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CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

DATE: FRIDAY 01, MARCH 2024

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 an audit manager at Mutoni and Associates, a firm of accountants, and you are responsible for the audit of Jean Pierre Group, a listed company with a financial year ending 31st December 2023.Your firm was appointed three years ago and is responsible for auditing all aspects of the group. You are provided with the following information:

Email from audit engagement partner:

To: Audit manager

From: Audit engagement partner

Subject: Audit planning of Jean Pierre group

Hi,

You need to begin the audit of the Jean Pierre group, and in order to assist you with this, I have provided you with some information that I believe will be helpful. I met the finance director of the group together with the representatives of the audit committee to discuss aspects of the audit expected.

Exhibit 1 – Points from permanent audit file

The Jean Pierre group is very large with at least ten (10) subsidiaries and five (5) associates. The group produces cosmetics and other beauty products which are sold under different brand names across the East Africa region in 7 countries including Rwanda, Kenya, Uganda, Tanzania and Congo as the primary markets, South Sudan, and Zambia with some limited operations across Burundi.

The products sold include hair care products, cosmetics and perfumes with offerings for both men and women, though the predominant market is for women. The company undertakes a lot of research and development to develop new products and the company has been successful in bringing new products to market regularly.

Exhibit 2- Notes from the meeting with finance director

During the year, the company has incurred significant expenditure in the acquisition of non-current assets with including FRW 200,000,000 spent on acquiring property, plant, and equipment while FRW 200,000,000 was spent in new product development. Half of this expenditure has been undertaken using a loan while another half has been funded from the company reserves.

In December 2022, allegations were made in the media and also by customers that some of the chemicals used by the company in making a brand of perfumes was causing skin infections and irritations with serious health problems. Due to this, the brand causing the problem has been withdrawn from sale and an impairment charge of FRW 30,000,000 has been recognised in the financial statements in respect of the brand causing health problems. However, group sales have grown by about 13% despite this problem and the group management is confident that there is no other brand that has been affected.

The management in the group is negotiating for the acquisition of Deep Shine Beauty Ltd, a company that develops and sells a range of perfumes. The group plans for the acquisition to take place in early June 2024 and the management hopes that the Deep Shine brands will be able to replace the revenue from the infectious brand that was withdrawn from the market. Due diligence is currently being done and the management hopes that this will support the proposed offer of FRW 1,300,000,000 to acquire 100% of Deep Shine Beauty Ltd's share capital. Bank of Kigali has already agreed to provide a loan for this acquisition.

Exhibit 3 – Latest forecast financial statements

Consolidated statement of financial position

	Note	**31st Dec 2023 FRW million**	**31st Dec 2022 FRW million**
Non- current assets			
Property, plant and equipment	1	92,000	78,000
Intangible asset – Goodwill	2	18,000	18,000
Intangible asset - Acquired brand names	3	80,000	115,000
Intangible assets – Development costs	4	25,000	10,000
		215,000	221,000
Current assets		143,000	107,000
Total Assets		**358,000**	**328,000**
Equity and liabilities			
Share capital		100,000	100,000
Retained earnings		106,000	98,000
Non-controlling interest		23,000	23,000
		229,000	**221,000**
Non-current liabilities			
Long-term loans	5	100,000	80,000
Deferred tax	6	10,000	2,000
Current liabilities		19,000	25,000
Total equity and liabilities		**358,000**	**328,000**

Consolidated statement of profit or loss for the year to 31st December 2023

	Projected 2023	Actual 2022
	FRW million	FRW million
Revenue	220,000	195,000
Operating expenses	(185,000)	(158,000)
Operating profit	35,000	37,000
Finance cost	(7,000)	(7,000)
Profit before tax	28,000	30,000
Tax expense	(3,000)	(3,000)
Profit for the year	**25,000**	**27,000**

Notes:

1. The capital expenditure of FRW 200,000,000 has been recorded so far during the year. The policy of the group is to recognize assets at cost less depreciation. During the year, the directors undertook a review of the estimated useful lives of the assets. As a result, the useful life of many of the assets were extended and the projected depreciation charge of the year is FRW 500,000,000 less than the comparative figure.
2. The management has performed an impairment review at the year end and concluded that goodwill is not impaired.
3. The brand names acquired are held at cost with no amortization being charged on the basis that the assets have an indefinite life. An annual impairment review is conducted on all brand names. A FRW 30,000,000 impairment has been recognised for the brand that was withdrawn.
4. Development costs relate to the expenditure incurred to develop new beauty products. Costs incurred in the research phase are expensed until the product is determined to be technologically feasible. Costs incurred after this stage are capitalized as required by IAS 38 *Intangible assets*.
5. A FRW 20,000,000 loan was taken out in January 2023 to finance a specific new product development project.
6. The deferred tax liability relates to the timing differences in respect of the accelerated depreciation in terms of tax capital allowances on the property, plant and equipment of the group. The liability has increased following the changes to the estimated useful life of the assets that was done by the directors.

Exhibit 4 – Additional services from audit committee

In addition to the proposed acquisition of Deep Shine Beauty Ltd, the management of the group is considering purchasing 100% shareholding of Blue Horizon Products limited. The audit committee of the group would like Mutoni and Associates to perform a valuation of Blue Horizon Products Limited to ascertain whether it is a viable investment. Blue Horizon Products Limited is also an audit client of Mutoni and Associates.

Required:

(a) **Evaluate the risks of material misstatement to be considered in planning the audit of the Jean Pierre Group. Make use of analytical procedures to identify the relevant risks.** (25 Marks)

(b) **Recommend any additional information that should be requested from Jean Pierre Group that would allow a more detailed preliminary review to be performed.** (5 Marks)

(c) **What audit procedures will be used in the audit of**:

(i) **The impairment of the Brand withdrawn.** (6 Marks)

(ii) **The planned acquisition of Deep Shine Beauty Limited.** (6 Marks)

(d) From the information in Exhibit 4, **discuss the ethical issues raised by the request to perform the valuation of Blue Horizon Products Limited.** (8 Marks)

(Total: 50 Marks)

SECTION B

QUESTION TWO

(a) You are a manager in Ralph and co, an auditing firm that has offices in Kigali and Musanze and Four partners who are ICPAR members. An advertisement has been drafted as part of the firm's efforts to increase client numbers and it has been suggested by one of the partners that it should be placed in the national newspapers including Kigali today, The New Times as well as other media. The advertisement is given below:

"Is your auditor charging you too much for poor quality services? Does your business need a fresh start? Look no further.

Ralph and co provides the most comprehensive range of finance and accountancy services in Rwanda as well as having the leading tax team in the country who will help you to save money.

Still not sure? We guarantee to be cheaper than your existing service provider and for the month of February we are offering free business advice to all new audit clients. Drop in and see us at our offices for a free consultation".

Ralph and co, CPA.

Required:

Comment on the suitability of the advertisement discussing any ethical and professional issues raised. (7 Marks)

(b) You are a manager in Kwizera and Associates, a firm of accountants with offices in Kigali; Kampala and Nairobi. Your responsibility is the monitoring of quality and ethical issues that may arise in relation to audit clients. Bizimana Limited is an audit client whose operations involve road transport and distribution. The auditor's report for the financial statements of Bizimana Limited for the year ended 31st December 2023 was issued last week. You are conducting a review of the quality of that audit and any ethical issues, and the following are the relevant matters that arise:

(i) Bizimana Limited's audit committee refused to agree to an increase in audit fees despite the company operations expanding into new locations thus requiring more work to be done. As a response, the materiality level was increased during the audit and some review procedures were not carried out. To reduce the sample sizes used in tests of detail, the samples were selected based on judgement instead of statistical methods. Also, only parts of the population being tested were sampled where some locations were not included in the sample of non-current assets selected for physical verification.

(ii) Some of the audit work was performed by an overseas office of Kwizera and Associates in an offshoring arrangement. This practice is encouraged by one of the partners who considers this approach as a way of enhancing efficiency in audit. The oversees office performs the work at a lower cost and it was largely low-risk, non-judgmental work included in this arrangement for the audit of Bizimana Limited including the numerical checks on documentation. The overseas office also read the minutes of the board meetings to identify issues relevant to the audit.

(iii) In July 2023, the finance director of Bizimana Limited joined Kwizera and Associates as an audit partner, working in the same office as the existing partners. Although he was not a member of the audit team, he updated the audit partner on some of the business developments which had taken place before he left Bizimana Limited. He held shares in Bizimana Limited which he sold in January 2024. Since joining Kwizera and Associates, he has been making proposals to increase income and one of the initiatives involves audit team members being encouraged to cross-sell non-assurance services and references to targets for cross-selling of such services are now included in partner and employee appraisal documentation.

Required:

Give your comments on the quality control, ethical and professional issues raised in relation to the audit of Bizimana Limited specifically on the following:

(i) Audit fees (6 Marks)

(ii) Use of the foreign office for audit (offshoring arrangements). (5 Marks)

(iii) Former finance director of Bizimana working for Kwizera and Associates as audit partner. (7 Marks)

(Total: 25 Marks)

QUESTION THREE

You are a senior manager in Solange and Associates, a firm of accountants in Rwanda. Your role includes performing engagement quality reviews, and you have been asked to review the audit work performed on Damascene Limited for the financial year ended 31st December 2023.

The following details relate to Damascene Limited:

1. Damascene Limited

Damascene Limited is a listed company and a significant new client to your firm. The audit of the company's financial statements for the year ended 31st December 2023 is nearing completion and the audit report is due to be signed next week. Damascene Limited manufactures machine components for spare parts in aviation industry. The drafted financial statements recognized revenue of FRW 8,700,000,000, assets of FRW 15,200,000,000 and profit before tax of FRW 1,800,000,000.

2. Review matters

i) Trade payables

The planned audit approach to trade payables was to place reliance on purchasing controls and keep substantive tests to a minimum. During the controls testing on trade payables, from a random statistical sample, the audit team identified three purchase orders which had not been authorized by the procurement manager. On review of the supporting documentation, the audit team concluded that the items were legitimate business purchases and therefore concluded that no additional procedures were required.

ii) Petty cash

Based on a review of petty cash transactions, the audit assistant identified that the petty cashier paid for taxi fares for personal, non-business journeys with a total value of FRW 175,000. Following discussions with the audit assistant, you have determined that he did not report the matter further as the amount is immaterial. Moreover, he also commented that the petty cashier is his brother and that he did not want to get him into trouble.

iii) Cut-off testing on revenue

Cut-off testing conducted on revenue has identified two goods dispatch notes, dated 2nd January 2024 for items sent to Karake Limited with a combined sales value of FRW 17,880,000 which had been included in revenue for the year ended 31st December 2023. The client's financial controller, David Murakoze, has explained that Karake Limited does not order on a regular basis from Damascene Limited. In the absence of a regular payment history with Karake Limited, and in order to minimize the receivables collection period from this customer, the sales invoice is raised and sent to the customer on the same day that the sales order is received. The average time period between receiving of the order and dispatching the goods to the customer is approximately one to two weeks. The audit working papers have concluded that no further investigation is necessary.

iv) Tax calculation

The finance director, Leslie Amahoro, has not completed the tax calculation for the year ended 31st December 2023. She has recently asked the audit assistant to calculate the company's tax payable for the year because the assistant was a recently qualified CPA with fresh knowledge on recent changes in the tax laws in Rwanda.

Required:

Evaluate the quality management issues and the implications for the completion of the audit in respect of each of the following, including any action that the audit team needs to take:

(a) Trade payables	(5 Marks)
(b) Petty cash	(7 Marks)
(c) Revenue	(7 Marks)
(d) Tax calculations	(6 Marks)
	(Total: 25 Marks)

QUESTION FOUR

(a) You are a manager at Kwizera and Associates, a firm of auditors in Kigali, Rwanda. You are responsible for evaluating proposed engagements and for recommending to a team of partners whether or not an engagement should be accepted by your firm.

Amahoro Limited, a listed company, is an existing audit client and an international internet service provider with a global network that spans over 100 countries and with more than 100,000 employees. The company offers services to both individual and corporate customers.

Amahoro Limited takes its corporate social responsibility seriously and has been publishing social and environmental key performance indicators (KPI) in a sustainability report which is published with the financial statements in the annual report. Due to pressure from shareholders as well as pressure groups, Amahoro Limited's management has decided that in the forthcoming annual report, the KPIs should be accompanied by an independent assurance report. Your firm has been approached with a proposal to provide this service.

To assist in your evaluation of this potential engagement, you have been given an extract from the drafted sustainability report containing some of the KPIs published by Amahoro Limited. in total, the report contains 25 environmental KPIs and 50 social KPIs disclosures.

Extract from sustainability report:

Year ended 31st December	**2023 Draft**	**2022 Actual**
Co2 emissions (million tons)	26.8	28.3
Energy use (million kilowatt hours)	4,895	5,250
Charitable donations (FRW million)	10.5	8.2
Number of serious accidents in workplace	60	68
Average annual spending on training per employee (FRW)	180,000	175,000

You have also had a meeting with Aline Mugore, the manager responsible for the audit of Amahoro Limited and the notes of the meeting are given below:

Kwizera and associates has audited Amahoro Limited for three years and it is a major audit client of our firm due to its global operations and the recent listing on two major stock exchanges. The audit is managed from our office in Kigali which is also the location of the global headquarters of Amahoro Limited.

We have not done any work on the KPIs, other than review them for consistency, as we would with any "other information" issued with the financial statements. The KPIs are produced by Amahoro Limited's sustainability department which is located in Musanze.

We have performed audit procedures on the charitable donations, as this is disclosed in a note to the financial statements and our evidence indicates that there have been donations of FRW 9,000,000 this year which is the amount disclosed in the note. However, the drafted KPIs has a different figure at FRW 10,500,000, and this is the figure highlighted in the draft chair's statement as well as the draft sustainability report. FRW 9,000,000 is material to the financial statements.

The audit is nearly complete, and the annual report is to be published in about four weeks, in time for the company meeting.

Your firm has recently established a specialist social and environmental assurance department based in Musanze and in case the engagement to report on the sustainability report is accepted, it would be performed by members of the team in Musanze, who would not be involved in the audit.

Required:

(i) Evaluate the matters which should be considered before your firm accepts the invitation to undertake the assurance engagement on the sustainability report of Amahoro Limited. (8 Marks)

(ii) Recommend the procedures that could be used to verify the number of serious accidents in the workplace and the average annual spending on training per employee. What are the difficulties in measuring and reporting on social and environmental performance? (6 Marks)

(b) A high-quality audit will require the exercise of professional judgement by the auditor and importantly, the midst which includes professional skepticism throughout the planning and performance of the audit.

Required:

Explain the meaning of the term professional skepticism and discuss its importance in planning and performing an audit. (4 Marks)

(c) You are an audit manager in Cess and company, working on the audit of the Twizera group whose financial year ended on 31st December 2023. This is the first time you have worked on the group audit. The drafted consolidated financial statements recognized profit before tax of FRW 6,000,000,000 (2022 – FRW 9,000,000,000) and total assets of FRW 90,000,000,000 (2022 – FRW 82,000,000,000). The group is involved in the manufacture of equipment used in the petroleum industry.

Goodwill of FRW 10,000,000,000 is recognized in the group statement of financial position, having arisen on several business combinations over the last few years. An impairment review was conducted in January 2024 by the group finance director and this year an impairment of FRW 5,000,000 is to be recognised in respect of the goodwill.

The finance director has prepared a file of documentation to support the results of the impairment review, including notes on the assumptions used, the calculations and conclusions. When he gave you this file, he made the following comment:

"I don't think you should need any evidence other than that contained in my file. The assumptions used are straight forward, so you shouldn't need to look into them in detail. The assumptions are consistent with how we conducted impairment reviews in previous years and your firm has always agreed with the assumptions used, so you can check that back to last year's audit file. All of the calculations have been checked by the head of group internal audit department.''

Required:

(i) Discuss how professional skepticism should be applied to the statement made by the group finance director. (3 Marks)

(ii) Design the principal audit procedures that should be performed on the impairment of the goodwill. (4 Marks)

(Total 25 Marks)

End of question paper.