CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

DATE: FRIDAY 25, AUGUST 2023

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 manager in the audit department of Sonic & Associates an ICPAR registered firm. Your firm won the tender to audit Kristal Venja (the Group) and all its subsidiaries excluding a newly acquired Kenyan subsidiary Brookside Ltd, which is audited by a Kenyan audit firm. Kristal Venja group of companies have similar financial reporting period and have adopted the IFRS as their applicable financial reporting framework. The group has more than 20 subsidiaries including international ones.

Kristal Venja is listed on the Rwanda Stock Exchange and has diversified its operations ranging from, construction and infrastructure, fast-moving consumer goods, construction materials, security services and hospitality sectors. Some of its operations are worldwide, operating across different continents.

The recent Ukraine war that resulted in shortage of oil internationally made Kristal venture into additional business of oil distribution in East and Central Africa. In 2022 this line of business grew exponentially with current forecast projected to be 12% of Kristal revenue from oil distribution business, growing to 15% in 2023.

Covid 19 pandemic and the resulting restrictions brought new methods of conducting business with growth of e-commerce courtesy of online sales. Many companies explored that opportunity creating increased competition and has eroded Kristal market share of oil distribution business. However, management is optimistic this is a temporally revenue drop with growth expected in 2023.

Management of Kristal attended Institute of Certified Public Accountant of Rwanda (ICPAR) Continued Professional Development (CPD) event on two topics; "Process automation for efficiency" and "Integrated reporting". Knowledge from the training was implemented through automation of all its warehousing facilities with improvements in technology for monitoring and managing inventory levels. This resulted to massive staff redundancies though several outlets are still employing thousands of staff on their warehouses.

In compliance with listed companies' requirements, Kristal management is keen on implementing "the integrated reporting" However, this is a technical area and it requires assistance from an audit firm, specifically in identifying key performance indicators to be presented and the relevant financial information.

Extracts from Kristal Consolidated financial statements

Statement of Financial Position

Particulars	Note	31-12-2022	31-12-2021
		Projected	**Actual**
		FRW "Million"	**FRW "Million"**
Non-current assets			
Goodwill	**1**	1,100	970
Other intangible assets	**2**	200	170
Other assets		742	700

Particulars	Note	31-12-2022 Projected FRW "Million"	31-12-2021 Actual FRW "Million"
Current assets		1,450	1,420
Total assets		**3,492**	**3,260**
Equity and liabilities			
Share capital	**3**	1,250	1,150
Other Equity		995	943
Non-current liabilities	**4**	650	620
Current liabilities		597	547
Total equity and liabilities		**3,492**	**3,260**

Statement of profit or loss

Particulars	Note	31-12-2022 Projected FRW "Million"	31-12-2021 Actual FRW "Million"
Revenue	**5**	5,770	5,990
Other operating income	**6**	120	80
Operating expenses	**7**	(5,540)	(5,800)
Operating profit		350	270
Finance charges		(28)	(30)
Profit before tax		322	240
Tax expense		(64)	(60)
Profit for the year		**258**	**180**

Notes:

Goodwill

1. Goodwill is in relation to Kristal subsidiaries, testing for impairment is on annual basis and management expects to conduct the annual review in December 2023. They do not intent to recognize impairment this year due to anticipated growth in revenue which is forecast for the next two years.

In March 2022, Kristal acquired 80% of equity in Brookside Ltd, a listed Kenyan company, for consideration of FRW 351 million.

Other intangible assets

2. Other intangible assets relate to software and other technological development costs. FRW 35 million was spent on developing IT system for dealing with customer enquiries and customers order processing. A further FRW 20 million was spent on warehouse automation, and FRW 5 million on developing new accounting software. These costs have been capitalized as intangible assets and are all being amortized over a 15-year useful life.

Share capital

3. There was issue of shares in July 2022 raising FRW 100 million, which was used to fund capital expenditure.

Non-current liabilities

4. Non-current liabilities includes borrowings of FRW 550 million (2021 – FRW 500 million) and provisions of FRW100 million (2021 – FRW120 million). Changes in financing during the year have impacted on the Kristal weighted average cost of capital. As per Kristal treasury management team the weighted average cost of capital currently stands at 10%.

Revenue

5. Revenue has decreased by 3·7% over the year, due to a new competitor in the market taking some of the Kristal market share.

6. Other operating income comprises the following items:

	2022	2021
Particulars	FRW "Million"	FRW "Million"
Reversal of provisions	60	40
Reversal of impairment losses on receivables and other assets	30	20
Foreign currency gains	28	23
Profit/(loss) on disposal of non-current assets	2	(3)
Total	**120**	**80**

7.Operating expenses includes the following items:

	2022	2021
Particulars	FRW "Million"	FRW "Million"
Staff costs	3,650	3,610
Cost of raw materials, consumables and supplies	1,725	1,780
Depreciation, amortization and impairment	145	140
Other operating expenses	20	270
Total	**5,540**	**5,800**

Determination of goodwill on the acquisition of Brookside Ltd

	Note	FRW "Million"
Cash consideration – paid 1 March 2018		80
Contingent consideration	1	271
Total consideration		351
Fair value of non-controlling interest	2	49
		400
Less: Fair value of identifiable net assets	3	(300)
Goodwill		100

Notes:

1. The contingent consideration will be payable four years after the acquisition date and is calculated based on a payment of FRW 525 million, only payable if Brookside Ltd reaches revenue and profit targets outlined in the purchase documentation. The amount included in the goodwill calculation has been discounted to present value using a discount factor based on an 18% interest rate.

2. The non-controlling interest is measured at fair value, the amount being based on Brookside's share price on 1 March 2022.

3. The assets and liabilities acquired and their fair values were determined by an independent audit firm, who were engaged by Kristal to perform due diligence on Brookside Ltd prior to acquisition. A fair value gain of FRW 12 million was made in relation to property, plant and equipment.

The two points below are an extract from the component auditors audit strategy in connection with audit of Brookside. Other sections of the audit strategy, including the audit risk assessment, have been reviewed by Kristal audit team and are considered to be satisfactory. Brookside Ltd is projected to be loss making this year, and Kristal audit team is confident that sufficient procedures on going concern have been planned for.

Controls effectiveness

We will place reliance on internal controls, which will reduce the amount of substantive testing which needs to be performed. This is justified on the grounds that in the previous year's audit, controls were tested and found to be highly effective. We do not plan to re-test the controls, as according to management there have been no changes in systems or the control environment during the year.

Internal audit

The internal audit team of Brookside Ltd will help perform audit procedures. We are planning to use the internal auditors to complete the audit work in respect of trade receivables, as they have performed work on this area during the year. It will be efficient for them to perform and conclude on the relevant audit procedures, including the trade receivables circularization, and evaluation of the allowance for trade receivables, which we will instruct them to carry out.

Required:

(a) **Using analytical procedures evaluate the audit risks to be considered in planning Kristal Venja audit.** (30 Marks)

(b) Goodwill arising on the acquisition of brookside Ltd is to be audited, **propose the audit procedures to be used in the audit of goodwill.** (6 Marks)

(c) Using the information provided, **evaluate the audit strategy prepared by Kristal Venja component auditor in respect of audit of Brookside Ltd.** (10 Marks)

(d) **Discuss the ethical and professional implications of the request by Kristal Venja for the audit firm in assisting preparing the integrated report.** (4 Marks)

(Total: 50 Marks)

SECTION B

QUESTION TWO

a) You are the audit manager responsible for the audit of Grill Masters Ltd for the year ended 30 June 2022. The audit field work has been completed and the general manager in charge of finance is seeking to finalize the financial statements. You are reviewing the audit file and the financial statements and you have noted the following issues:

1. An investment held at the year-end has since declined by FRW 12,500,000 in market value.
2. A tangible asset with a netbook value of FRW 8,000,000 was sold on 29 June 2022. The final selling price was contingent on valuer's report which was not received until 15 July 2022. As a result of this report, the profit recorded on this sale should be reduced by FRW 3,000,000.
3. A number of minor control points were noted and reported to management by way of a formal management letter.
4. Trade payables include a balance of FRW 7,000,000 owing to the parent company of Grill Masters Ltd. The parent company has assured the general manager that it will not seek repayment of the amount for two years from the date the audit report is signed. The general manager will confirm this in the letter of representation.
5. A legal case which was ongoing at the year-end has just been concluded. The case is disclosed and a provision of FRW 3,500,000 included in the draft financial statements. The outcome of the case was that Grill Masters Ltd should pay damages amounting to FRW 14,500,000 to the other party.

The draft financial statements, which do not contain any adjustments and some relevant disclosures relating to the above matters, show the following:

Item	**FRW**
Turnover	345,000,000
Profit before tax	29,000,000
Net current liabilities	14,000,000
Net assets	21,000,000

Required:

(i) For each of the issues noted from your review, **summaries the potential implications on the audit report (Treat each issue independently)** (10 Marks)

(ii) **Explain the overall audit opinion that you would express taking into consideration that no further adjustments or disclosures were made for the issues noted**. (5 Marks)

b) You have now commenced the audit for the year ended 30 June 2022. The partner in charge of the audit instructs you to carry out a review of the company activities since the financial year end.

Required:

Analyze audit procedures which you might carry out in order to identify any material post balance sheet events. (10 Marks)

(Total: 25 Marks)

QUESTION THREE

You are audit manager for International Team Auditors Ltd. The challenges brought by COVID 19 has forced your firm to strategize on measures of reducing operating costs. One strategy employed was downsizing its workforce. This was implemented by depending on part-time staff and temporal engagement of trainees /recruits from the universities. During this year's audit your firm has engaged 10 trainees and two part-time staff. You are now reviewing completed audit files and giving directions to various issues raised by your trainees. The following is the client's financial statement under audit by your trainees:

Statement of Financial Position			
Particulars	**Note**	31-12-2022 FRW	31-12-2021 FRW
Non-current assets		**"Million"**	**"Million"**
Land & Building	**1**	950	630
Investments	**2**	25	38
Intangible assets (Development costs)	**3**	150	93
Current assets (Inventories & Receivables)	**5**	325	242
Total assets		**1,450**	**1,003**
Share capital		820	730
Other Equity		350	154
Non-current liabilities		183	65
Current liabilities (Accrued expenses)	**7**	97	54
Total equity and liabilities		**1,450**	**1,003**

Statement of Profit or Loss			
Particulars	**Note**	31-12-2022 FRW **"Million"**	31-12-2021 FRW **"Million"**
Revenue		770	990
Other operating income (Revaluation Surplus)	**1**	120	80
Operating expenses (Depreciation)	**4**	230	340
Operating profit		660	730

The following issues were noted by your trainees and require your consideration:

1. Land and buildings were revalued during the year.
2. There was a challenge in verification of existence of investments.
3. Development costs were capitalized during the year as intangible assets.
4. Misstatements in accumulated depreciation.
5. While verifying valuation assertion of inventories, they noted that the following costs were charged to inventories.

(a) Selling expenses
(b) General and administration expenses
(c) Interest paid
(d) Under recovery of overheads

6. Some of the receivables could not be directly confirmed.
7. There were significant challenges on verification of accrued expenses.

Required:

(a) Advice the procedures to be performed to verify the revaluation of Land and buildings. (5 Marks)

(b) How would your trainee verify existence assertion of investments. (4 Marks)

(c) Identify three risks and three evidential matters in verifying development costs. (4 Marks)

(d) How would you verify adequacy of accumulated depreciation? (4 Marks)

(e) Comment on each of the above costs charged to inventories in (5) above. (4 Marks)

(f) What alternative procedures are applied if some receivables cannot be directly confirmed. (2 Marks)

(g) List four significant procedures to verify accrued expenses. (2 Marks)

(Total: 25 Marks)

QUESTION FOUR

(a) You are the audit manager of Sejjaka & Sembule Associates in charge of audits of service industry and the public sector. Unlike the private sector, the public sector involves the audit of performance information, in addition to the entities' financial statements. You have observed that performance measurement is an integral part of government policies, and the audit of this information is a key component of the accountability of many public sector bodies. The main focus of an audit of performance information is operational performance which is usually examined in terms of specific quantitative measures, such as KPIs, but is not limited to quantitative measures alone. Moreover, from your exposure you have come to realize that the audit of performance information is usually against pre-determined objectives. The auditor's role is to focus on the credibility, usefulness and accuracy of the reported performance in relation to those objectives.

The office of the Auditor General (OAG) is the body responsible for audits of public sector entities but due to its limited capacity in manpower it sub-contracts private audit firms to undertake public sector audits on its behalf. Your firm bid and won the tender to audit two public universities namely Gikondo University and University of Huye.

You have commenced the audit and the following performance information has been availed with respect to students drop out i.e non-completion of degree program.

University	**Number of students**	**Number planned for graduation**	**Number of drop outs**
Gikondo University	7,630	6100	230
University of Huye	5490	4940	190

Additional information:

Particulars	**Gikondo University**	**University of Huye**
Drop out due to failure in final examination	120	70
Drop out due to other reasons	110	120
Total drop outs	**230**	**190**

Required:
Using the information above attempt the following questions:

(i) **Explain the assertion "Existence of performance information is a preconditions for an audit of performance information"** (4 Marks)

(ii) **Discuss the steps in planning and conducting the audit of performance information**. (6 Marks)

(iii) **Analyse the performance of the two universities and identify the best performing.** (6 Marks)

(iv) **Explain some of the difficulties in use of performance information** (4 Marks)

(b) You are the audit manager of Kasenge CPA and in the process of auditing JiK JiK Club, a chain of nightclubs in Kigali suburbs. During the course of the audit, an employee of the club, informed you that a substantial cash deposit was paid into the club bank account by a non-identified depositor. A month later, the same amount was transferred into a bank account in the name of Lavindo Eateries Ltd, a company-based in Kenya. The employee also informed you that Mr Wahome, the managing director of Jik Jik Club, had instructed him not to record the transaction in the accounting records as it had nothing to do with JiK JiK Club business.

Required:

Comment on the situation outlined above. (5 Marks)

(Total: 25 Marks)

End of Question Paper

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