

QUESTION ONE

ZAMBIA INVESTMENTS LIMITED (ZIL)

1. BACKGROUND

Zambia Investments Limited (ZIL) owns and controls a restaurant chain consisting of eight restaurants, with at least one restaurant located in each of the main cities of Zambia. The locations are generally targeted at particular tourist destinations. ZIL has been owned by the same family for the previous 15 years and has always traded at a profit. However, a number of factors have meant that ZIL is now in danger of making a trading loss.

2. MANAGEMENT TEAM

NAME	DESIGNATION
Mr. Regis Kalabasis	Managing Director
Mrs. Kate Kalabasis	Finance Director
Mr. Pinto Leon	Chef
Mr. Ketson Bulaya	General Manager

3. BUSINESS ENVIRONMENT

There has been a substantial drop in the number of tourists visiting the Copperbelt region whilst, at the same time, the prices of many of the foodstuffs and drinks used in its restaurants has increased. Added to this, the local economy has shrunk with several large employers reducing the size of their workforce.

The owners of ZIL commissioned a restaurant consultant to give them an independent view of their business. The consultant observed that the eight restaurants were all very different in appearance. They also served menus that were very different, for example, one restaurant which was located in Livingstone specialised in fish dishes, whereas another restaurant 20 miles away had a good reputation as a steak house. The prices varied greatly amongst the restaurants; one restaurant in a historic country house offered 'fine dining' and was extremely expensive; yet another located near a busy railway station served mainly fast food and claimed that its prices were 'the cheapest in town'. Three of ZIL's restaurants offered a 'middle of the road' dining experience with conventional menus and average prices.

Some of the restaurants had licences which enabled them to serve alcohol with their meals but three restaurants did not have such licences. One restaurant had a good trade in children's birthday parties whereas the restaurant in the historic country house did not admit diners under the age of 18. The consultant recommended that ZIL should examine these differences but did not suggest how. The owners responded that the chain had grown organically over a number of years and that the location, style and pricing decisions made in each restaurant had all been made at different times and depended on trends current at that time.

4. BUSINESS PROCESSES AND CONTROLS

Facilities at each restaurant are of a standard design which incorporates a kitchen, a bar, a dining area, together with supervised child care. Each restaurant is managed on a day-to-day basis by a manager, in accordance with company policies. The restaurant manager is also responsible for preparing and submitting monthly accounting returns to head office.

Each restaurant is required to have a licence from the local authority to operate. Licences are granted for 24 months and are renewable subject to satisfactory reports from local authority inspectors. The average annual cost of a licence is K3.7million kwacha

Staff lateness is a recurring problem and a major cause of early bird customer complaints with early diners. New employees are generally attracted to this industry in the short term for its non-cash, including benefits, as well as the eating of free meals, but leave when they require increased financial rewards. As staff cannot be replaced quickly, this has resulted in relatively higher training costs.

Three restaurants on the Copperbelt are expected to run at a loss for the year ended 31 March 2011 due to falling demand and patronage. ZIL has invested heavily equipping these restaurants with state of the art equipment and dining facilities with the aim of attracting more customers. Some improvements to the restaurants are on-going and the building contractor has already billed twice as much and taken three times as long as budgeted for the work. The works are to be completed by March 2012.

Cash flow difficulties in the current year have put back the replacement of the much needed equipment for other restaurants.

Insurance premiums for liability to employees and the public have increased by nearly 45%. ZIL has met the additional expense by reducing its insurance cover on its plant and equipment from a replacement cost to a net realisable value.

5. RE-APPOINTMENT AS AUDITORS

Your name is Peterson Mumba and you are the senior manager in Chewe & Co, a firm of Chartered Certified Accountants registered with ZICA offering audit and assurance services mainly to large, privately owned companies. The firm has suffered increased competition due to new firms of accountants setting up in Lusaka. Several audit clients have moved to the new firms, leading to loss of revenue.

Fortunately, ZIL have retained Chewe & Co to audit the financial statements for the year ended 31 March 2011.

5.1. The Audit team

NAME	DESIGNATION	RESPONSIBILITY
Mrs Catherine Limbo	Audit Partner	Planning and Reporting
Mr. Peterson Mumba	Senior Manager	Planning and Completion
Mr Casius Chanza	Manager	Overall supervision
Ms Janet Lungu	Audit Senior	Supervision – Field work

6. WORKING PAPERS

The following working papers have been compiled for the attention of the senior manager:

- a) Environmental impact
- b) Matters arising from the audit

6.1. ENVIRONMENTAL IMPACT ASSESSMENT (ZIL/100/2011/JL)

One of the points initially drafted for possible inclusion in the report to the company's audit committee concerned the illegal dumping of drums containing used cooking oil, on nearby wasteland on the Copperbelt. There is evidence that some of this oil may have spilled into a nearby stream. Notes of discussion between the audit manager, Mr Chanza and Mr Regis Kalabasis show that it is the company's unwritten policy to disregard the local environmental regulations. This entails certain risk of incurring the fines.

However, the management of ZIL considers that the risk is too small relative to the cost of using the nearest licensed disposal unit. The matter is not referred to in the report.

6.2. MATTERS ARISING FROM THE AUDIT OF ZIL FOR THE YEAR ENDED 31 MARCH 2011 (ZIL/200/2011/CC)

As senior manager at Chewe & Co, you have specific responsibility for undertaking annual reviews of existing clients and advising whether an engagement can properly be continued. The following matters arose in connection with the audit of ZIL for the year ended 31 March 2011.

- 6.3. Chewe & Co is considering expanding the provision of non-audit services. Chanza, the audit manager has suggested that Chewe & Co could offer a recruitment advisory service to clients specialising in the recruitment of finance professionals. Chewe & Co would charge a fee for this service based on the salary of the employee recruited. Chanza previously worked for Mak Recruitment as a consultant for year before deciding to train as an accountant. It is considered that ZIL may benefit from such a service.
- 6.4. ZIL's finance director Mrs. K Kalabasis was so impressed with the commitment of the audit staff that she asked that Chewe & Co to pay them a bonus through an increase in the audit fee. In May 2011, Chewe & Co paid all members of the team below manager status a bonus amounting to a monthly salary. The bonus was processed through Chew & Co's payroll in the same way as overtime payments, and recharged to ZIL as part of audit expenses.
- 6.5. The final audit which lasted approximately four weeks was very time pressured and the audit team worked late into the night towards the end of the audit. ZIL's staff were very supportive throughout and paid for evening meals that were brought in so that the audit team could work with minimum disruption.

SECTION A

- 1) **As senior manager of Chewe and Co prepare a briefing memo for the attention of Catherine Limbo, in which:**
 - a) You should list and briefly describe the ethical and professional matters raised in working paper (ZIL/100/2011/CC), and (15 marks)
 - b) For each matter, recommend what action your firm should take as safeguards against these matters (15 marks)
- 2) **With regard to the environmental impact assessment:**
 - a) Comment on the ethical and other professional issues raised by this matter (10 marks)
 - b) Comment on your responsibility to report ZIL to the Environmental Council of Zambia (ECZ). (10 marks)

SECTION B

- 3) **In relation to the planning of the auditor of ZIL for the year ended 31 March 2011,**
 - a) Identify and explain FIVE business risks which should be assessed by the management of ZIL (10 marks)
 - b) Explain the likely impact of each risk on the financial statement elements of ZIL for the year ended 31 March 2011, stating clearly the extent of any understatement, overstatement or misstatement as appropriate (10 marks)
- 4) **With reference to the financial statement risks identified in (3b) above:**
 - a) For each risk suggest and justify ONE key assertions that should form the focus of your testing (10 marks)
 - b) Recommend a suitable procedures that should be carried out to provide reasonable assurance to confirm each of the assertions in (a) above (20 marks)