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**CERTIFIED PUBLIC ACCOUNTANT**

**ADVANCED LEVEL 1 EXAMINATIONS**

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

**DATE: FRIDAY, 02 DECEMBER 2022**

**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**

Assume that today is 1<sup>st</sup> April 2022.

You are an audit manager in Ingabire & Associates CPA and your firm was engaged for the first time in January 2022 to audit the financial statements of Lite Co. for the year ended 31 December 2021. Lite Co. is a large company based in Rwanda and is engaged in the construction of commercial and residential buildings.

The financial information extracted from financial statements are shown below:

	<b>31 December 2021</b>	<b>31 December 2020</b>
	<b>FRW in million</b>	<b>FRW in million</b>
Revenue	17,500	14,420
Profit before tax	784	714
Total assets	13,300	12,600

You have independently verified from the predecessor auditors that the audit opinion of the prior year's financial statements was unmodified and that the predecessor auditor resigned immediately after the audit report was issued.

Lite Co. mainly provides construction services for five key customers in Rwanda. According to the contractual arrangements with its customers, payment from the customers is received in three installments as below:

- 50% is due when the order is confirmed (stage one);
- 25% on completion of the buildings (stage two); and
- 25% paid as the last installment following six months after the handover of the building to the customer (stage three)

Generally, it takes nine months from the order being finalized to the completion of the construction of a building.

On 31 December 2021, there is an amount outstanding of FRW 400 million from Lion Masters Co. for a fifteen-floor commercial building constructed in Rubavu. The amount is a disputed stage three payment, which Lion Masters Co. is not confident of Lite Co.'s quality assurance over the building materials used in the construction. Lion Masters Co. is refusing to pay until the building is assessed to be 100% fit for the purpose by an independent government engineer.

One customer, Huye Estates Co. communicated in December 2021, through its lawyers to Lite Co., claiming damages for injuries suffered by the building lifts operator, who spent four hours in a lift of the building when it malfunctioned. Jean Katwaza, the Managing Director of Lite Co. has informed you that the claim is being ignored as it is generally known that Huye Estates Co. has a poor record in the maintenance of their buildings, and therefore the malfunctioning of the lift was Huye Estates Co.'s fault. Two orders for the construction of high-tower buildings which were placed by Huye Estates Co. in November 2021 have been cancelled by the customer.

At the reporting date (31 December 2021), the work-in-progress is valued at FRW 1,200 million and a physical inventory count of the building materials was held on 24 December 2021.

The chief engineer estimated the stage of completion of each building under construction on the date of the stock count (24 December 2021).

One of the major building materials used in the construction of the buildings is now being purchased from overseas with the new supplier, Xhi Ltd located in China and invoices Lite Co. in the Yuan currency. There is a trade payable of FRW 210 million owed to Xhi Ltd that is recorded within the current liabilities at the reporting date.

All completed buildings are handed over to the customers with a five-year warranty. At the reporting date, Lite Co.'s financial statements have recognized a warranty provision of FRW 350 million (31 December 2020 – FRW 336 million).

Jean Katwaza makes the estimate relating to the cost of repairs of any defaults on the buildings that fall within the scope of the warranty and this estimate forms the basis of the provision recognized in the financial statements.

Jean Katwaza owns 75% of the shares in Lite Co. and also owns 60% of the shares in Jet Co, which leases a head office building to Lite Co. Jean Katwaza is considering selling some of his shares in Lite Co. in the next three weeks from now and would like the audit to be completed by that time.

**Required:**

**(a) Discuss the matters specific to the planning of an initial audit engagement that should be considered in developing the audit strategy for the final audit for Lite Co. (8 Marks)**

**(b) Using the information provided, identify and explain the principal audit risks to be considered when planning the final audit for Lite Co. for the year ended 31 December 2021. (20 Marks)**

**(c) Recommend the principal audit procedures to be performed during the final audit in regard to the estimated warranty provision recognized by Lite Co. as at 31 December 2021. (8 Marks)**

**(d) One of the audit trainees under your supervision has approached you, inquiring about the importance of maintaining quality controls an audit firm should implement at the individual engagement level, including any challenges firms usually face during the implementation of quality controls. As the mentor to the audit trainee:**

**(i) Identify and describe FIVE quality control procedures that are applicable to the individual audit engagement. (10 Marks)**

**(ii) Discuss TWO problems that may be faced in implementing quality control procedures in a small firm of certified public accountants, and recommend how these problems may be overcome. (4 Marks)**

**(Total: 50 Marks)**

## SECTION B

### **QUESTION TWO**

Muzungu Agro Ltd (MAL) supplies a wide range of agricultural products for trading to domestic customers. The company has ten (10) divisions, with each division specializing in the sale of specific products, for example, seeds, agricultural tools, agricultural fertilizers, etc.

MAL has an internal audit department that provides quarterly audit reports to the audit committee for each division on a rotational basis across the ten divisions.

Products in the seed division are offered for sale to domestic customers via an internet site.

Customers review the product list on the internet and place orders for packets of seeds using specific product codes, along with their Bank debit card details, onto MAL's secure server.

Order quantities are normally between one and three packets for each type of seed. Order details are transferred manually onto the company's internal inventory control and sales system, and a two-part packing list is printed in the seed warehouse. Each order and packing list are given a random alphabetical code based on the name of the employee inputting the order, the date, and the products being ordered.

In the seed warehouse, the packets of seeds for each order are taken from specific bins and dispatched to the customer with one copy of the packing list. The second copy of the packing list is sent to the accounts department where the inventory and sales computer is updated to show that the order has been dispatched. The customer's Bank debit card is then charged by the inventory control and sales computer. Bad debts in MAL are currently 3% of total sales.

Finally, the computer system checks that for each charge made to a customer's Bank debit card account, the order details are on system file to prove that the charge was made correctly. The order file is marked as completed confirming that the order has been dispatched and payment obtained.

#### **Required:**

(a) Explain the advantages to Muzungu Agro Ltd of having an audit committee. (5 Marks)

(b) In respect of sales in the seed's division of Muzungu Agro Ltd, prepare a report to be sent to the audit committee of Muzungu Agro Ltd which:

(i) Identifies and explains four weaknesses in that sales system;

(ii) Explains the possible effect of each weakness; and

(iii) Provides a recommendation to alleviate each weakness.

(14 Marks)

**Note:** Up to 2 Marks will be awarded for presentation and clarity.

(c) To ensure efficiency, Muzungu Agro Ltd (MAL) is considering integrating (through a networking arrangement) the online sales systems in the Seeds division with the other departments such as the accounts department, the procurement department and the store department. The full integration will be carried out under the control of an external consultant to be formally engaged through Board approval by MAL.

**Required:** Explain the factors that should be taken into consideration by Muzungu Agro Ltd when appointing an external consultant to manage the proposed integration of the network system. (6 Marks)

(Total: 25 Marks)

### QUESTION THREE

Prime Publishers Ltd (PPL), a limited liability company based in Rwanda, is a major publisher and retailer of print and online materials used by scholars and organizations. PPL has registered a significant success in the publication of management study materials, which are accessible on PPL's bookshops and website. Further to the success of its business operations in Rwanda, it has extended its operations to other African countries. Most recently, PPL is extending its operations in Europe and Asia, where it is expanding rapidly.

You are an audit manager at Rukundo & Partners, a firm of Certified Public Accountants (CPA) registered in Rwanda with affiliates in various countries worldwide. You have been approached by Alexis Mugabo, the Chief Finance Officer of PPL, to advise on a bid that PPL is proposing to make for the purchase of a company in the name of "Tick Consult". You have ascertained the following from a briefing note received from Alexis Mugabo.

Tick Consult is a company that was formed in the early 1990s and provides training in management, communications, and marketing to a wide range of corporate clients, including multi-nationals. The "Tick Consult" name is well regarded in its areas of expertise. Tick Consult is currently wholly owned by Trinity Publishers, an international publisher of textbooks, whose shares are quoted on a recognized stock exchange in Europe. Tick Consult operates with two major business segments including the National business segment in Rwanda and the International business segment that covers Europe and Asia.

The National business segment in Rwanda comprises sixteen (16) training centers that are spread across the country. The audited financial statements of Tick Consult show revenue of FRW 17,500 million and profit before taxation of FRW 1,820 million for the Rwanda National business segment for the year ended 31 December 2021. Most of the National business premises in Rwanda are owned or held on long-term leases. Trainers in the Rwanda National business segment are mainly full-time employees.

The International business segment of Tick Consult has Ten (10) training centers in Europe and Asia. For the international business segments of Tick Consult, revenue amounted to FRW 8,820 million and profit before tax FRW 3,360 million for the year to 31 December 2021. Most of the International business's premises are held on operating leases. International trade receivables as at 31 December 2021 amounted to FRW 5,180 million. Although the International centers employ some full-time trainers, the majority of trainers provide their services as freelance consultants.

**Required:**

- (a) Explain the matters you should consider before accepting an engagement to conduct a due diligence review of Tick Consult. (12 Marks)
  - (b) Explain how inquiry and analytical procedures will appropriately be used in the due diligence review of Tick Consult. (13 Marks)
- (Total: 25 Marks)**

**QUESTION FOUR**

A proper understanding of internal controls is essential to auditors to ensure that they understand the business and can effectively plan and execute tests of controls and an appropriate level of substantive procedures.

You are the auditor of a small manufacturing company, Songa Enterprises, that pays its staff in cash and by bank transfer and maintains its payroll on a small stand-alone computer.

**Required:**

- (a) For the payroll department at Songa Enterprises, describe the:
    - (i) Internal controls objectives that should be in place; (4 Marks)
    - (ii) Internal control environment and internal control procedures that should be in place to achieve the internal control objectives (6 Marks)
  - (b) For the payroll charges and payroll balances (including cash) in the financial statements of Songa Enterprises:
    - (i) Describe the external auditor's audit objectives; (5 Marks)
    - (ii) List the tests of control and substantive procedures that will be applied to achieve the audit objectives identified in (b) (i) above (10 Marks)
- (Total: 25 Marks)**

**End of question paper**



