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**CERTIFIED PUBLIC ACCOUNTANT  
INTERMEDIATE LEVEL EXAMINATIONS**

**11.4: AUDITING**

**DATE: FRIDAY 28, APRIL 2023**

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**INSTRUCTIONS:**

- 1. Time allowed: 3 hours 15 minutes (15 minutes reading and 3 hours writing)**
- 2. This examination has two sections: A & B.**
- 3. Section A has three compulsory questions while section B has three questions to choose two.**
- 4. Five questions in total are to be attempted.**
- 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

a) Your firm is the external auditor of Ngororero Foods Ltd, a company that runs a chain of fast-food restaurants. From your risk analysis, you identified that a major risk of this sector is poor food quality which might result in damages claimed by customers. You had noted at the interim audit that the company's control risk in regard to purchases of food and its preparation in the kitchen was low. However, during your final audit, it has come to your attention that one month before the year-end, a customer has sued the company for personal injury caused by food poisoning, claiming an amount of FRW 90 million in compensation. Based on the profit of the company, the claim is material but management believes that it has a good defense against the claim.

After consulting the company's lawyer, you have concluded that it is possible that the claim will be successful. However, management has decided not to make a provision or disclosure in the financial statements regarding this matter.

#### **Required:**

In consideration of the Ngororero Foods Ltd's food purchases and its preparation in the kitchen:

i) **Recommend any three controls that the company should have in place to reduce the risk associated with food purchases and its preparation in the kitchen.** (3 Marks)

ii) **Explain any three tests of controls you should carry out to satisfy yourself that control risk in this area is low.** (3 Marks)

b) **Explain any two assertions relevant to accounts payable at the year-end date.** (2 Marks)

c) **In respect of the potential claim, state any three items of evidence you should obtain and explain how each of the evidence will enable you to form a conclusion on the likelihood of the claim being successful.** (6 Marks)

d) **Describe how the legal claim from the customer should be treated in the financial statements of Ngororero Foods Ltd at the reporting date and explain the effect of the applied accounting treatment on the auditor's report.** (6 Marks)

**(Total: 20 Marks)**

## QUESTION TWO

a) As a Senior Manager in Enable CPA Ltd, you act as a mentor to some of the young auditors in practice. As a mentor, you discuss frequently with your young mentees on professional and personal matters. You are currently preparing to facilitate at the forthcoming training where you are required to provide guidance on the following:

ISA 265 “Communicating deficiencies in internal controls with those charged with governance and management” that requires auditors to report deficiencies in internal controls with those charged with governance and management.

### Required:

**Explain to your trainees what a management letter is, indicating at least four information contents that is included in the management letter. (5 Marks)**

b) **Briefly explain what is meant by the ‘Going Concern Concept’ and describe any five procedures that they will need to perform in order to form an opinion on management’s conclusion that the company is a going concern. (6 Marks)**

c) **Briefly explain the three types of modified audit opinions that the auditor may issue on a company’s financial statements audited. (3 Marks)**

d) **Describe any two circumstances under which an auditor may issue a qualified opinion. (2 Marks)**

e) Sinyolita manufacturing Ltd (SM Ltd) is one of your clients. The following is the summary draft and audited results of the company:

Description	2022 Draft	2021 Audited
	FRW "Million"	FRW "Million"
Revenue (for the year to 30 September)	120	112
Profit before taxation (for the year to 30 September)	24	16
Total assets (As of 30 September)	92	88

One of your junior auditor highlighted that during the audit of SM Ltd, she discovered that inventory valued at FRW 12 million had been excluded from the end of inventory valuation in the financial statements of the company for the year ended 30 September 2022. After discussing this with management, she was satisfied that it was an unintentional oversight. The error was corrected prior to the conclusion of the audit.

### Required:

**Briefly explain the implication of this case on the auditor’s report. (4 Marks)**

**(Total: 20 Marks)**

### QUESTION THREE

Your audit manager has shared with you the draft financial statements of Rwema Company Ltd for the year ended 31 December 2022 and the audited financial statements for the year ended 31 December 2021. This is your first year on this client and the audit manager has requested you to use the extracts of financial information below to calculate key ratios for your audit planning and documentation purposes.

Extract draft figures of Rwema Co Ltd for year ended 31 December 2022 and 31 December 2021.

Description	31 <sup>st</sup> December 2022 (FRW)	31 <sup>st</sup> December 2021 (FRW)
Revenue	6,408,279	7,794,301
Gross profit	2,412,797	2,891,686
Profit before interest and tax	527,112	501,556
Property, plant and equipment	308,947	352,001
Inventories	1,247,487	1,199,384
Receivables	1,491,498	1,792,635
Trade payables	998,123	1,050,754
Other current liabilities (incl. bank)	107,501	181,634

Your re-computation of key ratios from the financial information above shows the following:

Ratio	31 <sup>st</sup> December 2022	31 <sup>st</sup> December 2021
Gross profit margin	37.65%	37.1%
Receivables' days	85 days	84 days
Inventory turnover ratio	3.2 times	4.1 times
Current ratio	2.47	2.64
Acid test ratio	1.35	1.58
Return on capital employed	27.1%	22.7%

**Required:**

- a) Define analytical procedures and give at least 3 examples of sources of information to conduct analytical procedures. (4 Marks)
- b) From your analytical procedures above, clearly show the possible audit risks identified and how they will be addressed in your audit planning documentation for:
  - i) Revenue (4 Marks)
  - ii) Profit before interest and tax (4 Marks)
  - iii) Receivables (4 Marks)
  - iv) Inventories. (4 Marks)

**(Total: 20 Marks)**

## SECTION B

### **QUESTION FOUR**

You are an Audit manager at JET Auditors Ltd, an international firm of qualified accountants/auditors. In the portfolio of audit clients under your team in the year 2022 is a new client “Solution Tech Ltd” a listed company on Rwanda stock exchange (RSE) and you are planning the final audit for its financial statements for the year ended 30 June 2022. Solution Tech Ltd designs and develops software for e-commerce with high-security features which have won industry awards.

In the last 3 years, the Solution Tech Ltd invested FRW 500 million in creating new software to appeal to a large number of multinational companies, and sales are now made in over 10 countries. The software is developed in the country, but the manufacture of the security features takes place overseas. The software is largely sold through retail outlets, but approximately 30% of Solution Tech Ltd.’s revenue is generated through online sales (sales made on the company’s website). In some countries, Solution Tech Ltd’s products are distributed under a franchise agreement which gives the franchise holder the exclusive right to sell the products in that country. The cost of each franchise to the distributor depends on the estimated sales in the country to which it relates, and the franchise lasts for an average of five years.

The income that Solution Tech Ltd receives from the sale of a franchise is deferred over the period of the franchise. As of 30 June 2022, the total amount of deferred income recognized in Solution Tech Ltd.’s statement of financial position is FRW 2 billion.

As part of a five-year strategic plan, Solution Tech Ltd obtained an RSE listing in December 2021. The listing and related share issue raised a significant amount of finance, and many shares are held by institutional investors. The founder of Solution Tech Ltd is Rania and she now retains a 20% equity shareholding, and a further 10% of the company’s shares are held by her family members.

Despite being listed, the company does not have an internal audit department, and there is only one non-executive director on the board.

#### **Required:**

- a) Comment on any six matters that you should consider specific to initial audit engagement when developing the audit strategy for Solution Tech Ltd. (6 Marks)**
- b) Evaluate seven risks to be considered in planning the final audit of Solution Tech Ltd for its financial statements for the year ended 30 June 2022. (14 Marks)**

**(Total: 20 Marks)**

## QUESTION FIVE

Icyerekezo Microfinance Bank (IMB) is a new significant audit client of your firm. While reviewing the work done by your junior auditors you noted the followings:

- ✓ At the audit strategy stage, it was agreed that the audit of loans and advances would involve reliance on the effectiveness of internal controls. However, during the test of controls, your team noted that five significant loans were issued when these were not approved by the appropriate approving officers. Further review indicated that the loans were genuinely issued to customers but were only approved by officers whose approval limit has been exceeded.
- ✓ During the period under review, the tax authority carried out a tax investigation and noted significant variance between the company's estimated tax liabilities and the tax authority's assessment. On further discussion, it was noted that the previous tax computation was done by junior staff of the bank who does not have the requisite experience and the tax computations were not duly reviewed by experienced senior officers of the company.
- ✓ A variation was noted between the amount in a customers' receivables balance in the ledger and the client confirmation. However, the variance was considered not material and not adjusted for. The team informed you that during a discussion with the receivables manager, it came to their attention that the debtor in focus is a close family member of the Managing Director.

The team is considering the impact of the above observations on the audit process.

### Required:

- a) **Draft a report to management evaluating the implications of the above observations on the control environment and the audit strategy/procedures. (14 Marks)**
  - b) **With reasons, comment on whether the identified control deficiencies at IMB will need to be reported to those charged with governance of the entity. (6 Marks)**
- (Total: 20 Marks)**

## QUESTION SIX

a) A Certified Public Accountant in practice should agree to provide only those services that they are competent to perform. Before accepting a specific client engagement, they should consider whether acceptance would create any threats to compliance with the fundamental principles.

He/she should also evaluate the significance of identified matters that are important in deciding to accept the audit engagement. Where barriers to accepting a new engagement are clearly insignificant, actions should be applied as necessary to eliminate them or manage the barriers to an acceptable level.

### Required:

In accordance to ISA 300 Planning an Audit of Financial Statements, evaluate any five matters that should be considered to ensure an appropriate planning and conduct of an audit of the financial statements of a new client is conducted. (5 Marks)

b) ISA 320 “Materiality” states that the auditor considers materiality at both the overall financial statement level and in relation to class transactions and account balance level.

### Required:

Discuss the materiality concept in relation to an audit of financial statements and describe at what stages of the audit, the auditor uses the materiality concept. (6 Marks)

c) You are the senior on the audit of Hamida & Sons Limited (HL). Upon your manager’s instruction, you had determined the acceptable materiality level to be FRW 10 million at the initial planning stage. However, at the time of evaluating the results of audit procedures carried out at the interim stage, you have reduced the materiality level to FRW 7.5 million.

### Required:

i) Briefly explain to your audit manager the possible causes which may result in the need to reduce the materiality level. (2 Marks)

ii) Discuss the impact of the reduction in the materiality level on audit risk and the audit procedures to be performed. (3 Marks)

iii) During the course of an audit, both quantitative, as well as qualitative misstatements, need to be considered. Give any four examples of qualitative misstatements. (4 Marks)

(Total: 20 Marks)

**End of Question Paper**

