CERTIFIED PUBLIC ACCOUNTANTS

ADVANCED LEVEL 1 EXAMINATIONS

A 1.2: AUDIT AND ASSURANCE SERVICES

DATE: FRIDAY 30, AUGUST 2024

MARKING GUIDE & MODEL ANSWERS

QUESTION ONE

MARKING GUIDE:

a)	**Computer assisted audit techniques:** 2 marks each for each CAAT identified and explained up to a maximum of 10 marks. On average at least 5 points expected from the candidates. 1 mark for each point that is identified but not explained. *Do not award any mark for general points that do not relate to the scenario in any way.*	10 Marks
b)	**Business risks:** Up to 2 marks to be awarded for each business risk identified and evaluated. Award only 1 mark for each business risk identified but has not been evaluated or explained. Maximum marks for this part is 14 marks so on average 7 points are expected from the candidates. *Do not award any mark for general points that do not relate to the scenario in any way.*	14 Marks
c)	**Risk of material misstatements:** Award up to 2 marks for each risk of material misstatement identified and evaluated or explained. Maximum marks available is 16 marks and an average of 8 points are expected from the candidates. *Do not award any mark for general points that do not relate to the scenario in the question.*	16 Marks
d)	**Matters to consider and procedures to perform:** Award 2 marks for correctly identifying and explaining each matter relating to the goodwill and 2 marks each for the procedure identified and explained. an average of 5 points are expected from the candidates For each valid point identified relevant to the case study but not explained only 1 mark should be awarded. *Do not award any mark for general points that do not relate to the scenario.*	10 Marks
	Total marks	**50 Marks**

MODEL ANSWERS:

a) Computer assisted audit techniques that can be used to audit the website sales:

- Use of audit software to carry out tests of control on how payments are processed through the website such as how prices are calculated and whether there are possibilities of processing payments that are incorrect or unauthorised.

- The audit software can also be used for substantive tests to assess completeness and accuracy relating to sales.

- Use of test data to assess the control system applicable and whether it is working as expected to minimise errors in the website sales

- Integrated test facilities that involve processing test data for website sales live to assess how the system will process it.

- Embedded audit facilities by incorporating the auditor's own program code that is embedded in the system of Ingabire company to assess whether data is being processes as expected or not.

- Application program examination where the auditor would check whether amendments to the system could have been carried out during the accounting period and the auditor will want to ascertain if sufficient controls were used both before and after the amendments.

b) Evaluation of business risks

- There is significant risk relating to the ability of the company securing licences for its new products that are developed. In this case, costs that are incurred in research and development to come up with new products may not be recovered if the licences are not granted by the relevant government authorities and commercial production does not start.

- The development of new products requires innovation from the company and there is a significant risk that the company can find itself in breach of patents from other companies if the employees copy from other companies. Other competitors can also copy Ingabire company products and this can lead to prolonged court cases either to defend the company or to act against other companies. It is indicated in the case that the company already took action last year against a competitor for breach of patent.

- The company undertakes a lot of advertising to promote its products and this carries the risk that the advertising regulations that are applicable in the country may not be followed well leading to court cases against the company as well as fines being imposed.

- The company seems to be rapidly expanding and this presents risk because despite having strategic advantages to the company, there is a risk that the expansion can lead to lack of synergy and the management may struggle with the many large operations of the company. Additional costs will also have to be incurred in relation to the increased operations of the company.

- The company has court cases pending where it is anticipated that up to Frw 5 million may be paid as compensation. This is likely to give bad publicity to the company and will also have financial implications for the company.

- The introduction of the new system, which is not expected to run concurrently with the old system for some months presents a huge risk of failure that can cause complete breakdown in the operations of the company and can lead to huge losses for the company and impair the data migration process from old system to the new one.

- The decline of the operating margin from 24% to 18% as well as the earnings per share from Frw 10 to Frw 5 is worrying sign of risk of non-cost reflective revenues as indicated by the fact that the revenues of the company have actually increased but still the operating margin declined.

- The gearing ratio has increased from 0.7 to 0.8 which implies that the company has increased its reliance on debt and this exposes Ingabire Ltd to the credit risk from inability to meet debts expectations.

- The gross profit margin is also declining from Frw 12 million to Frw 10.5 billion while net cash flow is declining from Frw 8 billion to a net loss of Frw 2.6 billion; this signifies the profitability risk from the increasing cost of sales as well as liquidity risk from deteriorating cashflow.

- The company seems to be using systems that are now outdated. Despite the fact that it has not caused any challenges thus far in terms of controls or operations, the fact that the industry is competitive is an indicator that the company risk losing its competitive position to other competitors.

- The industry that Ingabire operates in is highly competitive and the fact that the company does research and development, means that it needs to always have very highly skilled staff. Failure to get these staff or in cases where they move to work for the competitors will pose a serious risk to Ingabire as it will lose its competitive position in the market.

c) Risks of material misstatement of Ingabire Ltd

- The management of Ingabire is in the process of raising finance for the court case of Frw 5 million as well as the extension of an existing loan of Frw 50 million for developing new additives. This means there will be pressure to ensure a favourable position in the financial statements and understate these liabilities. Revenues may be overstated and expenses understated to show higher profitability and attract the loan as a result of good financial position.

- The recognition of research and development costs may not be in accordance with the requirements of IFRS 38 intangible assets as some research costs may be capitalised and some development costs may be capitalised without meeting the capitalisation conditions.

- The development costs capitalised may not be amortised properly in accordance with IFRS 38 and may either be understated or overstated. The amortisation is expected to reflect the pattern of economic benefits and should be amortised over the life of the product developed.

- There is a risk that the court cases have not been recognised or the obligations have not been appropriately measured in accordance with IAS 37. The unpaid liability may therefore not be recognised or may be recognised wrongly and as a result the liabilities and corresponding expenses may be overstated or understated. The legal fees may also be accrued and failure to recognise the accrual will understate liabilities.

- The patents that Ingabire owns should be capitalised as intangible assets and where the amounts for the patents have been expensed, it will mean that the assets will be understated and expenses overstated. Amortisation for the related patents should be provided and failure to do so will understate expenses or if they are not calculated correctly the expenses will either be understated or overstated.

- The diversification of the business into new areas through acquisition will mean that the business will likely have new business segments and reporting will require these segments to be reported. It is indicated that the new business in South Sudan has contributed an increase in revenue of 20% which indicates it is significant enough to be reported as a reportable segment in accordance with IFRS 8 and failure to include the performance of the segment will mean that the financial statements are likely to be misstated.

- The goodwill on acquisition may have been calculated incorrectly. This is because there is a risk the deferred consideration was not calculated correctly if the discounting of the cash flows was not calculated correctly as required under IFRS 3.

- The use of old outdated systems could be an indication of impairment of some assets in the company and there is a risk that the assets are overvalued in the financial statements.

- The acquisition of the brand name “soft foods Uganda” needs to be recognised as an intangible asset and the brand will be amortised over the useful life of 20 years. There is a risk that either the measurement of the brand has not been done correctly or the amortisation has not been done correctly leading to understatement or overstatement of the brand.

d) Matters to be considered and procedures to be performed in respect of the goodwill

The matters to be considered:

The goodwill on acquisition should be recognised as an intangible asset as required by IFRS 3 Business combinations and IAs 38 intangible assets. The purchase consideration must reflect correctly the value of the business and the non-controlling interest should be valued either at fair value or as a proportion of the net assets acquired. The auditor should consider whether a due diligence was conducted to confirm the assets and liabilities acquired and then assess the fair values to determine if they are in accordance with IFRS 13 fair value measurement. The goodwill must also be tested for impairment at the end of each year.

Procedures to be performed:

- Agree the purchase consideration to the contract signed for the acquisition and also confirm the price of Frw 5,500,000 and the contingent consideration used in the calculation of the goodwill are correct.
- Inspect the bank statement to confirm the amount of Frw 5,500,000 paid for the acquisition is correct as per the calculations.
- Review the board minutes that relate to the acquisition to confirm that the board approved the acquisition.
- Review the purchase documentation as well as a register of shareholders to confirm the non-controlling interest as correct.
- Where the shares of the company are not listed, discuss with management to determine how the price was assessed or arrived at and to determine if reasonable.
- Inspect a copy of the due diligence report that was used in assessing the acquisition to confirm that the price paid was reasonable according to the due diligence and also correct and that all items were disclosed to get the correct assets acquired.
- Undertake a review of the calculations that were used to get the net assets and confirm if the group accounting policies have been applied.
- Discuss with the management on the potential impairment of the goodwill at the end of the year to confirm carrying amount of goodwill at end of the year.

QUESTION TWO

MARKING GUIDE:

a)	**Procedures to be undertaken:** 2 marks for each procedure including review of previous working papers, accounting policies. 5 points expected from the candidates *Do not award any mark for general points included that are not related to the scenario.*	10 Marks
b)	**Matters casting doubt on going concern:** Award up to 2 marks for each point identified and evaluated or explained. Where calculation is included, 1 mark will be for the calculation to support the answer. 4 points expected from the candidates *Do not award any mark for general points included that are not related to the scenario.*	8 Marks
c)	**Electronic reporting:** 1 mark for briefing note format 1 mark for explaining what electronic reporting is 1 mark for identifying correctly that consent of auditor is needed to include the audit report on the website 1 mark for identifying that the auditor needs to confirm the audit report has appropriate wording before inclusion on website 1 mark for each procedure to a maximum 3 marks	1 mark 1 Mark 1 Mark 1 Mark 3 Marks
	Total marks	**25 Marks**

MODEL ANSWERS

a) Audit procedures applicable on transaction

- The installation fees of Frw 52 million represent 1.7% of revenue (52/3000*100) and is therefore material. The installation fees relating to the warranties in the current year are Frw 40 million (Frw 52-40) and are still material.

- There is a present obligation resulting from past events and therefore a liability should be recognised.

- The probability of outflow of economic resources is probable and as a result to be able to settle the obligations.

- Obtain the warranty terms in the contract with customers to confirm that a legal obligation exists that can lead to the liabilities being recognised.

- Obtain correspondence with the customers to check customer complaints and confirm if they are covered by the warranty agreements.

- Obtain the terms if the installation agreements and costings to assess the 40% increase in prices.

- Obtain a schedule of installations that were done by the company during the year and confirm with invoices and customer orders.

- Obtain a schedule of the work done and costs incurred for each job undertaken for the clients based on the job cards.

- Recalculate the warranty provisions as a way to confirm that indeed it is not impossible to measure as explained by the directors.

b) Going concern matters:

- The company finance controller Jean Mugisha has left the company and it seems that the company is yet to replace him which could indicate inability to meet financial obligations and consequently will have going concern doubts.

- There are two court cases with the potential of high fines amounting to Frw 35 million that could cripple the cash position of the company and lead to potential liquidation.

- The loss of key staff seems to be a concern because the company sales director was dismissed and is seeking compensation for wrongful dismissal that could also lead to heavy compensation amounts.

- Inventory items in the company warehouse were damaged by fire in the warehouse at Gikondo. Although considered not to be material to the financial statements, it will have a significant impact on the cash position of the business as these items will need to be acquired quickly to allow for continues operations.

- A cash flow forecast prepared shows more problems for the company because in six months the company will need cash injection to keep operating. This is a serious going concern problem as the company is seeking an overdraft that will lead to additional cash payments and the limit is only Frw 6 million which may not be sufficient to offset the cash requirements.

- At the end of the year the company only has cash of Frw 1.6 million and this is very insufficient, indicating serious cash flow problems.

c) Electronic reporting

TO: Managing Director

Gitarama Limited
P.o Box:…..

<u>TOPIC</u>: The meaning of electronic reporting and procedures that the external auditor would perform once the electronic reporting is adopted.

Electronic reporting involves the entity presenting financial statements electronically, mostly through the company website.

The consent of the auditor would normally be required in order to publish the audit report on the company website and this would have to be included in the engagement letter.

The auditors need to ensure the audit report has appropriate wording before it is published on the website.

The auditor will be required to perform the following procedures:

- Review of the process that was used in deriving the information from hard copy accounts.

- Inspection to confirm that the information contained in the electronic reports is identical to the information in the hard copy documents.

- Reviewing to confirm that the presentation used has not distorted the information on the hard copy documents so as not to give a different view from that in the original hard copy documents.

QUESTION THREE

MARKING GUIDE:

a)	**Matters to consider in the compensation claim**	
	1 mark for each identified and explained matter to be considered relating to the claim by passengers and explaining them. Award 0.5 Marks for identified but not explained matter. An average of 5 points are expected from the candidates	5 Marks
	2 marks each for each point relating treatment of IAS 38 *intangible assets* and 2 marks for the effect on the financial statements of failure to include/recognise Award only 1 mark for identifying only the treatment but without linking it to the scenario.	4 marks

	Do not award any mark for general points included that are not related to the scenario.	
b)	**i) Benefits of due diligence** Up to 2 marks for each benefit identified and evaluated. Only 1 mark for each point identified but not evaluated. Maximum 6 marks so around 3 points expected from the candidates.	6 Marks
	ii) matters to consider in the due diligence and information needed Award 1 mark for each matter identified and evaluated and 0.5 mark for each matter identified but lacking explanation. To a maximum 5 marks Award 1 mark for identifying that due diligence uses negative form of words. Award 1 mark for identifying limited assurance is used in due diligence Award 1 mark for identifying audit opinion is given in positive form. Award 0.5 mark for each valid procedure over non-financial data in sustainability report *Do not award any mark for general points included that are not related to the scenario.*	5 Marks 1 Mark 1 Mark 1 Mark 2 marks
	Total marks	**25 Marks**

MODEL ANSWERS:

a) Matters to consider

- The claim by the passengers needs to be recognised even if it will be settled by the insurance company. The auditor should find out the materiality of the claim not recognised as the liabilities will be understated.
- IAS 37 provisions, contingent assets and contingent liabilities requires a provision to be recognised where it is as a result of past events and an outflow of economic benefits is expected from the entity. The auditor should find out with the legal experts whether there is possibility that this amount will be payable
- Ascertain if the claim is reasonable by asking the client lawyers and seek their opinion on the possibility of outflow of the payment
- Whether any settlement has been discussed with the passengers on whether they can be paid without going to court and if there is any amount agreed
- With regards to the intangible asset, determine the amount that was paid for the brand

- Assess the valuation of the assets associated with the brand to determine its value
- Assess whether the Amahoro tours brand has been impaired at the end of the year.
- Assess any agreements signed with the passengers to determine if Mugenzi company was required to compensate them.

b) i) Principal benefits of a due diligence review on Ngoma limited

- It would facilitate the identification of assets and liabilities of the target company mainly the items that have not been included in the financial statements such as intangible assets that are internally generated. It would also help to identify any undisclosed or hidden liabilities.

- It would help to identify any operational problems that could become problematic. This is especially important in reference to the two revenue streams as a way of identifying if strategic fit would be possible after acquisition in terms of growth and also profitability.

- The externally provided review would be considered more credible as it would allow the management of Jean limited to concentrate on their internal operational matters while the review is done by experts with specialised knowledge and skills. The management of Jean limited would not be in a position to do the review on their own sufficiently due to lack of knowledge and skills.

ii) Matters to consider during the due diligence review and additional information needed to perform the review:

- The financial statement of the company should be considered in terms of reliability especially whether they have been audited. These financial statements will be essential in establishing trend in performance for the business. The financial statements will be used to recalculate some of the figures to establish the trends and establish other liabilities such as loans as well as guarantees.

- The assessment of performance must be done on the basis of industry trends and therefore industry forecasts must also be obtained for this purpose of analysing industry trends.

- Since Ngoma limited is a subsidiary of another company it is very essential to establish who the ultimate owners/ shareholders are.

- The contracts with the existing staff will need to be assessed to determine the number of employees who do not have contracts and who should then be asked to leave while those with contracts can be maintained. This will also allow the determination of redundancy payments required.

- The leases that are valid on the buildings and other assets must be established to determine the total liabilities that the company has and the total assets.

- Regulatory licences that are valid and which need renewal and those that have expired.

- Customer contracts that the company has as well as supplier contracts

Further information

- Copy of Ngoma limited register of shareholders to ascertain identity of the majority shareholder.

- Agreements relating to any loans received by Ngoma limited

- The full audited financial statements for Ngoma limited

- Copies of any contracts signed with employees
- Copy of rental agreements.

Negative form of words in the due diligence report:

"Nothing has come to our attention that casts any doubt on the credibility of the information that has been reviewed for the period".

Positive form of audit opinion:

"The accounts and financial statements portray true and fair view of the financial state of affairs of the entity......"

Due diligence is a review report and therefore provides limited assurance. On the other hand, the auditor’s report gives reasonable assurance which is more reliable than the limited assurance. The review engagement obtains less evidence than that required in an audit and the procedures used are also less detailed or thorough compared to an audit.

Examination procedures that could be carried out to provide assurance on the non-financial data once the plan goes through:

- Inspect the records for any complaints received by customers
- Inspect any correspondence between the entity and regulatory authorities that coul;d indicate non-compliance
- Review the regulations applicable to the client Jean limited
- Inspect the records for any accidents reported in the company that could indicate breach of health and safety in the company.

QUESTION FOUR

MARKING GUIDE

a)	**i) Matters to consider before accepting forensic investigation engagement** Award 1.5 marks for each matter identified and evaluated and only 1 mark for each matter identified but has not been explained. Maximum marks is 3 so at least two matters are expected from the candidates *Do not award any mark for general points that are not related to the scenario.*	3 Marks
	ii) objectives of forensic investigation and procedures that can be used Award 1mark for each objective identified and evaluated and only 0.5 mark where the objective is identified but is not explained. 3 objectives expected from the candidates 1.5 marks each for each procedure expected to be used. At least 6 procedures expected from the candidates. Award only 1 mark for a step identified without the example of a procedure. *Do not award any mark for general points that are not related to the scenario.*	3 Marks 9 Marks
b)	**i) Principal matters to include in tender document** Award 1 mark for each matter to be included in the tender document. At least five points needed from the candidates *Do not award any mark for general points that are not related to the scenario.*	5 Marks
	ii) Matters to consider before accepting engagement Award 1 mark for each matter to be considered. At least five points expected from the candidates. *Do not award a mark for general points that are not related to the scenario*	5 Marks
	Total marks	**25 Marks**

MODEL ANSWERS:

a) i) The matters to be considered before accepting the engagement to perform a forensic investigation:

The audit firm would first consider whether there is sufficient skills and experience to perform the work if the assignment was accepted. This is because forensic investigations normally require very detailed knowledge of fraud investigations. They are specialist assignments that require fraud investigation techniques and the legal framework, interview and interrogation skills and collection and safe custody of evidence collected.

Currently, the firm has a dedicated forensic investigation department which implies that the firm would have to ensure the staff with the required skills for this assignment are identified. Independence of the firm must also be considered and from the case study, Muhima limited is not an audit client which indicates a high level of independence will be maintained.

The fee that is negotiated with Muhima limited must also be sufficient enough to cater for the payment to those specialists that will undertake the investigation. Depending on the complexity of the engagement, senior staff may be involved and this will require the fee to be very sufficient to cover their expenses.

ii) Objectives of a forensic investigation:

The first objective when investigating the fraud at Muhima limited will be to prove that a deliberate fraud has actually taken place. This is because the employees remaining on the inventory could have been an error and this will need to be established.

If it is established that this was indeed a deliberate fraud, then it will be important to establish who was involved and evidence will be needed that can be used in court against those involved.

The forensic investigation will also have the objective of quantifying the financial loss caused by the fraud. This will help in any recovery of the amount lost in the fraud.

The steps in undertaking the forensic investigation:

- Determine what needs to be investigated for Muhima limited. In this case, a fraud was committed that involved theft of inventory from the warehouse.

- Establish the period over which the fraud has taken place. This can be traced from the time the year started to reconcile with the previous as a way of establishing the current year inventory loss.

- Establish how the fraud was done and how it was hidden. This will involve following the steps in the process of delivering inventory in the warehouse and how items are requisitioned and moved from the warehouse.

- Collection of evidence to ascertain that indeed a fraud has taken place, who was involved in the fraud, the amount that was involved. This can be done through reviewing and testing the authorisation procedures for the movement of inventory items, and who is normally responsible for the movement of inventory items. The staff in the warehouse can be interviewed as a way to collect evidence of what happened.

- After evidence has been collected, a report will be compiled that summarises the evidence collected and which also quantifies the financial loss suffered that will act as basis for any claim for recovery prosecution against the staff involved for theft.

- Court proceedings against the staff involved will then be the last step where the forensic investigation team will be called upon to give evidence as expert witnesses.

b) i) Principal matters to include in the tender document

- The outline of the audit firm with a description of the services offered and location where the firm operates. Since Ruhengeri is a small local company, it will not be essential to have overseas offices.

- The fees to be charged for the audit of Ruhengeri and how it is calculated.

- The audit needs of the client company Ruhengeri and how these will be met by the audit firm.

- The document will also state other non-audit services that could be offered to Ruhengeri limited. This is especially important as the directors have given an indication that other non-audit services can be requested.

- The document should highlight the ability of the firm to audit Ruhengeri limited by showcasing the experience and expertise of the staff that the firm has.

- The proposed audit approach will be included in terms of how the firm will obtain knowledge of the business, planning methods and procedure to obtain evidence. This should clearly state that the audit will be carried out in accordance with ISA requirements.

- The key staff that will be engaged in undertaking the audit as well as other non-audit services for Ruhengeri.

- Communication with management in terms of the reports and how these will add value to Ruhengeri limited.

- The timing of the audit in terms of the duration expected for the audit of Ruhengeri to be completed.
- Quality control and ethics issues should also be included by highlighting that the audit and associated services will be carried out in accordance with high standards of quality and ethics.

ii) Matters to consider before accepting the assignment:

- The size of Ruhengeri limited in order to ascertain if the firm has sufficient resources for the completion of the audit.
- The regulations that are applicable to Ruhengeri limited as well as the audit firm.
- Relevant expertise in terms of having staff with the required level of knowledge and skills to undertake both the audit and the non-audit services for Ruhengeri limited.
- Scope and time pressure in terms of the work to be done and the duration within which the work is required to be completed.
- The fact that this is the first audit which means that a lot of work will need to be done to gain an understanding of Ruhengeri limited, its controls and working environment.
- Whether the preconditions for an audit are present, which means that the directors of Ruhengeri must give their commitment that they will allow access to information that the auditor needs and that they accept responsibility for preparation of the financial statements.
- The independence of the audit firm by ensuring no conflicts of interest are likely to arise.

End of Marking Guide and Model Answers.