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**CERTIFIED PUBLIC ACCOUNTANT**

**ADVANCED LEVEL 1 EXAMINATIONS**

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

**DATE: FRIDAY 28, APRIL 2023**

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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. The question paper should not be taken out of the examination room.**

## **SECTION A**

### **QUESTION ONE**

You are a senior audit manager in Bizimungu and Mugeni Partners, a local firm of professional accountants based in Rwanda. This is the first year you have been assigned as the audit manager on the audit of HAMS Hotels Group (HHG) which comprises of a parent company (HAMS Hotel Rwanda), three (3) subsidiaries based in Rwanda and the two (2) newly acquired subsidiaries based in Kenya. All the companies in this group operate as “hotels” under a strong “HHG” brand name acquired ten years ago. The group operates hotels that are situated in major cities in Rwanda and Kenya. Your firm has been the auditor of HHG for the past eight (8) years and throughout this period, your firm has been the auditor of the parent company and all the subsidiaries.

The parent and subsidiaries all have the same reporting date and all apply a similar accounting framework. In addition, all the subsidiaries (including those based in Kenya) prepare their separate financial statements in the same currency which is FRW.

You are currently planning the final audit for the financial statements of all the individual entities and the HHG consolidated financial statements for the year ended 30 June 2023. To assist with the audit planning, you have met with the audit engagement partner Jean Pierre Tuyizere who has shared with you notes of his meeting held last week with Mr Muzungu (the Group Managing Director (MD) and Chair-person of the HHG Board of Directors) in which the following highlights were discussed:

#### **Stock listing on Rwanda Stock Exchange**

In July 2021, the HHG parent company and each of the three subsidiaries located in Rwanda successfully obtained a listing on the Rwanda stock exchange market as individually listed companies. The listing status has improved the HHG brand in and outside Rwanda. A large number of high-profile individuals and companies purchased the HHG shares on their first floatation. The stock listing requirements include annual publication of a reliable financial performance of the company and a full compliance to the corporate governance code in Rwanda. Though in the past, HHG has operated without an audit committee, Mr. Muzungu is coordinating the plans to institute an audit committee for the Group in the near future.

#### **Operating license and an accident at the hotel**

Each of the companies making HHG operate with a separate operating license issued periodically by the respective governments of Rwanda and Kenya. These licenses are only renewed after the relevant government departments have conducted an inspection of the hotel’s compliance to specific laws and regulations. All the companies in the group operate each with a separate five (5) year license and currently the licenses of each company will expire in two (2) years from 30 June 2022.



In October 2021, a famous foreign-based footballer who visited Rwanda and used one of the HHG hotels was seriously injured in the hotel's gym due to the poor condition of the equipment in the gym.

The footballer who due to his fame is widely followed has reported the accident on his social media account indicating that he intends to start a legal case against HHG demanding legal damages of FRW 50 billion. The accident and the legal claim by the footballer have received a lot of media publicity in and outside Rwanda. Though the HHG legal team indicates discussions with the footballer have commenced and the legal case with the footballer will be resolved in the interest of HHG, an inspection team from the Government of Rwanda is planning to conduct an inspection of all facilities of the HHG hotels located in Rwanda in June 2022. The renewal of the licenses for all the HHG hotels in Rwanda will only be granted upon the successful inspection report following the accident of the sportsman.

### **Diamond Five-Star standard**

HHG currently operates with a “diamond five-star standard” license status after HHG's accreditation under the Diamond five-star standards achieved in 2018. HHG's Income from corporate customers has grown significantly in the past years due to the diamond five-star standard maintained by HHG. The Diamond five-star standard accreditation which is the highest standard for hotels operating in Rwanda and Kenya is only maintained if strict standards of high-quality equipment is maintained in the hotels including upgraded furniture and equipment appliances in the hotels at all times. In order to maintain this standard, in January 2022, HHG invested FRW 150 billion in upgrading and maintenance of its equipment in the hotels and gyms in all the hotels based in Rwanda. The purchased equipment is imported from Europe and though the full amount has been paid to the supplier, the equipment will be received by HHG in Rwanda after nine (9) months from January 2022. This is the first time that HHG has procured the hotel equipment directly from Europe following an instruction from the Group Managing Director, Mr. Muzungu, to make an emergency direct procurement of the equipment from “Fountain Suppliers Limited”, a European-based company owned by Mr. Muzungu's wife. As part of the procurement terms, Fountain Suppliers Limited will provide a paid-for maintenance service for the procured equipment every year (for a total of 5 years) and the first maintenance of the purchased equipment is expected on 30 June 2022. The maintenance costs have been agreed as FRW 5 billion per year and all the maintenance costs for the five years have been included in the advance payment of FRW 150 billion paid to Fountain Suppliers limited. The payments to Fountain Suppliers Limited are all made in the Euro currency.

Because of the high amount of cash needed to fund the investment in the new hotel and gym equipment procured from Fountain Suppliers Ltd, HHG obtained a ten-year loan of FRW 150 billion from an international bank on 1 October 2021 after the approval by the HHG Board. The loan which was obtained at a floating interest rate of 10% per annum was obtained in USD currency and is being paid on a six (6) monthly basis (principal and interest) in the same USD currency. There have been significant fluctuations in the RWF: USD exchange rates throughout the year.

## Expansion plans

In the years before the current financial year, HHG has only owned hotels in Rwanda. However, in January 2022, the HHG Board approved an expansion plan that allowed HHG to acquire two hotel companies based in Kenya. The expansion plan is intended to extend the HHG brand and market share to Kenya, a country with a large number of tourists in need of quality hotel services. The acquisition of the two hotel companies in Kenya which are now subsidiaries to HHG was completed on 1 April 2022. Since January 2022, the senior management of HHG have mainly been operating from Kenya to ensure a successful takeover and smooth transition of the management of the two hotel companies.

The cost of the acquisition of the hotels in Kenya was agreed at FRW 250 billion which will be fully settled in Kenyan shillings on 1 April 2023. The acquisition cost will be funded through a share issue which is the only optimal funding source for the expansion plan as HHG is currently operating with a large bank overdraft and in addition it is at the limit of bank borrowing limit. Any loans available to HHG would be obtained at an incremental borrowing rate of 10% per annum.

The Government of Rwanda has formally agreed to provide HHG a grant of FRW 35 billion to assist HHG in its expansion plan on condition that HHG will attract its international customers in the Kenyan-based hotels to extend their visits to Rwanda as tourists. The grant is provided to specifically fund HHG's marketing costs and the cost of a refurbishment for the two hotels in Kenya in order to maintain the "diamond five-star standards" in Kenya. The grant is expected to be received in June 2022 and the relevant expenditures shall commence in August 2022. Mr. Muzungu, the MD of HHG has instructed the Group Chief Finance Officer of HHG to recognize the full amount of the grant as income in the current year since the Government of Rwanda has always been one of HHG's largest customer in Rwanda.

## Extracts of management accounts

The engagement partner has shared with you the following extracts of HHG's management accounts received from HHG's Chief Financial Officer:

Particulars	Projected on 30 June 2022	Actual on 30 June 2021
	FRW'millions	FRW'millions
Revenue (Note 1)	112,500	83,250
Profit before tax	24,750	12,488
Cash and cash equivalents	(43,830)	33,750
Total assets	1,687,500	1,248,750
Long-term borrowings	720,000	380,000



**Note 1: Details of Revenue**

Particulars	Projected on 30 June 2022	Actual on 30 June 2021
	FRW'millions	FRW'millions
Income from Hotel rooms	61,800	43,290
Hire of conference halls	19,500	12,800
Restaurant income	21,200	19,160
Other income	10,000	8,000
	<b>112,500</b>	<b>83,250</b>

The majority of HHG customers use services from HHG for a short contractual period of time that does not exceed an average of seven (7) days.

The above management accounts are used to provide key highlights of the HHG revenue details and other segmental financial information in the meetings of the Board of Directors as part of the Board's evaluation of HHG's periodic financial performance.

**Required:**

Using the information relating to HHG as provided:

- a) Evaluate the business risks to be considered in planning the final audit of HHG. (14 Marks)
- b) Evaluate the principal risks of material misstatements to be considered in the final audit of individual financial statements and consolidated financial statements of HHG. (26 Marks)

**Note:** In the evaluation of the risks of material misstatements, ignore any risks relating to segmental information.

**c) Recommend audit procedures to be performed on:**

- i. The government grant received from the Government of Rwanda. (5 Marks)
- ii. The segmental information relating to the Group's revenue. (5 Marks)

**(Total: 50 Marks)**

## SECTION B

### **QUESTION TWO**

Assume today is 1 April 2023.

You are a manager in Muhoza and Partners, a local audit firm in Rwanda and you specialize in conducting fraud investigations. An audit client of your firm, Byamungu Rwanda Wholesalers (BRW) sells packed juice to the public in Rwanda at a wholesale price. BRW operates a number of stores that are open to the public throughout Rwanda allowing both the retailers and the general public to purchase the soft drinks in large and small quantities at a whole-sale price from any one of BRW's stores. The receipts from customers are majorly in cash and most of BRW's own expenses are also settled in cash. At the end of March 2023, our audit firm issued an unmodified audit opinion on BRW's latest audited financial statements for the year ended 31 December 2022.

BRW's business has rapidly expanded in the last two years when the company introduced a direct delivery service to retailers who are located in any part of Rwanda. The direct delivery is only done if an order is placed by a phone call to BRW within three (3) days of the required delivery. On the delivery of the supplies to the retailers, the delivery team receives the full amount of the receipt in cash.

All cash receipts received by the delivery teams are handed over to the accountant who is based at BRW's head office in Kigali within a day for deliveries made in Kigali and not later than the following day for deliveries made outside Kigali. The cash handed over to the accountant is kept in a lockable cash safe box kept in the accountant's office until the cash is banked on the company's official bank account within the week in which the cash is received. In most cases, the accountant himself banks the cash on the BRW bank account other than the cashier. At times, this cash is used to directly pay for purchases and other office expenses where the payment is done directly by the accountant. The accountant solely maintains the keys to the cash safe box. In addition, the accountant maintains and updates the company's cash book and this is only reviewed once at the end of the month by the Finance manager.

In a meeting you held yesterday with the Finance manager of BRW, the following information was brought to your attention:

#### **Stolen items from the stores**

On 20 March 2023, while conducting a spontaneous check, the internal auditor of BRW discovered a large number of discrepancies in BRW's inventory records for the largest store located in Kigali. An extract from the internal auditor's report to the BRW's management, includes the following finding and recommendation:



“Based on the internal auditor’s review of the inventories kept in the largest stores in Kigali, a large stock of inventory has always gone missing. It is possible that someone is fraudulently taking these inventory items out of the stores. Based on a quarterly physical stock-take, it is consistently reported that that about 500 cartons of the packed juice (each carton contains one-hundred large packed bottles of juice) are disappearing from the stores every month. I recommend that BRW management engages an expert to investigate the inventory loss and quantify the value of the loss”

### **Stolen cash book and cash**

The accountant disappeared on 15 March 2023, taking the company’s cash book and he also took all the cash that had been kept in the safe box for the last five days’ sales. The cash book was last reconciled on 31 December 2022 for the final audit purposes. The finance manager has reported the fraud case against the accountant to the Rwanda police.

### **Required:**

In reference to the information regarding BRW:

- a) **Explain the relevance of “forensic accounting” to the report and recommendation made by the internal auditor of BRW regarding the suspected loss of inventory.** (8 Marks)
  - b) **If engaged to conduct an investigation in the alleged fraud, recommend the investigation procedures you will conduct on the financial loss relating to the stolen inventory.** (5 Marks)
  - c) **Comment on six matters to be considered in determining the extent of BRW’s financial loss resulting from the alleged stolen cash** (12 Marks)
- (Total: 25 Marks)**

### **QUESTION THREE**

You are a manager in Jadon Associates an audit firm that has operated in Rwanda for more than ten years and keen to increase the firm’s revenue. Jadon Associates has been an auditor to Trinity Limited for the last seven years after Trinity Limited was referred to our firm by Marie Insurance Company. Jadon Associates paid a commission of 15% of the audit fees received in the first audit of Trinity Limited to the CEO of Marie Insurance Company (Valence Twagirayezu) in person when Valerie demanded for payment to him by our firm as a “referral fee”.

Trinity Limited is listed on the Rwanda stock exchange market and has always been one of our firm’s largest clients. The engagement partner on the audit of Trinity Limited in all the seven years has been Moses Matabaro.

Trinity Limited has been a large producer of school furniture in Rwanda for several years with a sales revenue of FRW 48 billion and employed 160 employees in the year ended 31 March 2023.

Our firm has commenced the final audit for the year ended 31 March 2023, and the following issues have come to your attention:

(1) New Heights Academy (NHA), a private institution providing professional courses and based in Remera, Kigali is the largest customer of Trinity Limited. Shortly before the end of the financial year, NHA made an order to Trinity Limited of classroom furniture which had not been delivered by Trinity Limited by 31 March 2023. Trinity Limited's financial statements for the year ended 31 March 2023, include work-in-progress of FRW 4.8 billion and trade receivables of FRW 3.2 billion both relating to NHA's order of furniture.

Jadon Associates is also the auditor of NHA and our firm is also aware that NHA is facing severe financial difficulties and we are aware that NHA will not be able to continue trading in the near future. Therefore, it is highly probable that NHA will not be able to settle the amount owed to Trinity Limited. In addition, NHA will not take the ordered class room furniture even when this is completed by Trinity Limited. The amounts relating to NHA are considered material to Trinity Limited and the potential financial loss expected to be suffered will put Trinity Limited's going concern in doubt.

(2) You have confirmed that Trinity Limited has to this date not settled the outstanding audit fees for the audit of the prior year's financial statements (year-ended 31 March 2022). You are also aware that with effect from this year, Trinity Limited started outsourcing its internal audit function to our firm which is provided by our firm's consultancy unit. The fees from the internal audit consultancy service which is billed every quarter have significantly increased our firm's revenue.

However, fees for this service for the last two quarters for the internal audit services provided to Trinity Limited for the last two quarters has not yet been settled by Trinity Limited. Our firm is aware that due to the potential loss of its largest customer (NHA), Trinity Limited may soon suffer significant financial difficulties. Consequently, our firm has demanded Trinity Limited to settle the outstanding audit fees and outsourced internal audit fees before the current audit continues. Trinity Limited has therefore initiated a bank payment for all outstanding fees to Jadon Associates and our firm have advised Trinity Limited to deliberately push the bank to process this payment very fast as a "special clearance".

**Required:**

- a) Using the information provided, describe the ethical issues and challenges our firm faces in relation to the final audit of Trinity Limited for the year ended 31 March 2023. (15 Marks)
- b) As the audit manager, write a letter to the engagement partner in which you explain the work the audit firm would perform in regard to the following balances reported in the financial statements of Trinity Limited for the year ended 31 March 2023:
  - i) Work-in-progress furniture for NHA. (3 Marks)
  - ii) Trade receivable relating to NHA. (3 Marks)



And using the same letter to the engagement partner, explain:

- iii) Any two other “actions” Jadon Associates would take if sufficient evidence regarding the work-in-progress and trade receivables from NHA is not obtained. (2 Marks)

Note: Two (2) profession marks will be awarded for the report format (where 1 mark of the 2 marks must be given for a reasonable introduction). (2 Marks)

(Total: 25 Marks)

#### QUESTION FOUR

You are a senior audit manager in Karega and Kambanda Partners Certified Public Accountants. You are in charge of the audit of Abacus Global Electronics Rwanda Limited (AGE-Rwanda), a company operating in Rwanda with five wholly-owned subsidiaries in five other African countries. AGE-Rwanda is a major retailer of electric appliances which are used in hospitals in Rwanda and other African countries through its subsidiaries. Your firm only audits the parent company AGE-Rwanda while the subsidiaries are separately audited by local audit firms based in countries where each subsidiary is based.

Your audit firm is in the final stage of the audit of the consolidated financial statements of the AGE-Rwanda group and you are now communicating with the component auditors of the subsidiaries for any financial information that impacts on the group audit report.

You have received an email from the auditor auditing AGE-Sudan, a subsidiary based in Sudan which has three (3) major customers who comprise of the largest private hospitals in Sudan. The audit for the subsidiary’s financial statements for the year ended 31 December 2022 has just been completed and an audit report was issued last week. Two extracts picked from the email include:

- a) A consignment of equipment of a high value was detained by the Sudan Customs on 30 November 2022. AGE-Sudan has now paid for the equipment with the cost of the equipment included in the financial statements and disclosed as “goods-in-transit” since the equipment has not been received. The audit team has neither been able to physically verify the equipment nor obtained external confirmation regarding the existence of the equipment.

**Required:**

For this issue as raised by auditor of AGE-Sudan in the email, explain:

- i) The additional information that you would require from the auditors of AGE-Sudan to complete the audit for the consolidated financial statements. (5 Marks)
- ii) The possible consequences of these issues for the consolidated financial statements and on the auditor’s report. (4 Marks)

**b) The local currency of Sudan has suffered significant devaluation against the US dollars leading to the Government of Sudan introducing temporary exchange rate restrictions effective from 15 January 2023. From January 2023, due to significant cash flow shortages, AGE-Sudan whose purchases for inventory are all settled in US dollars can only manage to settle 50% of its liabilities for purchases as they fall due. The unsettled bills are extended to a future payment date resulting in additional interest costs and greater exposure to exchange rate fluctuations to AGE-Sudan.**

**Required:**

**For this issue as raised by auditor of AGE-Sudan in the email, explain:**

- i) The additional information that you would require from the auditors of AGE-Sudan to complete the audit for the consolidated financial statements. (7 Marks)**
- ii) The possible consequences of these issues for the consolidated financial statements and on the auditor's report. (6 Marks)**

**c) This morning, you have received a copy of the auditor's report on AGE-Sudan's financial statements for the year ended 31 December 2022 which issued two (2) days ago. The auditor's report on the AGE-Sudan's financial statements was modified regarding the company's ability to continue in operational existence for the foreseeable future.**

**Required:**

**Explain the possible consequences of the AGE-Sudan (subsidiary) audit report modification on the Group auditor's report (3 Marks)**  
**(Total: 25 Marks)**

**End of question paper**





