	Date: 14/06/2008	
Subject: Understanding of the entity and systems		

1. Introduction

BSC is located in Zambia with regional offices in Botswana, Malawi and Namibia. It occupies a highly competitive position within the construction industry. It was established 15 years ago by a group of engineers that previously worked for the National Housing Authority

Over the last ten years, it has managed to secure both long term and short term contracts from the governments and large corporations.

2. Products, services and markets

BSC provides a portfolio of construction works and related services. The services are classified in three categories, long-terms contracts, short term contracts, and consultancy and maintenance contracts

Long term contracts

These are construction works that are undertaken on behalf of Government and large corporations. They include the construction of roads, bridges, multi storey buildings and business premises, as well as shopping malls.

Short term contracts

These comprise construction works required by individuals for both business and private purposes. This includes the construction of housing units, business premises and units, including development of small holder farming units

Consultancy and Maintenance contracts

In most cases, BSC are retained to provide consultancy and maintenance services. However, any maintenance and consultancy within the agreed warranty period is not charged.

Although most of the operations have been concentrated in Zambia, BSC has now began to establish its presence within the region. For example, it has recently been appointed as one of the key contractors to be involved in the construction of the Robamu Gabe Airport in Zimbabwe.

3. Operations

In order to respond to the increased level of construction of works in Zambia, BSC has established site offices in each of the provinces of Zambia. These offices are manned by technical team headed by a site engineer, a foreman and other supporting staff. Each

office is also equipped with necessary assets required to carry out maintenance works in the province.

Additional resources in terms of staffing and equipped are mobilised as and when major construction works need to be undertaken.

During the year, it was decided to close down the Kasama and Mongu sites as it was not anticipated that any significant construction works would be undertaken in the near future. Any maintenance works would be provided by other sites within the vicinity of Kasama and Mongu.

4. Accounting policies

For the 2008 financial statements, BSC's accounting policies conform to the *Zambian Statements of Generally Accepted Accounting Practice (GAAP)*. This comprises:

- a) Applicable laws and regulations
- b) International Financial Reporting Standards (IFRS)
- c) International Accounting Standards (IASs)

The financial statements are prepared on the basis of historical cost and modified to include fair values in respect of specific non-current assets and liabilities as required by the GAAP

No changes are proposed to the accounting policies for the year ended 30 September 2008, except where it is necessary to comply with the new or revised accounting standards. However policies related to revenue recognition will continue to reflect the substance of transactions based on the agreement with customers.

5. Materiality

In accordance with Petwe's methodology, materiality is selected depending on the understanding of the business and risk assessment. Generally, low risk leads to higher materiality and higher risk leads to lower materiality as this implies more work to be done or lower level of error tolerance. During the audit review the planning materiality in relation to actual risks and errors discovered.

In accordance with generally accepted international practice, the following guidelines were considered to determine materiality.

Basis	Guideline percentage (Range)	Calculation (based on average)
Revenue	0.5% - 1%	K250 million
Total assets	1% - 2%	K187 million
Profit before tax	5% - 10%	K205 million

Accordingly, a planning materiality level of K200 million was set.

Client: BSC	Year-end: 30/09/2008	A2008-2
Prepared by: A Banda	Date: 12/07/2008	
Subject: Purchases and payments cycle		

A brief description of the purchases and payments cycle is provided below:

	PURCHASING DEPARTMENT	RECEIVING DEPARTMENT	ACCOUNTS PAYABLE CLERK	CASH PAYMENTS CLERK
	Purchase order is prepared from approved requisition	Goods received are checked for quantity and quality against order	Invoice from supplier is received	All documents are reviewed for completeness, accuracy and account allocations
	Purchase order is approved by supervisor	A receiving report is prepared	Invoice agreed to receiving report, purchase order and requisition	Documents are stamped, initialled and cancelled
	One copy of order sent to supplier, copy of purchase order and requisition sent to accounts payable clerk	Copy of report is sent to accounts payable clerk and one copy filed in chronological order	Invoices checked for arithmetic accuracy, including any discounts applicable.	An input payment voucher is prepared and entered into the computer for processing
			An input voucher is prepared and entered into the computer system for processing	A cash disbursement transaction file is produced
			A transaction processing report is produced	A journal is automatically generated to update accounts payable master file and related accounts
			Once the transaction is reviewed and approved, a purchase journal is automatically	The list of disbursements is reviewed and approved by treasurer before being sent to the

			generated to update purchases, inventories and payable accounts	supplier accompanied with a remittance slip
			All documents are sent to the cash payments clerk for payment	All documents are filed in numerical sequence

Notes:

- The company uses an adequate detailed chart of accounts
- All documents are pre-numbered and are accounted for by function other than by preparer
- Bank reconciliations are done monthly by an independent person
- Procedures are applied daily. Any backlogs are resolved promptly by authorising over time
- Accounts payable master file total is reconciled to the general ledger total monthly.

Client: BSC	Year-end: 30/09/2008	A2008-3
Prepared by: D Mutondo	Date: 10/11/2008	
Subject: Trade accounts payable		

Supplier	Balance as at 30 Sept 2008 (K '000)	Supplier	Balance as at 30 Sept 2008 (K '000)
Diesel Electric	110,500	Petwe \$ Partners	15,900
Temba Holdings	30,600	Pacific Tiles	26,440
Auto World	4,000	Kutemba Services	3,455
Toyota Zambia	155,000	Ellis and Co	17,540
Zambia State Insurance	5,500	Next technology	4,500
Turnpan Zambia	455,550	National Housing Authority	16,670
BH Ltd	9,675	ERZ	123,780
Caterpillar Zambia	975,450	Southern Cross Motors	215,800
Garner Pty – RSA	100,750	Mazembe Haulage	568,340
Landscape Services	4,070	Bintu Carriers	8,750
Yates Control	12,750	ABC earthmovers	125,900
Nelson engineering	15,000	Pitts (Pty) Ltd	100,760
DHL	5,500	Automotive Equipment	98,280
Zambia Safaris	8,950	TS Tyre Services	12,600
Blue Steel	30,475	Kronos Quarries	9,000
Minestone Ltd	75,000	Stone Crushers Ltd	5,870
Gabmans Ltd	45,840	Steel Gliders	10,620
Zambia plumbing works	15,550	Mpaka Drilling	18,260
BP Zambia	275,620	Total	K3,799,173
Engen	75,090		
Bolts and Nuts Ltd	9,290		

Other related information:

The vendors with the greatest volume of transactions during the year were as follows:

Diesel Electric	BP Zambia
Turnpan Zambia	ERZ
Caterpillar Zambia	Mazembe Haulage
Garner (Pty)	ABC Earth Movers
RSA	Pitts (Pty) Ltd
Blue Steel	

*Sampling materiality for accounts payable is K200 million

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Client: BSC	Year-end: 30/09/2008	A2008-4
Prepared by: B Chalwe	Date: 4/11/2008	
Subject: Revenue recognition		

Policy

It is the company's policy to recognise all revenue on invoice date. All discounts granted are accounted for as part of selling expenses

Procedures for invoicing and revenue recognition

1) Short term- construction contracts

For these contracts, BSC recognises revenue according to the agreement with the customer. For different agreements, revenue is recognised as follows:

- 'Bill and hold' sales, in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing, revenue is recognised when the buyer takes title
- For housing units constructed subject to conditions, revenue is normally recognised when the buyer accepts commissioning and inspection works are complete.
- 'Lay away' sales under which the goods are delivered only when the buyer makes the final payment in a series of instalments. Revenue from such sales is recognised when the goods are delivered.

2) Consultancy and maintenance services

These are generally invoiced and revenue recognised once the consultancy and maintenance services are completed, based on time schedules and bill of materials used. A 40% deposit is demanded to be paid before the commencement of any consultancy or maintenance works.

3) Long term - construction contracts

When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract is recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the balance sheet date. The recognition of revenue and expenses is based on the stage of completion of a contract. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed.

In determining the stage of completion, BSC makes reference to the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs.

Client: BSC	Year-end: 30/09/2008	A2008-5
Prepared by: M Mwape	Date: 10/12/2008	
Subject: Matters arising from the audit		

The following matters represent possible adjustments to BSC financial statements before they can be finalised. Management attitude is that “once books are closed, they are closed,” and management does not want to make any adjustments. Planning materiality was (K200 million). Possible adjustments:

- a) Deferred tax amounting to (K215 million) as at 30th September 2008 has been calculated relating to accelerated capital allowances at a tax rate of 30% under the full provision method as required by IAS 12. In a budget statement released in October 2008, the Minister of finance suggested an increase in the income tax to 35%. The directors have proposed to adjust the draft financial statements for the further liability arising.
- b) On 1 June 2008, BSC introduced a 10-year warranty on all sales of its range domestic housing units. Sales of housing units for the year ended 30 September 2008 totalled (K7.5billion). The notes to the financial statements disclose the following:
“Since 1 June 2008, the company’s constructed domestic housing units are guaranteed to be free from construction defects in materials and workmanship under normal domestic use within a 10-year guarantee period. No provision has been recognised as the amount of the obligation cannot be measured with sufficient reliability.”
- c) Following the closure of the Kasama and Mongu sites, BSC decided to sell some non-current assets and these were classified as held for sale as from January 2008. During the six months to June 2008, BSC actively solicited but did not receive any reasonable offers to purchase the assets and, in response, reduced the price. The assets continued to be actively marketed at a price that is reasonable given the change in market conditions. However, by the end of the year, market conditions deteriorated further, and the assets were not sold by the end of year. BSC believes that the market conditions will improve and has not further reduced the selling price of the assets. BSC continues to classify the assets as being held for sale as at 30 September 2008.
- d) The management of BSC has indicated that for the first time, the annual report is to be published on the company’s website

QUESTION 1

REQUIRED

SECTION A

1. With reference to (A2008-1), your firm has been requested to assist in the preparation of the financial statements and tax computations for the year ended 30th September 2008. In addition, during the interim inventory count, the audit staff were offered to purchase housing units at a discount of 40%. Discuss whether the facts indicate violations of the code of professional conduct. If so, identify the nature of the violations and recommend any action that should have been taken.

(10 Marks)

2. Working paper (A2008-2) describes control procedures and activities in the purchases and payments cycle. Identify those control procedures that should be included and tested to provide appropriate sufficient evidence to support an assessment of a low control risk. The control procedures should be structured under the following headings:

- a. Ordering
- b. Receipt and invoices
- c. Recording and accounting

(30 Marks)

SECTION B

3. Assume that your understanding of internal controls over purchases and payments and the related tests of controls and substantive tests of transactions support an assessment of a low control risk. Also assume that analytical procedures support the overall reasonableness of the balances. Accounts payable balances as at 30 September 2008, are included in working paper (A2008-3)

- a) List those relationships, ratios, and trends, that you believe will provide useful information about the overall reasonableness of accounts payable
- b) Using appropriate sampling criteria, determine the accounts payable balances that should be selected for testing
- c) Prepare an audit program for the test of detail of accounts payable balances selected in (b) above, clearly stating objectives and audit assertions to be addressed.

(30 Marks)

4. With reference to (A2008-4), evaluate and discuss the company's revenue recognition policies and procedures.

(10 Marks)

SECTION C

5. Prepare memorandum to the engagement partner in which you set out your proposals on how each of the matters arising from the audit schedule (A2008-5) should be resolved to enable your firm express an unqualified opinion. For each matter, provide reasons for your proposal.

(20 Marks)

Total

(100 Marks)

QUESTION 2

You are a senior manager in Dwight & Touch, a firm of Certified Public Accountants registered with the Zambia Institute of Chartered Accountants (ZICA). For the third year running, your firm has been retained as principal auditor for the KDM Motors group. You have currently been assigned to manage the audit of the consolidated financial statements of KDM group for the year ended 31 March 2008. The partner in charge is Mr. Changa Chuku.

KDM group is a conglomerate in the motor industry and also involved in mining, manufacturing and retail. The group has three principal subsidiaries which are Shonda Motors, Kacheka Crockery Ltd and Choprite Retail. You are not currently the auditor of Shonda Motors as the KDM only recently acquired this subsidiary company in the last financial year. However, it is the policy of KDM group that all of its subsidiaries should be audited by the same auditor.

In order to promote consistency and efficiency, the board of KDM group have approached you to accept nomination as external auditors to Shonda Motors for the year ended 31 March 2008. Shonda has grown rapidly over the past two years through an aggressive market development strategy.

Shonda's previous auditors, Sanjevu Partners, a much smaller firm, qualified their report in the previous. Over lunch with a number of your firm's partners, the company Chairman and managing director, Mr. John Hicks maintained that Sanjevu Partners could not cope with the audit of a company of their size and, in particular, were not equipped to audit recently installed sophisticated computing accounting program. He also suggests that they need a firm of your reputation in order to reassure the market as they intend to seek a public listing within two years.

In accordance with professional requirements, you have obtained permission from Shonda Motors to communicate with the out-going auditors, Sanjevu Partners to obtain professional clearance. Although permission was granted without delay, Mr Hicks hinted that Sanjevu was likely to delay in responding as they would not be too amused to lose an audit client as lucrative as Shonda Motors.

As manager in charge of the KDM group audit, you have been provided with the following information and working papers to enable you finalise the audit for the year ended 31 March 2008.

Work paper	Reference number
KDM group – Financial and operating information	B2008-X1
Acquisitions during the year	B2008-X2
Professional Etiquette- Clearance procedures	B2008-X3
Extracts from management letter – Shonda Motors	B2008-X4
Annual Report – Yeti Motors	B2008-X5

Client: BSC	Year-end: 31/03/2008	B2008-X1
Prepared by: D Zulu	Date: 11/06/2008	
Subject: KDM group – financial and operating information		

The following financial and operating information consolidates the results of the enlarged KDM group

	Year ended 31 March	
	2008	2007
	(Draft)	(Actual)
	(K'Million)	(K'Million)
Revenue	682,700	440,400
Cost of sales	(310,900)	(199,100)
Distribution and administration expenses	(286,600)	(170,000)
Research and development costs	(2,500)	(2,200)
Depreciation and amortisation	(92,700)	(66,100)
Interest expense	(26,600)	(20,200)
Loss before taxation	(36,600)	(17,200)
Customers	9.0million	4.5million
Average revenue per customer (ARPC)	K75.8million	K97.8million

Other operating information:

- During the year, KDM group made three acquisitions. These are tabulated at working paper (**B2008x2**).
- In order to sustain growth, significant costs are expected to be incurred as operations are expanded, systems integrated and new products and services introduced.
- For the companies in the motor industry, new cars are imported, on consignment, every three months from two main suppliers. The normal terms are for KDM group to pay the purchase price of cars plus 3%, three months after taking delivery. KDM does not return unsold cars, although it has a legal right to do so.
- An extensive range of spare parts is held for which perpetual inventory records are kept. Car servicing and body repairs are carried out in workshops by employed and sub-contracted service engineers.
- 'Trade-ins' (i.e. part exchange) are offered on all sales of new and used cars. New car sales carry a three year manufacturer's warranty and used cars carry a six-month guarantee. Many used cars are sold for cash

- f) All directors of the KDM group are allowed to select a car from each consignment to use for their business and personal travelling until the next consignment is received. Such cars are sold at a discount as ex-demonstration models
- g) In order to identify all companies under the same umbrella, KDM has patented the brand name K@dm. The costs associated with the development of the brand have been expensed. All companies in the group are expected to operate under the new brand and corporate image

Client: BSC	Year-end: 31/03/2008	B2008-X2
Prepared by: B Chilufya	Date: 14 /05/2008	
Subject: Acquisitions during the year		

KDM has grown rapidly over the past few years through an aggressive take-over strategy. During the year, KDM made investments in three other enterprises:

1. Kansenshi Emeralds

On 1 October 2007, KDM purchased 40 million K1 equity shares in Kansenshi Emeralds. The issued share capital of Kansenshi on 1 October 2007 was 50 million K1 equity shares

Kansenshi Emeralds has been accounted using acquisition accounting method

2. Yeti Motors

On 1 December 2007, KDM purchased 30 million K1 shares in Yeti Motors. The issued equity share capital of Yeti Motors on 1 December was 75 million K1 equity shares. The remaining equity shares in Yeti are held by a large number of investors – none with more than 5 million equity shares.

Yeti motors has been accounted for using the proportional consolidation method

3. Budget chain stores

On 1 January 2008, KDM purchased 25 million K1 equity shares in Budget stores. The issued equity share capital of Budget stores on 1 January 2008 was 80 million K1 equity shares. Another investor owns 50 million equity shares in Budget stores. On a number of occasions the investor has required Budget stores to follow policies that do not meet with the approval of KDM.

Budget chain stores has been accounted for as an associate using equity accounting in the consolidated financial statements.

Note:

Equity shares in all of the three companies above carry one vote per share at general meetings. No party can control or influence the composition of the board of directors of any of the companies other than through its ownership of equity shares. There have been no instances where the shareholders in any of the companies have acted together to increase their control or influence. None of the companies has issued any additions equity shares since KDM purchased its interests. All of the companies are separate legal entities.

For the current year, these companies have been audited by other auditors

Client: BSC	Year-end: 31/03/2008	B2008-X3
Prepared by: D Zulu	Date: 23/07/2008	
Subject: Professional etiquette- clearance procedures – copy		

Mr. Changa Chuku
Dwight & Touch
234 Cresta Close
Riverside

KITWE

16 January 2008

Dear Mr Chuku,

RE: CLEARANCE PROCEDURES

I acknowledge receipt of your letter requesting us to provide you with any reasons why you should not accept appointment. Our response has taken longer than expected because Mr John Hicks was initially reluctant to give us permission to communicate with you. We suspect this is because of our insistence that our outstanding fees should be settled immediately. After some protracted arguments, this matter has now been resolved and we are happy to respond.

We have given this matter a lot of thought and we strongly are of the opinion that there are significant matters that should be taken into account before accepting appointment.

Shonda Motors has been of one our more profitable clients, given its size and dominance in the market. However, we suspect that the chief executive is aware of this and therefore expects auditors to feel “grateful” for being a given a chance to audit such a big company.

As you may be aware, Mr John Hicks is both the Chairman and chief executive. He therefore presides over the appointment of auditors. In our first year, Mr Hicks appointed us as auditors and a letter of engagement signed before the appointment was presented and endorsed in the AGM. He believes that the letter of engagement should be general rather than specific and as he expected us to provide any other audit related and assurance service. Consequently this resulted in disagreements over our scope of work and our responsibilities. It is therefore not surprising that our relationship has taken a different turn recently with Mr. John Hicks accusing us of being ‘too strict and too professional.’

Relative to your firm, we are a small firm and in a sense our size may be regarded as being completely disproportionate to the size and profile of Shonda Motors. However, we suspect that the real reason for not reappointing us is because we qualified our opinion in the previous year.

Weaknesses identified on our management letters for the last three years have not been fully addressed as Mr John Hicks feels that it is more important to develop Shonda Motors with a forward looking perspective rather than dealing with past mistakes. Most of these weaknesses are related to lack of sufficient and appropriate evidence to support certain transactions. Mr John Hicks has a lot of information about Shonda Motors, some of which is not accessible through the accounting process. He claims this is a privilege of being a chief executive. Such information is provided only when it is specifically requested for and, according to him, on the 'need to know basis.'

Professionally speaking, my firm should have resigned as auditors before the end of the financial year. However Mr Hicks threatened us with action to spread rumours that we were incompetent and unprofessional.

I hope this information will provide you with a reasonable basis on which you can make a decision as to whether to accept or decline the nomination. If you need any other information or clarification, please do not hesitate to contact me at the earliest opportunity.

With kind regards,

Kirshna Sanjevu
Senior Partner

Plot 654, Kariba House
First Floor, Northern Wing

Client: BSC	Year-end: 31/03/2008	B2008-X4
Prepared by: A Chibamba	Date: 20/06/2008	
Subject: Extracts from management letter – Shonda Motors		

1. John Hicks is the chairman and chief executive officer of Shonda Motors. Although the company is sufficiently large to justify the establishment of an internal audit department, he believes this is not necessary as the control environment is strong.
2. John Hicks oversees the appointment of directors to the board. There are no special duties allocated to any of the directors.
3. Insufficient consideration has been devoted by management to developing the accounting system in line with the expanding business. In particular there is a lack of concern for control. A number of petty employee frauds have been in previous audits as a result of control weaknesses. No action was taken against the employees identified as engaged in fraud. The attitude seems to be to encourage risk taking employees who, if they make money on the side whilst securing good deals for the company, that is seen as a legitimate bonus.
4. The newly installed accounting system is unreasonable complicated. Shonda Motors claims this is necessary because of the need to maintain records to justify the company's claims for volume rebates, and bonuses under the complex incentive schemes by which car manufacturers reward dealers. The system has also been used to inflate expenses so that low taxes are paid to Zambia Revenue Authority.
5. Although there has been no evidence of deliberate misrepresentation by the directors, Sanjevu's audit staff were hindered in their audit work by a less than helpful attitude by senior management who adopted an aggressive stance whenever a query was raised. The Chief financial officer was constantly on the phone to the partner claiming the audit staff were incompetent and accusing them of wasting his time asking unnecessary questions.

Client: BSC	Year-end: 31/03/2008	B2008-X5
Prepared by: A Phiri	Date: 30/06/2008	
Subject: Annual Report – Yeti Motors		

The financial statements of Yeti Motors show total assets of K120 billion, revenue of K260 billion, and profit before tax of K9 billion for the year ended 31 March 2008. The annual has revealed the following

- a) The statement of changes in equity includes K4.5 billion under a separate heading of miscellaneous item which is described as ‘other difference not recognised in income’. There is no further reference to this amount or other difference elsewhere in the financial statements. However, the Management Report, which is required by Law, is not audited. It discloses that changes in shareholders’ equity not recognised in income include K4.5 billion arising on the revaluation of investment properties.

The accounting policies note to the financial statements state that the company has implemented IAS 40 *Investment Properties* for the first time in the year ending 31 March 2008 and also that ‘the adoption of this standard did not have a significant impact on Yeti Motors financial position or its results of operations during 2008’.

- b) The chairman’s statement asserts ‘Yeti Motors has now achieved a position as the leading suppliers of Honda cars and parts in the SADC region, with a dedicated commitment to accountable and ethical professionalism. Public information available suggests that Yeti Motors is not ranked among the top five suppliers of Honda cars and parts in Zambia.

QUESTION 2

REQUIRED

SECTION A

1. With reference to **(B2008-X3)**, list and briefly describe the reasons why Dwight & Touch should not accept nomination as auditors of Shonda Motors for the year ended 31 March 2008, stating clearly any factors that might support acceptance of the nomination. (25 Marks)
2. The extracts from the management letter at **(B2008-X4)** suggest a serious breakdown in the corporate governance of Shonda Motors.
 - a) Discuss fully appropriate recommendations that would improve their corporate governance practice. (10 Marks)
 - b) Set out clearly the action you would take on discovery of the potential tax fraud described in the management letter extract. (10 Marks)

SECTION B

1. With reference to working paper **(B2008-X1)**,
 - a) discuss the risk of material misstatement in the consolidated annual financial statements of KDM, and (30 Marks)
 - b) Set out detailed consolidation procedures that should be undertaken to ensure that the consolidated financial statements have been prepared on the basis of suitable consolidation methods. (15 Marks)
2. As stated in working paper **(B2008-X5)** the Chairman of Yeti Motors has included certain information in the Annual report for the year ended 31 March 2008. Identify and comment on how the auditors of Yeti Motors should deal with these matters in the report for the year ended 31 March 2008. (10 Marks)

Total (100 Marks)

END OF EXAMINATION