



INSTITUTE OF CHARTERED ACCOUNTANTS OF ZIMBABWE

Public Practice Examination

19 NOVEMBER 2014

TOTAL MARKS: 100

TIME – Two and a half hours (plus 30 minutes reading time)

INSTRUCTIONS TO CANDIDATES

1. This examination paper consists of **ONE** question (Section A and Section B) with **9** pages (excluding cover). The **required** section will be handed out at the end of the reading time.
2. Answer each section of this question in a **SEPARATE** answer book, as follows:

QUESTION	SECTION	MARKS	ANSWER BOOK
2	A	42	Yellow
	B	58	Green

The marks shown against the requirements of each section are an indication of the expected length and detail of your response.

3. Enter your examination index number on the cover of each answer book as well as on all answer sheets.
4. Your **NAME** must **NOT** appear anywhere in the answer books.
5. Answers may **NOT** be written in pencil.
6. Answer the questions using effective presentation and pay particular attention to the use of concise language, clarity of explanation and logical argument. Marks will be awarded for these aspects of your response.
7. It is your responsibility to ensure that any additional writing paper used, is fastened to the **CORRECT ANSWER BOOK** for each section.
8. It is your responsibility to ensure that all answer books are handed in to the invigilator **before** leaving the examination room, as answer books or additional pages handed in thereafter, **WILL NOT BE MARKED**.

Disclaimer clause

All names of persons, places, and business entities mentioned in this examination paper are purely fictitious in nature and any resemblance to real persons, living or dead, places and business entities are purely coincidental. The question in this paper reflects current and comparative figures in US Dollars to meaningfully compare financial performance with no account being taken of the anomalies of converting previous Zimbabwe Dollars to US Dollars.

QUESTION 2

Joe Snow & Co, a firm of Registered Auditors based in Harare, renders external audit, other assurance and advisory services to clients.

Upon completing your training contract at another firm and having registered with the PAAB as a Registered Auditor, you successfully applied for a position as a partner at Joe Snow & Co with the understanding that you would acquire 49% of the Joe Snow & Co partnership and assume full responsibility for the audit and assurance portfolio over time. You commenced your duties as a partner of Joe Snow & Co on 1 November 2014. Prior to this date, Joe Snow & Co had one partner, Mr Joe Snow (a Registered Auditor), and twelve staff members.

One of the audit clients is Best Build (Pvt) Ltd ('Best Build'). Mr Snow was the engagement partner on the audit of Best Build for many years, and prior to your assumption of duties, he handled certain planning activities for the 2014 audit. One of your first tasks after your appointment was to take over responsibility for the audit of Best Build's financial statements for its financial year ended 31 October 2014 – as part of Mr Snow's phased exit from audit work.

You are currently reviewing the planning documents for the audit of Best Build for its 2014 financial year and your staff provided you with the following audit work papers and other correspondence:

Work paper	Reference number
Understanding of the entity: overview	100-01
Understanding of the entity: notes taken at the first planning meeting for the 2014 audit	100-20
Overview of accounting system	301-02
Investment property: overview of account balance	500-01
Correspondence	Reference number
Proposal from IT 4 U (Pvt) Ltd to supply customised IT solution to Best Build	Appendix A

A materiality figure of \$100 000 for purposes of planning and performing the audit of the 2014 financial statements of Best Build has been set. You are in agreement with this figure.

Client: Best Build (Pvt) Ltd	Year-end: 31/10/2014	100-01 1/1
Prepared by: CA Shew	Date: 6/10/2014	
Reviewed by:	Date:	
Subject: Understanding of the entity: overview		

Nature of the business

Best Build is a company that constructs small to medium-sized office blocks in Zimbabwe in terms of fixed-price contracts entered into with clients.

This business model has proven to be successful over the years and Best Build has been very profitable because of the managing partner's conservative approach to contract expenditure. As prices for the contracts are generally determined by competitive tender, the control of contract expenditure contributes directly to profit.

Ownership

The authorised share capital of Best Build (in terms of the company's Memorandum and Articles of Association) is:

- 10 000 Class A ordinary shares.
- 10 000 Class B ordinary shares.

The shareholding of Best Build is currently as follows:

Pestachio Family Trust	7 000 Class A ordinary shares
Best Build Employee Share Trust	3 000 Class B ordinary shares (issued January 2014)

Board of partners

Mr Pietro Pestachio	Managing partner
Mr Joe Pestachio (Pietro's son)	Marketing partner
Mrs Jane Pestachio (Pietro's wife)	Human resources partner

Accounting framework

Best Build adopted IFRS (International Financial Reporting Standards) as its accounting framework a few years ago (following Mr Snow's recommendation in this regard).

Client: Best Build (Pvt) Ltd	Year-end: 31/10/2014	100-20 1/3
Prepared by: CA Shew	Date: 6/10/2014	
Reviewed by:	Date:	
Subject: Understanding of the entity: notes taken at the first planning meeting for the 2014 audit		

Purpose of meeting: To update the auditor's understanding of any changes at Best Build since the 2013 audit report was issued.

Date: 2 October 2014

Venue: Head office of Best Build in Arundal

Present:

Mr Joe Snow (JS) Audit engagement partner (interim)

Ms Carol-Ann Shew (CAS) Senior on audit (who took the notes)

Mr Pietro Pestachio (PP) Managing partner of Best Build

JS: Introduced CAS to PP, as CAS was assigned to the audit of Best Build for the first time.

PP: Asked what had happened to Mr Mac Damia, whom he remembered as the senior on the 2013 audit, and who had caused him a lot of frustration and headaches due to the many audit-related questions Damia asked.

JS: Indicated that he had decided to not assign Damia to the audit again, as a result of PP's unhappiness about the time he had to spend in answering Damia's many questions. He added (for CAS's benefit) that Joe Snow & Co was very proud to continue to have Best Build as a client, as Joe Snow & Co's motto of 'solutions for clients' can be clearly demonstrated.

PP: Agreed by commenting that every year when Best Build's financial statements were prepared, JS advised the Best Build accountant of creative solutions for implementing the 'theoretical' accounting standards based on the 'bigger picture rather than the detail of the standards'. He also acknowledged that JS's active participation in certain key decisions had helped him to establish a successful company.

JS: Pointed out that going forward his focus would increasingly be on rendering non-audit engagements to clients. He explained that a new partner at Joe Snow & Co would therefore be responsible for the 2014 audit of Best Build and would commence duties on 1 November 2014. JS undertook to do a formal handover once the new partner had commenced duties, but added that JS would still be available for all non-audit services that Best Build may require. He then asked about the business conditions being experienced by Best Build.

PP: Noted that despite good profitable projects, cash flow continued to be under strain – something he found surprising and could not really explain. PP added that the current decline in new building projects experienced nationally would also have a negative impact on the company's results for the next few years. At this point PP provided JS with a copy of the most recent management accounts (reflecting the figures extracted from Best Build's trial balance at 30 September 2014).

JS: Asked whether there were any other matters the team should be aware of for purposes of planning and performing the audit.

Client: Best Build (Pvt) Ltd	Year-end: 31/10/2014	100-20 2/3
Prepared by: CA Shew	Date: 6/10/2014	
Reviewed by:	Date:	
Subject: Understanding of the entity: notes taken at the first planning meeting for the 2014 audit		

PP: Explained that there were two matters that should be highlighted, namely:

(i) Employee share trust

During the 2014 financial year Best Build had established a scheme whereby the company's employees could become shareholders of Best Build via an employee share trust. This was viewed by the board as a necessity to improve the probability of success in being awarded the building contracts it tendered for.

The employee share trust subscribed for 3 000 B ordinary shares in Best Build, priced at 75% of their fair value (as determined by the partners) at the date of issue. The B ordinary shares have the same rights and obligations as the A ordinary shares in all respects, except that the board of directors of Best Build can decide to declare different amounts of dividends for each class of share. All dividends received by the trust must be used to service the interest charges on the loans raised (from the Pestachio family) to pay for the Best Build shares subscribed for. PP added that recently the trade union expressed concern about how this scheme actually benefited participating employees, and requested that an audit of the trust be undertaken.

PP therefore enquired whether Joe Snow & Co could audit the financial statements of this employee share trust and thereby allay the union's concerns.

(ii) Claims from customers

A number of claims had been received by Best Build during the year relating to damages suffered by customers due to 'shortcuts' having been taken during construction and inferior building materials having been used. These claims had been investigated and remedial action taken, where necessary, to ensure that these problems did not recur and affect current and future building projects. PP added that he had referred all claims to the company's attorneys, and requested that this matter be treated as 'strictly confidential so as to not draw unnecessary attention to a matter that has been dealt with'.

JS: Responded to PP's requests as follows:

- (i) Regarding the request to audit the employee share trust, JS indicated that this would be fine, as it was a very small job – and would be handled by the audit team assigned to Best Build.
- (ii) Regarding the request to keep the claims confidential, JS stated that he recognised the sensitivity of the matter given the negative effect that this could have on Best Build's business. He added that the matter would in all likelihood not have any effect on the audit report.

CAS: Asked who the key role players in management were – for purposes of determining to whom enquiries should be addressed.

Client: Best Build (Pvt) Ltd	Year-end: 31/10/2014	100-20 3/3
Prepared by: CA Shew	Date: 6/10/2014	
Reviewed by:	Date:	
Subject: Understanding of the entity: notes taken at the first planning meeting for the 2014 audit		

PP: Responded that ‘nothing happens at Best Build without my knowledge’. He therefore proposed that instead of the audit team being ‘sent from pillar to post’, questions should be addressed to him rather than to the other partners of Best Build. He undertook to direct the audit team to another partner if necessary.

CAS: Asked whether there had been any changes to Best Build’s accounting system since the 2013 audit.

PP: Indicated that there had been no changes to the accounting system for the past few years. He added that Best Build may have to improve its management information systems to enable him to manage the business more effectively. PP indicated that after discussions with Mr John Wallis, managing partner of IT 4 U (Pvt) Ltd, he was of the opinion that Best Build should purchase the IT 4 U-developed software package, and then have IT 4 U customise relevant parts thereof to meet the needs of Best Build. He added that he was keen to initiate this project as soon as possible. Accordingly, he had entered into discussions with IT 4 U (Pvt) Ltd regarding the next steps. However, it was noted that the implementation of the system was planned only for the 2015 financial year.

JS: Noted that he had another appointment, and therefore requested that the meeting be concluded. He added that CAS had enough information to plan the audit (with reference to the information gathered in this meeting, and from the 2013 audit files), and that she could now undertake the assessment of the risk of material misstatement, and then formulate appropriate audit responses. He also reminded CAS to plan the audit of the employee share trust’s financial statements as well.

PP: Asked whether he again had to sign a letter which explains, among other things, what the audit was all about, his (and the rest of management’s) responsibilities, and how the fees will be payable – as had been the case some years ago.

JS: Just before leaving the meeting, JS indicated that as this letter had been signed previously, this would not be necessary.

Client: Best Build (Pvt) Ltd	Year-end: 31/10/2014	301-02 1/1
Prepared by: P Ecan	Date: 13/10/2014	
Reviewed by:	Date:	
Subject: Overview of accounting system		

Key staff

Accountant: Mrs Ally Mond was appointed to this post twelve years ago and is currently the only person in the company with an accounting background. She is a single mother and has two children, Benny and Candy, who are studying towards their degrees at a university. It was noted from prior audits that Ally Mond is very helpful and will go so far as to cancel her leave and come into the office over weekends to assist the auditors and partners whenever information is required.

Managing partner: The accountant reports to the managing partner, Mr Pestachio, who has stated on a number of occasions that he trusts Mrs Mond implicitly, as she has been a star performer over the years and is someone who is always willing to go the extra mile.

System overview

The company uses SmartAccounts, an off-the-shelf accounting package commonly used by smaller organisations. The functionality of the SmartAccounts package is limited to maintaining basic records of primary entry (e.g. cash book), the general ledger, and the debtors and creditors subsidiary ledgers. This system is supplemented by EasyPay, a standard payroll package developed by a well-known software company. Contract and fixed-asset ledgers are not integrated with the accounting systems and are maintained on computer spreadsheets.

Mrs Mond is the only user of the specific desktop computer on which the SmartAccounts package is loaded. Access to the application is restricted to this computer. To obtain access to the SmartAccounts functionality, the MS Windows user account logon and password as well as the SmartAccounts username and password are required. Mrs Mond keeps these passwords simple so she can remember them.

Best Build uses the PayAway internet banking solution of Grow Bank, the company's banker, for the payment of salaries and other creditors. Mrs Mond uploads the files containing payment information from the accounting and payroll packages after she has accessed the banking system using the password required to capture payment information. Two passwords are required to release payments – Mrs Mond enters the first approver password once she is satisfied that the data is correctly loaded, with either Mr Pietro Pestachio or Mrs Jane Pestachio entering their password as second approver.

Full backups of the accounting records are made daily by Mrs Mond to an external hard drive that is locked in the safe at the company head office.

Client: Best Build (Pvt) Ltd	Year-end: 31/10/2014	500-01 1/1
Prepared by: P Ecan	Date: 12/11/2014	
Reviewed by:	Date:	
Subject: Investment property: overview of account balance		

1. During the 2014 financial year, Best Build took ownership of the Walnut Towers building and the land on which it is located. This building was originally constructed for PNUT Holdings (Pvt) Ltd, but this company went into liquidation in December 2013, three months before construction of Walnut Towers was completed. The ownership of the property was transferred to Best Build as part of a settlement agreement concluded with the liquidator of PNUT Holdings (Pvt) Ltd.
2. The board of Best Build decided to retain the Walnut Towers building for rental purposes. Accordingly, it contracted Acorn Rent Managers, an independent property management company, to be responsible for the management of the Walnut Towers property, including the collection of rent.
3. The following summary of the investment property balances in the general ledger at 31 October 2014 was prepared by Mrs Mond:

	2014	2013
	\$	\$
Investment property – at cost	1 543 000	–
Accumulated depreciation	–	–
Balance per draft financial statements	1 543 000	–

4. The following points were noted during the meeting with Mr Pestachio and Mrs Mond on 11 November 2014:
 - Investment property is accounted for using the cost model (per the company's accounting policy). The cost amount reflected in the general ledger represents the balance on the work-in-progress account for the Walnut Towers contract on the date construction of the building was completed.
 - The useful life of the Walnut Towers building has been determined to be 50 years. This figure was determined with reference to the useful lives of buildings disclosed in the financial statements of a number of listed companies.
 - On the basis of Mr Pestachio's assessment, largely due to the effects of inflation, the residual value of the Walnut Towers building in 50 years' time will exceed its cost. Accordingly, no depreciation will be calculated on investment property for the 2014 financial year.
 - Despite an aggressive marketing campaign, tenants were secured for only 15% of the lettable floor area of Walnut Towers as at 31 October 2014.

APPENDIX A

IT 4 U (PVT) LTD
REG. NO. 2014/015522/07

11 Pecanwood Office
Park
Mount Pleasant
0110

Tel. no.: 350 450

28 September 2014

Mr Pestachio
Best Build (Pvt) Ltd
Arundal Office Park
Mount Pleasant
Harare

Dear Pietro

PROPOSAL TO SUPPLY CUSTOMISED IT SOLUTION TO BEST BUILD

Thank you for a most enjoyable golf game last week. As was discussed after the game, we would like to take the opportunity to propose that your company engage our services to customise our in-house-developed software package, *Acc 4 IT*, for your specific needs. I have taken the liberty of compiling a proposal in this regard. I would appreciate it if you could study this proposal and, if you find the terms acceptable, sign the proposal to indicate your acceptance thereof (refer to the space provided at the end of this proposal). We will start with the project upon receipt of the signed proposal and the required deposit.

Product: To customise *Acc 4 IT*, our desktop-based fully integrated accounting system that contains the following elements:

- General ledger, debtors, creditors and cash-book modules.
- Project management and accounting modules.
- Payroll module.
- Fixed assets register, including investment property.
- Management reporting module.
- Electronic interface with the current PayAway banking system.

Platform: The system will run on the MS Windows operating system.

Price: The cost of the basic software package is \$2 500, including installation. On the basis of an hourly rate of \$50 per hour, we estimate that the system can be customised for the needs of Best Build for an additional \$1 000 – this will, however, depend on the actual hours spent by our staff. The estimated total price (of \$3 500) is payable as follows: 60% on acceptance of proposal, 30% on delivery and installation of the completed system and the balance when the project is completed by ourselves.

PROPOSAL TO DEVELOP IT SYSTEM (continued)

Security: The software will allow for one designated 'super user' with all the privileges normally associated with such a user, as well as two other end users. The system will be set up to enforce unique user identification (logon/usernames) as well as good-practice password standards. Automated daily back-ups will be built into the software.

Reports: All audit listings, review and exception reports and other management and statutory information reports required by you will be designed and implemented as soon as the specifications are received from yourselves.

We look forward to assisting you with this project. Please feel free to contact me directly should you require any further information.

Regards

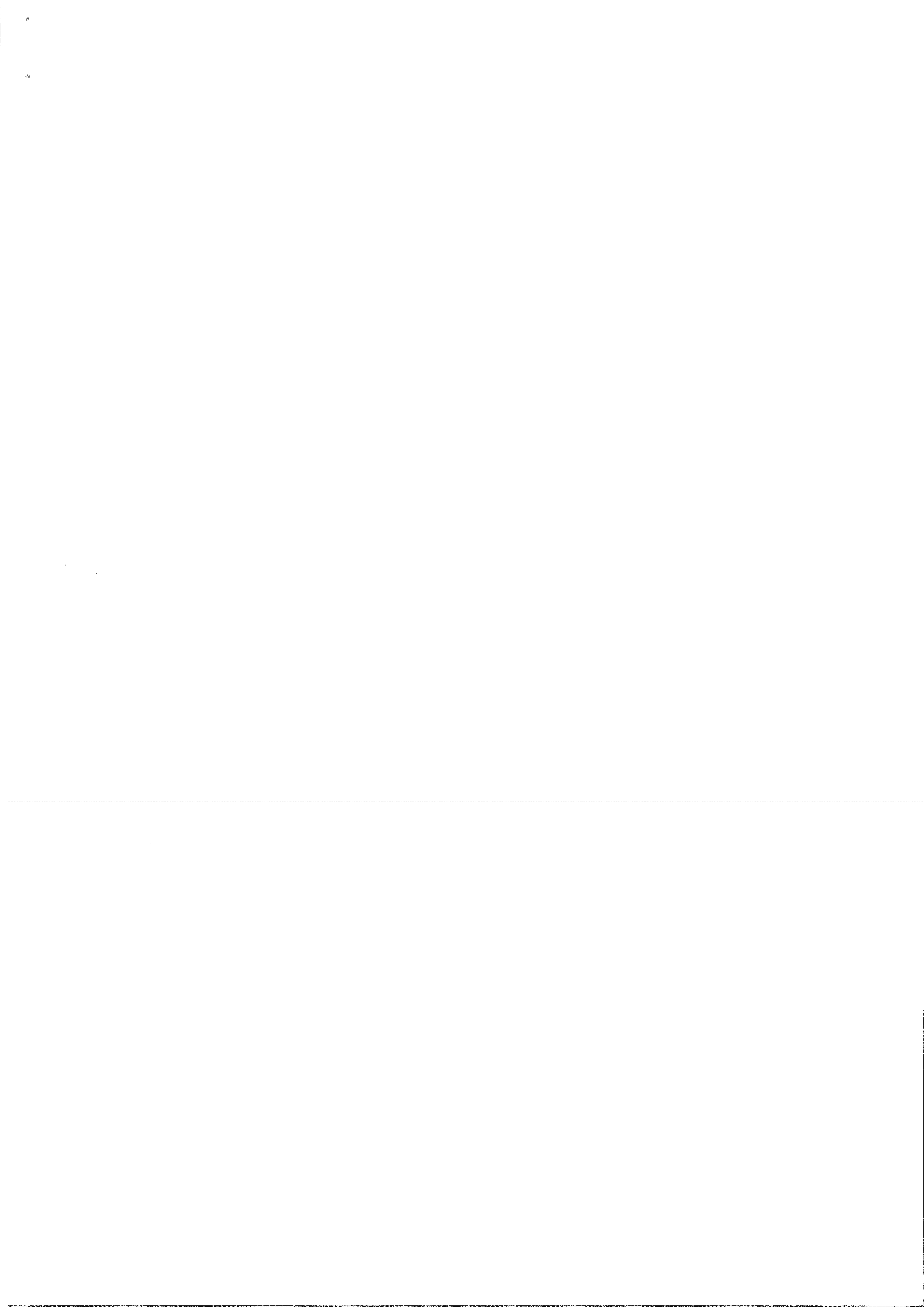
JT

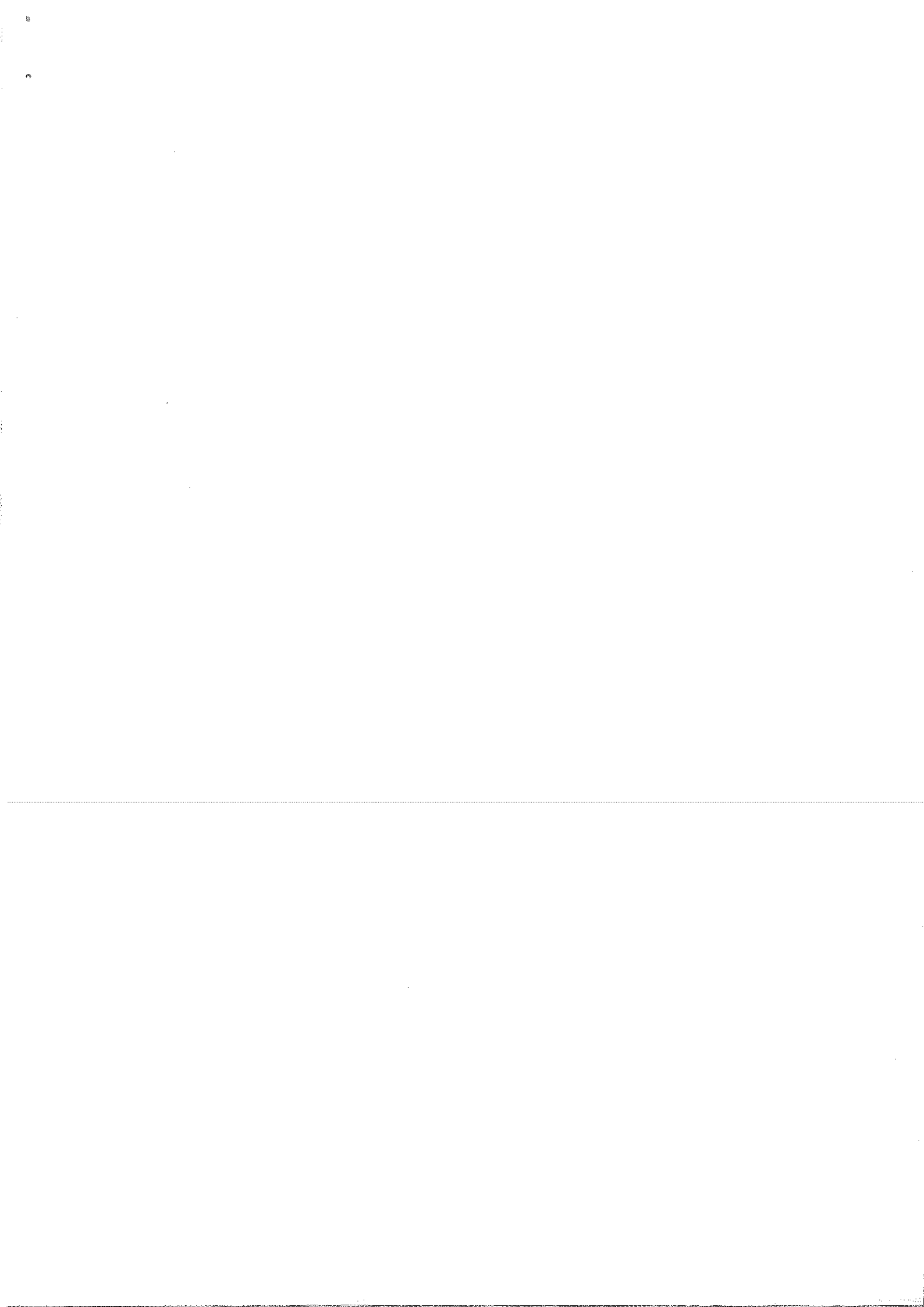
John T Wallis
Partner

Accepted on behalf of Best Build (Pvt) Ltd:

Mr P Pestachio
Managing Partner

Date





QUESTION 1

REQUIRED

<p style="text-align: center;">SECTION A (Answer in the PINK answer book)</p>

1. With reference to work paper C2, and using a tabular format:

Mark
guideline

- (i) Identify the weaknesses in the system of internal control for the maintenance of standing data.
- (ii) Explain the implications of each weakness for the 2014 audit plan.

(5)

(10)

(15)

2. Assume that:

- | |
|--|
| <ul style="list-style-type: none">(a) The system of internal control for the maintenance of standing data is effective; and(b) The engagement partner has specifically requested that only those controls per work paper C4 on which it would be appropriate to place reliance should be tested (bearing in mind the need to be cost-efficient) in order to provide audit evidence about the assertions for work-in-progress. |
|--|

Formulate the tests of control to test the operating effectiveness of the application controls for the capturing of chargeable hours. Prepare your answer in tabular format and for each control activity to be tested:

- (i) State its reference number per work paper C4 (i.e. 1 to 14).
- (ii) Describe the control objective(s) of the control activity.
- (iii) Describe the tests of control necessary to test the operating effectiveness of the control activity.

(24)

3. Having considered work paper C15, discuss the appropriateness of the approach followed to recognise and measure revenue from incomplete projects in the 2014 financial statements of Byte Counter.

(7)

SECTION B
(Answer in the **BLUE** answer book)

4. Having reviewed work papers M4 and M5, describe the further substantive procedures required to obtain sufficient appropriate audit evidence about the valuation assertion for total receivables. (24)

For the purposes of answering parts 5 and 6, assume that all the audit work has been completed and that the only outstanding matters are those detailed in work paper W6.

5. You have set up a meeting with Byte Counter's financial director, Ms Naidoo, in order to attempt to resolve the matter described in note (1) on the schedule of unadjusted audit differences (refer work paper W6). Formulate the questions that you would ask Ms Naidoo (including requests for documents and records) pertaining to this matter. For each question, also motivate why you would ask the question. Answer using a tabular format. (18)
6. Assume that the matter described in note (1) has been resolved and removed from the schedule of unadjusted audit differences on work paper W6. Discuss, with reasons, the audit opinion that should be expressed on the 2014 annual financial statements of Byte Counter should the other unadjusted audit differences remain. (12)

TOTAL (100)