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## CERTIFIED PUBLIC ACCOUNTANT (CPA)

### ADVANCED LEVEL 1 EXAMINATIONS

#### A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

**TUESDAY: 5 JUNE 2018**

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#### INSTRUCTIONS:

1. **Time Allowed: 3 hours 45 minutes** (15 minutes reading and 3 hours 30 minutes writing).
2. This examination has **two** sections; **A & B**.
3. Section **A** has **one** Compulsory Question while section **B** has three optional questions to choose any two
4. In summary attempt **three** questions.
5. Marks allocated to each question are shown at the end of the question.
6. Show all your workings.

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## **SECTION A**

### **QUESTION ONE**

#### **AFRICAN BANK RWANDA LIMITED (ABL)**

African Bank Rwanda Limited (ABL) is a new audit client of your firm, TBS & Co., and their financial year ended on 31 December, 2017. You are the audit manager assigned to this audit.

The bank is registered under the Rwanda Companies Act (Law relating to companies) as a company limited by share capital and is listed on the Rwanda Stock Exchange (RSE).

ABL is a subsidiary of African Bank Kenya Limited (ABK), a bank incorporated and domiciled in Kenya. The bank, therefore, operates independently of the parent bank in Kenya and other subsidiaries of the group in Uganda and Tanzania. The Group auditors will therefore be free to consult TBS & Co when the need arises as the financial statements of ABL will need to be consolidated in the group financial statements.

Notes prepared by the engagement partner:

1. ABL's strategic aim is to expand and become the largest bank in Rwanda. The bank opened up 10 branches during the year and hopes to either open up more branches or acquire an existing bank which has presence in areas of interest to ABL as per strategic plan 2017-2020.
2. The banking sector is highly regulated by the National Bank of Rwanda. The banking sector is now in the spotlight and under close scrutiny due to the global threat of terrorism and money laundering activities.
3. There are over 10 licensed commercial banks in Rwanda sharing an estimated bankable population of 30% of the population. The telecom companies are also providing mobile money platforms and this has also increased the bankable population. At least every mobile phone user has a mobile money account with his/her telecom company.
4. The bank occasionally experiences power interruptions and system breakdowns on some of its Automated Teller Machines (ATMs). The clients have to find other ATMs to access services in case this happens to ATMs near them.
5. The bank's impairment charges remained high largely due to the current economic hardships being faced by the population and the global economy at large coupled with the changes in the political landscapes in the big economies. The bank has decided to scale down on its home and personal loan products.
6. The bank, in a bid to curb the ever increasing employment expenses, has piloted the use of automated machines in some of its branches that can receive money from clients and credit customer accounts instantly. The bank hopes to reduce on the number of employees operating as tellers.

Notes from the meeting with the audit committee and Chief Finance Officer of the bank:

1. The bank's financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). The bank has early adopted two new financial reporting standards, being IFRS 9: Financial Instruments and IFRS 15: Revenue from Contracts with Customers. The Standards are otherwise effective January, 2018 but the board decided to early adopt.
2. The bank's Chief Finance Officer (CFO), Mr John Ruto joined the bank at the beginning of the financial year. John has a wealth of experience in the banking sector having worked with other banks in Kenya as an IT specialist. He is a Certified Public Accountant.
3. Kengo, one of the board members of the bank was implicated in a corruption scandal in another entity where he is involved as a director. Kengo has never been prosecuted and therefore is deemed to be innocent. He is the head of the Assets and Liabilities Management committee. The committee is charged with the responsibility of overseeing the management of the bank's assets and the loans and advances given to clients.
4. The bank acquired a loan of USD 5,000,000 from the African Development Bank (ADB) in line with its strategic plan of making ABL the largest bank in Rwanda. The loan is payable in 3 years and is secured on a signed and notarised Promissory Note. The loan is for expansion of ADL'S loan portfolio.
5. The loans and advances portfolio for the bank is Frw 50 billion. The impairment charge for credit losses during the year reduced to Frw2.3 billion from Frw 3 billion. The bank hopes to grow its loan portfolio to Frw100 billion according to the strategic plan for 2017 to 2020.
6. The bank employees are entitled to a bonus if the bank makes a profit. The bank made a profit of Frw17 billion and therefore all staff will be entitled to a bonus of 10% of the profits as per the bank policy.

Notes from the meeting with the Internal Audit Department of the bank:

1. The bank has an internal audit department headed by a member of the Institute of Certified Public Accountants of Rwanda as required by the National Bank of Rwanda. The other staff members are not yet members of the Institute.
2. The internal audit department reports directly to the Managing Director and Executive Director of the bank.
3. The internal audit staff can also be deployed on other assignments outside their department in case they are available to avoid redundancy but also to be able to support other departments.
4. The bank management through the Human Resource department handles the recruitment and remuneration of the internal audit staff.

Notes from the meeting between the engagement partner and audit team:

The engagement partner informed the audit team about the new pronouncement that has been included in the professional Code of Ethics for Accountants (the 'code'), that is, Non-Compliance with Laws and Regulations (NOCLAR). Certified Public Accountants now have a duty to respond to non-compliance or suspected non-compliance by clients with laws and regulations.

Extract of the statement of profit or loss:

	2017	2016
	Frw'billion'	Frw'billion'
Interest income	33.5	35.3
Interest expense	<u>(4.3)</u>	<u>(3.9)</u>
Net interest income	29.3	31.4
Fees & commission income	11.3	9.6
Fees & commission expenses	(0.4)	(0.2)
Net trading income	12	12.6
Other operating income	<u>0.6</u>	<u>0.1</u>
Total income before credit impairment charges	52.8	53.5
Impairment charges for credit losses	<u>(2.3)</u>	<u>(3)</u>
Total income after credit impairment charges	50.5	51
Employment expenses	(11.8)	(11)
Depreciation & Amortisation	(2.2)	(1.9)
Other operating expenses	<u>(14.5)</u>	<u>(16)</u>
Profit before income tax	22	21
Income tax expenses	<u>(5)</u>	<u>(4.9)</u>
Profit for the year	<u>17</u>	<u>16</u>

**REQUIRED:**

- (a) Discuss with your audit team the possible audit risks in relation to the audit of ABL. **(12 Marks)**
- (b) Evaluate the actual and possible business risks facing ABL. **(10 Marks)**
- (c) Discuss with the audit team the audit evidence expected on the audit file in relation to the audit of the loan from ADB. **(8 Marks)**
- (d) Discuss with the engagement partner the key issues the group auditors (KRG & Co.) will consider in their consolidation of ABL into the Group financial statements. **(8 Marks)**
- (e) Evaluate the objectivity of ABL's internal audit department. **(6 Marks)**
- (f) Discuss with your audit team the steps TBS & Co. will take in case the audit team comes across actual or suspected issues of Non-Compliance with Laws and Regulations during the audit of ABL. **(6Marks)**

**(Total: 50 Marks)**

## SECIION B

### QUESTION TWO

National Properties Limited (NPL) is an audit client of your firm, TFK & Co. NPL is in the business of managing and leasing of commercial and residential properties.

TFK & Co. used for the first time automated audit software to carry out NPL's audit. There is however no rules yet regarding integrity, confidentiality and availability of audit records that should be applied that are equivalent to the usual hard copy or printed documents.

The audit for the year ended 31 December, 2017 is nearly complete and the auditor's report will be signed soon on 30 June, 2018. The draft report shows the following:

	2017	2016
	Frw 'million'	Frw 'million'
Profit before tax	18.5	14.5
Total assets	8,000	7,800

The following outstanding matters require your consideration:

#### Finance costs:

Frw 60 million has been included in the statement of profit or loss relating to interest incurred on a loan of Frw 500 million borrowed from PLK, a company in France. The audit team indicates in their working papers, that NPL did not make any payments of interest or principal to PLK during the year but accrued the interest in the financial statements. The only evidence on file is a repayment schedule covering four years. NPL have no further information to give to TFK & Co. despite further requests.

#### VAT

NPL had an outstanding dispute with the Rwanda Revenue Authority (RRA) over VAT charged on costs incurred on building a multipurpose building in Kigali. The VAT claimed by RRA was Frw 50 million. NPL objected and filed a case with the tax tribunal. This matter has, however, been fully reflected and disclosed in the financial statements and has no effect on the going concern status of NPL.

#### Insurance claim:

NPL has been negotiating with Quick Insurance Company Limited (QICL) over a claim the company filed during the year relating to compensation for damage caused by fire on one of its properties. On 31 January, 2018 QICL paid NPL Frw 400 million in relation to the claim. This has

not been included in the financial statements for the year ended 31 December, 2017 because it was received in 2018.

### **REQUIRED:**

- (a) Discuss the implication on the auditor's report and recommend any further actions in respect of:
    - (i) Finance costs. **(8 Marks)**
    - (ii) VAT. **(6 Marks)**
  - (b) Comment on the insurance claim received by NPL and explain further audit procedures needed to be carried out by your audit team. **(6 Marks)**
  - (c) Advise your firm, TFK & Co. on the rules/controls that should be put place in relation to the automated audit working papers in order to safeguard the integrity, confidentiality, and availability of audit records. **(5 Marks)**
- (Total: 25 Marks)**

### **QUESTION THREE**

Beauty Clays Limited (BCL) has approached your firm, WTL & Co., to carry out the audit of their financial statements for the year ended 31 December, 2017. BCL is engaged in the manufacture and sale of building materials. The audit should have been carried out earlier on but BCL had to change auditors, ADC & Co due to professional negligence. This therefore means that the audit work must be completed in two weeks time although under normal circumstances, the audit should have taken a month.

WTL & Co. as a firm have never audited a company in the manufacturing sector but one of the partners and some staff have the relevant experience from elsewhere to audit BCL.

The audit partners have decided to accept the appointment for many reasons including:

1. BCL's proposed fee is Frw 30 million which is a substantial contribution to the firm. This can cover 3 months of staff salaries. The firm will also provide tax services which will bring in additional income. The firm will also give professional advice to BCL which will be billed in form of commission fees, if acted upon.
2. The audit partner, Sam, has accepted the engagement because he is a personal friend to the chief executive officer (CEO), John, as they are both members of Rwanda Golf Club.
3. Tony, the other partner was able to acquire roofing materials from BCL on credit with the assistance of Sam's links to the CEO and, therefore, WTL & Co. feel that if they decline the assignment, the relationships developed over years may be constrained.
4. BCL has good corporate structures with a board of directors composed of 7 members and therefore the audit risk is low and WTL & Co. does not need to bother about the integrity of BCL, its board of directors or its management.
5. The audit team headed by yourself will be required to be alert to possible and actual fraud indicators so as to be able to perform further audit procedures if necessary.

**REQUIRED:**

- (a) Explain to the audit partners the necessity of WTL & Co carrying out integrity checks on BCL before accepting the audit engagement. **(6 Marks)**
- (b) Identify and advise the partners on the professional and ethical issues that may arise during the audit of BCL. **(8 Marks)**
- (c) Discuss with the audit partners the key attributes in relation to quality of audit work needed by the partners and staff for the audit of BCL. **(5 Marks)**
- (d) Advise WTL & Co on how to eliminate or minimise the possibility of professional negligence during the audit of BCL. **(6 Marks)**
- (Total: 25 Marks)**

**QUESTION FOUR**

The Office of Auditor General (OAG) has appointed your audit firm; VGT & Co to audit Kigali Hospital (KH), a government owned and aided hospital for the year ended 31 December, 2017. In a meeting with the management of the hospital, the OAG and your firm, your audit partner, Jean inquired about media reports about alleged fraudulent practices at the hospital. Some of the stakeholders have even complained to the relevant authorities. The OAG has requested you firm to verify this allegation and this will form part of the terms of reference of the audit.

The hospital has many stakeholders such as employees, clients (patients), suppliers, the local community, regulators and government. The hospital has developed policies and procedures to meet all the stakeholder expectations. Such policies and procedures include: environmental compliance policies, health and safety, training of staff, charitable support to communities, and relationship with society. The OAG has also requested VGT to review KH's performance against the set policies and report to management for corrective action.

**REQUIRED:**

- (a) Discuss with the hospital management:
- (i) the factors that may contribute to fraud in KH. **(6 Marks)**
- (ii) possible indicators of employee fraud to look out for at the hospital. **(5 Marks)**
- (b) Discuss with your firm partner how you will assess the performance of the hospital in relation to the set policies and procedures. **(8 Marks)**
- (c) Explain to your audit partner on how you intend to use analytical procedures during the audit of KH. **(6 Marks)**
- (Total 25 Marks)**

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**END OF QUESTION PAPER**

