CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

DATE: FRIDAY 29, AUGUST 2025

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

MARKING GUIDE –

QUESTION ONE: STAR TRUST BANK (STB) GROUP	Marks
Part (a): Matters to consider prior to accepting the engagement to audit the individual financial statements of Star Trust Bank (STB) and the STB consolidated financial statements. Award up to 1 mark for each correct point made representing the "Matters to consider prior to accepting the audit engagement" (where the 1 mark includes 0.5 marks for identifying correctly a required matter/issue and 0.5 marks for explaining "why" this is needed) - These must be supported by ONLY the information in the scenario (NOT generic points) - a maximum of 7 marks	7
Q1 (b)(i): Business risks faced by STB Group to be considered in the final audit Award up to 2 marks for every well explained business risk using information from the scenario "specific to STB Group". The 2 marks for each business risk should be awarded as follows: Up to 1 mark where the business risk is both identified and explained correctly (otherwise award only 0.5 mark if the business risk is only identified but not explained) 1 mark for the implications of the business risk (e.g. due to the business risk there are potential cash flow shortages, revenue reduction, etc. Specific business risks include: - Regulated industry and investigation (up to 4 marks) - Reputation exposure and the new brand - High Competition (up to 3 marks) - Declining financial performance - Reliance on a sole external supplier of telecommunications infrastructure - Guarantee to Telex Ltd.'s loan - Potential loss of the legal case and a legal penalty - Internal control deficiencies Credit should be given to any other relevant business risks well developed and related to the information in the scenario.	

Note: **Do Not Award -** Points that are generalised and therefore not aligned/related to the specific information regarding STB Group as provided in the scenario (including speculative issues) **MAXIMUM MARKS for Q1 (b)(i) - using the guide provided above**	8
Q1 (b)(ii): Risks of material misstatements (ROMMs) to be considered when planning the final audit for HHG **Award up to 3 marks (except where it is stated otherwise) using the ROMM marking guide provided below for the following ROMMs specific to the audit of STB Group (but are not limited to):** - BIC License – amortization and impairment loss (maximum of 5 marks) - Segmental reporting - Shareholding in Telex Ltd (maximum of 5 marks) - Loan guarantee - provision for a liability - Loan guarantee to Telex Ltd – related party transaction - Provision relating to the legal claim and potential legal penalty - Going concern Any other valid ROMMs raised by the student that are relevant to the audit of STB Group relating to the information provided in the scenario (where applicable using the ROMM marking below) Where correctly applied, award 1 mark for each valid point referencing to "materiality" item well developed and 0.5 marks for any other correct calculation (e.g., calculation of finance cost on the deferred consideration for the acquisition of BIC, amortization charge of BIC's 5-year license etc.) - these calculations will be cross-marked once throughout the question **The ROMM marking guide for each correctly identified audit risk award is provided as below:** (i) Accounting treatment: Award up to 1 mark for a reasonable/correct reference to the accounting treatment relevant in the circumstances otherwise its 0.5 marks where they only attempt but do not well develop the accounting treatment or no mark for a wrong accounting treatment (Note: no penalty for a wrong quotation of the IFRS number and/or title since it's the guidance for the accounting treatment that is of importance here) (ii) Risk of material misstatement (ROMM): Award up to 1 mark for a well-developed risk of material misstatement where they use the specific information provided in the scenario for HHG to "identify" the potential ROMM (taking 0.5 marks of the allocated 1 mark) and go ahead to explain or recognise how this is a ROMM (taking the other 0.5 marks of the allocated 1 mark) (iii) Where the financial statement risks are correctly identified in the audit risk assessment, award 0.5 marks for every correct financial statement risk arising from the ROMM (e.g. assets are "overstated" - goes for 0.5 marks and expenses are	

"understated" - gets the other 0.5 marks) picking the "double-entry application" or a full 1 mark for a correct "disclosure" impact **Other points (marked outside the ROMM guide)** - Deficiencies in internal controls (maximum of 3 marks) - Management bias (maximum of 3 marks across the entire question) **Note: Do Not Award:** Generic (speculative) risks developed from rote-learning which are not supported by the information given in the scenario Application of analytical procedures and / or risks related to opening balances of STB and BIC as the question instruction clearly indicated this should be ignored Detection risks as the question as these are clearly NOT part of risks of material misstatements	
MAXIMUM MARKS for Q1 (b)(ii)- using the guide provided above	15
Q1 (c): Analytical review procedures which will form part of the audit work on the incomes and expenses Award up to 1 mark for each valid analytical review procedure based on the model answer and/or any other valid analytical procedure(s) provided by the student answers (where the 1 mark includes 0.5 marks for a correct "what - supported by a valid source where applicable"	4
Q1 (d): Principal audit procedures on the opening balances of the individual financial statements of STB Award up to 1 mark for each valid audit procedure based on the model answer and/or any other valid audit procedure(s) provided by the student answers (where the 1 mark includes 0.5 marks for a correct "what - supported by a valid source where applicable" and the other 0.5 marks for a valid "why or reason" relating to the financial statement assertion being tested.	4
Q1(e) Ethical issues Award up to 1 mark for each valid point raised as a relevant ethical threats and/or challenges in relation to the request to Kwizera & Partners to assist STB in the implementation of the new payroll system. *Note: Specifically, the 1 mark for a point on ethics is not given for a mere mention of the "type of ethical threat (e.g. stating self-interest threat" but the mark is awarded for "explaining how the ethical threat arises and its consequences of the ethical threat to the firm"* Award 1 mark for any correct safeguard proposed to manage the ethical threat	

Note: Both the ethical threats and the safeguards must be specific to the scenario and the safeguards must be appropriate to the circumstances presented in the question scenario **Maximum marks for Q1(e)**	 6
Q1(f): Reliance on the work of Pickman & Co (a component auditor) Award up to 1 mark for each valid factor and / or procedure applied in placing reliance on Pickman & Co (as a component auditor) on the financial statements of Exodus Bank - this will be based on the model answer and/or any other point(s) provided by the student's answer (where the 1 mark includes 0.5 marks for a correct "what - supported a valid source where applicable" and the other 0.5 marks for a valid "why or reason" - maximum of 6 marks	6
Total marks for Question One	**50**

MODEL ANSWER TO QUESTION ONE

Part (a): Matters to consider before accepting the audit engagement

The following matters are important for Kwizera and Partners to consider before accepting to conduct an audit engagement of the financial statements of Star Trust Bank (STB), Be-Safe Insurance Company (BIC) and the consolidated financial statements

- Kwizera & Partners needs to consider whether the firm has the capacity to perform an external audit on the individual financial statements of Star Trust Bank (STB), Be-Safe Insurance Company (BIC) and the consolidated financial statements for the current year and the subsequent years especially since STB's ten-year expansion plan will include opening bank branches outside Rwanda and investments in other companies including a diversification in the insurance sector. The firm needs to assess whether it has sufficient resources to complete the audit assignments of such a group of companies within the stipulated time-frame in each year as the STB group continues to expand for example the audit of the individual financial statements for the current year have to be completed by 31 July 2025 which is only one month from the end of the financial year and this may not be achieved as the firm will be auditing STB financial statements for the first time where the learning curve may be longer than the available time to complete the first year audit.

- The firm needs to consider whether we have the required knowledge and experience to conduct an audit engagement for a group of companies under the STB group that operate in specialized sectors like the financial institutions and the insurance sector. These sectors will certainly have specific accounting requirements / standards and will be highly regulated with specific laws to comply to that increases the firm's risk to identify any significant non-compliances to laws and regulations by the client.

- The firm needs to consider whether it has sufficient personnel with the required skills and experience in conducting an external audit assignment of a financial institution and an insurance company external audit assignments as these will apply special accounting standards and government regulations in the countries where STB investments are operated from for example the firm's personnel should be knowledgeable of the special rules for financial institutions operating in the foreign countries like Kenya and Uganda where STB has opened up bank branches as the regulations in these countries are stringent and are different from the regulations applied in Rwanda.
- Since Be-Safe Insurance Company (BIC) has not undergone an external audit of its financial statements in the past due to its prior small size, it is important to consider the adequacy and accuracy of the opening balances for the prior period that has never been audited as this will require Kwizera & Partners to conduct additional audit on the opening balances considering that the client is proposing a low audit fee in the first year of the audit.

- On the basis that BIC will be audited for the first time, Kwizera & Partners needs to consider the high probability that BIC's management may not have an adequate understanding of an external audit process including the important knowledge of the pre-conditions for an audit (e.g., providing the audit team with all necessary documents and free access to information) to minimize any expectation gaps, scope of the audit, any limits of an audit which may impact negatively on the quality and conclusion of the audit.

- On the basis that STB has opened branches in other countries, the firm needs to evaluate whether it has affiliate firms of professional accountants in the same countries (like Kenya and Uganda) where STB has opened branches to ensure a timely and quality audit assignment in the current and subsequent years. This is very important especially considering the tight deadline in which the audit report should be issued in the current year and also the fact that operating through affiliate audit firms in these countries will minimize the operational costs of travel and upkeep of the audit firm.

Note: Credit will be granted where the student provides any other valid points regarding the assessment of Kwizera & Partners' practical ability to provide separate audits for the individual financial statements (of the parent and the subsidiary) and the consolidated financial statements in terms of time deadlines or low fees proposed by the client.

- The issue of a high audit risk needs to be considered by assessing whether the client has the required competence to prepare both the individual financial statements and the consolidated financial statements on the basis that this is the first time STB will be preparing consolidated financial statements as there are high chances of potential errors in the preparation of the consolidated financial statements that will likely result into material misstatements.

- Since BIC's financial statements will be audited for the first time, the firm needs to consider whether the nature and format of the auditor's report and the level of assurance is what will be expected by the new client (BIC) since the auditor's report can only provide a reasonable level of assurance as opposed to an absolute level of assurance that may be expected by the client (BIC).

- Client's integrity: the key management personnel of the potential client (STB) may have an incentive to manipulate the STB individual financial statements so as to ensure that the Government of Rwanda provides the requested tax waiver based on the financial information reported in the audited financial statements which exposes the integrity of the client and the audit firm will not wish to be associated with a client whose integrity may be questionable

- Note: Credit *will be granted where the student links the client's integrity to management bias / pressure to either provide financial statements that indicate the achievement of key performance indicators required by the stock market regulator in the first year of the stock listing status for both STB and BIC and/or to support the rationale for the diversification through an investment in the new business sector (the insurance industry).*

- Before accepting the audit engagement, Kwizera & Partners need to consider the need to obtain key references regarding the integrity of the directors and senior management personnel of both STB and BIC by conducting the 'client due diligence reviews" (or "Know Your Client" procedures) and this will substantially take time that the client will have to accept.

- **Low audit fees:** The fees estimate for the external audit as proposed by the client to be low fees which may potentially be a low-balling arrangement in the first year of the audit and therefore Kwizera & Partners will need to ensure that the Board of STB is aware of the fact that the fees for the future audits may increase or a compensation of the low audit fees may be negotiated by provision of professionally acceptable high lucrative non-audit assignments if these will be available at STB.

- **Access of the former auditors and professional clearance:** Before accepting the audit engagement, Kwizera & Partners need to confirm whether STB will provide approval for the firm to contact the former auditor for any information that is needed to help make a decision to accept the audit engagement and also obtaining a professional clearance from the former auditors. Such a communication with the former auditor is important as this provides additional information that will be used to decide whether to accept the engagement for example this helps assess the integrity of the client's management and client business background.

Ethical considerations:

- The firm's audit report on the financial statements of STB is expected to be used to support STB's request to the Government of Rwanda for a tax waiver and this may create an advocacy threat as the firm may be perceived by Government of Rwanda to be promoting or representing the interests of STB in the application of a tax waiver and this will compromise the audit firm's objectivity.

- A self-interest threat will also arise where the audit firm is required to provide an audit assignment at a low audit fee implying a "lowballing arrangement" where the firm may hope to compensate the initial low audit fees with the provision of other lucrative non-audit assignments proposed to the client and it may be possible that such non-audit assignments are not relevant to the client and yet the firm will press for such assignments to earn extra fee income in order to compensate the low audit fees.
- In addition, the low audit fees will result in a reduction in the quality of the audit work as the Kwizera & Partners will likely cut back on the audit work / procedures to be conducted in order to work within the reduced audit costs and avoid any financial losses.

- Action: If the audit engagement is accepted, Kwizera & Partners will need to ensure that appropriately qualified audit personnel are assigned to the audit of the individual entity and consolidated financial statements and in addition sufficient time is devoted to the audit assignment in order to ensure a quality audit service is provided to STB, its subsidiary (BIC) and the consolidated financial statements.

Note: Though only seven (7) well explained / supported matters are required by the question to earn full marks, the model answer below provides a variety of valid points that are supported by the information provided in the scenario.

Part (b) (i): Evaluation of business risks

Regulated industry and investigation

The STB Group (including both the financial institution and the insurance company) operates in a highly regulated industry and is required to obtain a license issued by the government-licensing authorities in Rwanda and other countries where STB operates with bank branches, and there is a risk that should the license be revoked for any reason, the companies in the STB Group would not be able to operate. In order to renew the license, for example the STB branches in must maintain a good level of customer service, so there is a risk of non-renewal, if as a result of the investigation the Group is found to have overcharged its customers.

A similar case went against one of the STB's competitors in July 2024, and if a penalty of a similar amount were to be charged to the STB, the amount would be a minimum of FRW 2,000 million, based on the Group's two million customer base. Though the potential fine is only 2.5% of the Group assets (2,000m / 80,000m x 100), this remains a significant amount of cash flows that will be lost especially as the STB group is currently unable to settle some of its existing supplier payables. In addition, the Group would need to raise finance to pay any potential fine, and it could even face going concern problems if the license were to be revoked or a fine were issued, and therefore, such is the financial impact of the potential fine.

Reputation exposure and the new brand

A significant part of the Group's revenue is based on customers' confidence of the STB reputation and group's future success relies on building long-term relationships with its customers. A failure to meet customers' expectations with regard to the level of service provided could negatively impact the Group's reputation, new brand (Lions Finance) and its competitive position. Any investigation by the licensing authority in any of the countries where STB operates from could also attract media attention and negatively impact on the business financial performance of the STB Group.

High Competition

The industry is competitive, and while the information on market share shows that the Group enjoys a reasonable market share (60% in 2024 and 45% in 2025), the Group's share of the market is significantly declining. The extract from the financial performance report indicates that there has been a decrease all areas regarding the revenue of the STB Group for example the proportion of normal customers operating accounts with the STB Group companies has dropped from 70% (in 2024) to 64% (in 2025) of their entire Group revenue composition and also the percentage of customers opening additional accounts with the STB group companies has reduced from 78% (in 2024) to 71% (in 2025). The Group may need to cut the service fees charged to customers in order to remain competitive, and it must invest to ensure that its range of products / services is appealing to customers. This will put further pressure on cash flow and operating margins.

Declining financial performance

The financial performance report shows that the Group's financial performance and position has deteriorated in the year, with operating margin falling from 11·4% (in 2024) to 10·5% (in 2025). The decrease in the number of customers from 2.2 million customers (in 2024) to 2 million customers (in 2025) is a trend that is worrying especially since the implementation of the expansion plan by opening bank branches in Kenya and Uganda and/or acquiring BIC should have increased the overall number of customers in 2025. The decreasing financial performance in 2025 is potentially linked to the emergency of a new competitor bank, Front International Bank (FIB) and this indicates that the competitive environment is impacting on STB Group's financial performance and the Group liquidity which is evident in the Group's failure to settle obligations to suppliers and the former auditor's fee.

Reliance on a sole external supplier of telecommunications infrastructure

The Group relies on Telex Ltd to provide the online banking platform over which the bank customers access the online banking on their bank accounts. There is a risk that should Telex Ltd no longer be willing or able to supply its online banking platform to the STB Group, perhaps due to Telex Ltd being taken over by a competitor of the STB Group, there could be disruption to accessibility of the bank's online banking facility which will frustrate the large number of the STB customers who now use the online banking facility and such customers will swift to other commercial banks providing an uninterrupted online banking facility. STB has purchased a further shareholding in Telex Ltd to attempt to disrupt any takeover of Telex by a competitor, but a shareholding of only 18% may not be sufficient to block a hostile takeover bid.

Guarantee to Telex Ltd.'s loan

The Group has guaranteed a 5-year loan of FRW 15,000 million to Telex Ltd. The loan amount is significant, representing 19% of STB Group total assets, and therefore, if Telex Ltd defaults on its loan repayment the STB Group would have to find the cash to settle the obligation. While there is no specific indication from the information provided that Telex Ltd is likely to default on the loan, the bank which is Telex Ltd.'s main finance provider must have had some concern to the extent of requiring STB Group to provide a guarantee to Telex's loan. This will drain the STB Group's cash flows if Telex Ltd defaulted or failed to repay the loan as the STB Group will have to settle such a significant amount of the loan using its only depleting cash reserves.

Potential loss of the legal case and a legal penalty – non settlement of an outstanding lease payment

The STB group is facing a legal case against a lessor for non-settlement of a lease rental amounting to FRW 1,800 million and the legal expert advises that it is highly probable that STB Group will lose the legal case and will have to pay a legal penalty. The amount of FRW 1,800 million and the legal penalty whose figure has been not mentioned will be a cash drain on the Group considering STB is already facing cash flow difficulties. In addition, the legal case proceeding may have a negative impact on STB group reputation and could be the reason for the decrease in the number of customers as most corporate customers will not want to associated with a bank that is facing reputational damage. The legally forced settlement of the FRW 1,800 million plus a legal penalty is a high probability for STB Group as in the past other companies facing similar legal claims have always lost the legal cases and have been subjected to high legal penalties. This will result in a drain of the Group cash flows and in additional will damage the Group's reputation and consequently a further loss of customers that impacts adversely on the Group's revenue and profits.

Internal control deficiencies

The interim audit work indicates that there are some deficiencies in internal controls relating to payroll. The deficiencies indicate a weak control environment and that control activities are not operating effectively. There are several possible consequences, including inaccuracies in deducting taxes from the staff salaries, recording taxes in the PAYE tax returns which could result in fines and penalties should errors come to the attention of the tax authority. In addition, the control deficiencies mean that payroll fraud could go undetected. In particular, fictitious or ghost employees could be set up on the payroll system. The control deficiencies could be indicative of problems with internal controls across the Group's operations and such deficiencies could result in financial losses to the STB Group.

Note: *Credit will be awarded for other relevant business risks, for example, the fixed franchise payment for the use of the "Lions Finance" based on 15% of the STB's gross revenue which will become a constant cash flow drain in the future years, that increased competition could impact the Group's ability to retain the existing customers if the competitors are introducing new bank service products, the need to invest in new technology like other in addition to the online banking facility to remain competitive, and cybersecurity issues to protect against client data misuse that can attract penalties etc.*

Part (b) (ii): Evaluation of Risks of misstatement

BIC License – amortization and impairment loss

BIC's renewed its 5-year license in October 2024 and this is recognized at cost of FRW 1,200 million in both BIC's individual financial statements and the consolidated statement of financial position. This is material, representing 1.5% of Group total assets. The license is held at cost and is not amortised over its a useful life of 5 years. According to IAS 38 *Intangible assets*, this is an acceptable accounting treatment, as long as the asset has an indefinite useful life, in which case IAS 38 requires that the useful life of the intangible asset should be reviewed each reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset.

There is a risk that the assumption regarding the renewal of the license when it expires is not appropriate, for example if BIC fails to comply to the license conditions that must be satisfied for the license renewal to be granted by the licensing authority. If there is an indication that the license may not be renewed, then it will no longer has an indefinite life, and the change in the useful life assessment from indefinite to finite should be accounted for as a change in an accounting estimate. There is therefore a risk that intangible assets are overstated and operating expenses understated if amortisation of the license has not been appropriately accounted for.

In addition, IAS 38 Intangible assets and IAS 36 Impairment of assets require that where an intangible asset is classified to have an indefinite useful life, the entity is required to review the asset for any impairment loss regardless of whether there are existing indicators for impairment loss. There is a risk that BIC and the STB Group have not conducted the required annual impairment loss review if for example the reduction of the STB customers could have extended to BIC which clearly indicates that BIC's license may be impaired. There is therefore a risk that intangible assets are overstated and operating expenses understated if an impairment loss of the license has not been appropriately conducted and/or accounted for.

Segmental reporting

As a listed entity, the Group financial statements on the basis that both STB and BIC are listed entities must comply with IFRS 8 *Operating Segments*, which requires that financial and descriptive disclosures are made in the notes to the financial statements regarding reportable segments. A reportable segment is one whose reported revenue is 10% or more of the total revenue of all operating segments. This is relevant to the Group this year, because the revenue generated from the "other non-routine product customer customers" has increased from 5% to 21% of revenue, according to the extract from the financial performance information. Therefore, on the basis of the information provided, this is a reportable segment, assuming that other conditions are met, for example, that its financial results are reviewed by the chief operating decision maker. In addition, in the year 2025, due to the STB Group's expansion plan where additional bank branches have been opened in Kenya and Uganda which constitute different geographical areas of operations and the diversification into another business product line through the acquisition of BIC that operates in the insurance sector, these are clear signs of separate business segments whose separate financial information will be regularly reviewed by the chief operating decision maker. The risk is that incomplete or inaccurate disclosure is provided in the notes to the Group financial statements.

Shareholding in Telex Ltd

The Group has increased its shareholding in Telex Ltd to 18%; this is recognized at cost of FRW 2,500 million, which is material at 3.1% of Group total assets. There is a risk that rather than being recognized as a financial asset, Telex Ltd should be recognized as an associate of the Group. IAS 28 *Investments in Associates and Joint Ventures* defines an associate as an entity over which the investor has significant influence. Where an entity holds 20% or more of the voting power in an investee, it is presumed the investor has significant influence. If the holding is less than 20%, significant influence is not presumed, but could be demonstrated, for example, through participation in the policy-making process, material transactions between the entity, provision of essential technical information, and the interchange of managerial personnel. The Group could exercise significant influence over Telex Ltd for the following reasons:

- The Group has guaranteed a loan of FRW 15,000 million for Telex Ltd – this indicates a close connection between the companies and could be deemed to be a material transaction, as the loan amounts to 19% of Telex Ltd.'s net assets.
- One of the Group's directors, Paul Niyonagize, is working with Telex Ltd on the development of its new online banking platform, this indicates that the Group is participating in the strategic and operational development of the company, and there is an interchange of key management personnel.

Therefore, there is a risk that the investment should be equity accounted as an investment in an associate under IAS 28, with the carrying amount of the investment increased or decreased to recognize the Group's share of the profit or loss of Telex Ltd after the date of acquisition. There are other risks of material misstatement in relation to recognition and presentation of income in the Group statement of profit or loss for example where a one-line presentation of a "profit or loss share from the associate" should be presented in the Group profit or loss, and in relation to disclosure in the notes to the financial statements.

In addition, there is a risk that the amount recognized as a financial asset is overstated. The Group holds 18% of Telex Ltd, which has net assets of FRW 57,000 million meaning the STB Group's shareholding is equivalent to approximately FRW 10,260 million (18% x FRW 57,000 million). However, the investment in Telex Ltd has been recognized as a financial at a cost of FRW 16,000 million, indicating that the amount recognized is overstated, and that an impairment review should be carried out to determine the recoverable amount of the asset.

Note: *Credit will be awarded for other valid risks of material misstatement points relating to consolidated statement of profit or loss, consolidated statement of cash flows, and to the disclosure requirements of IAS 28.*

Loan guarantee - provision for a liability

The Group has guaranteed a loan of FRW 15,000 million made to Telex Ltd which is material at 19% of total assets. There is a risk of material misstatement if the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* have not been followed. The information provided in respect of Telex Ltd does not indicate that a provision for the loan guarantee needs to be recognized because the Telex Ltd has reported a net assets position and does not appear to be at risk of defaulting on the loan. However, there is a possibility that the guarantee will be called in and therefore the granting of the guarantee may give rise to a possible obligation. This is a contingent liability which should be disclosed in the notes to the financial statements but not provided for in the accounts, and there is a risk of inadequate disclosure in the notes to the Group financial statements.

Loan guarantee to Telex Ltd – related party transaction

In addition, following on from the earlier discussion, if Telex Ltd is an associate of the Group, then the STB and Telex Ltd are related parties, and the loan guarantee is a related party transaction that should be disclosed under the requirements of IAS 24 *Related Party Disclosures*. IAS 24 specifically mentions that the provision of guarantees or collateral is an example of a related party transaction, so there is a risk of inadequate disclosure in the Group financial statements if the related party transaction is not adequately disclosed.

Provision relating to the legal claim and potential legal penalty

As mentioned in the business risk evaluation above, the lessor whose lease payment FRW 1,800 million remained outstanding beyond the settlement date has initiated legal proceedings against STB Group and it is highly likely that STB Group will be found legally liable. There is a risk that a provision might need to be recognized in accordance with IAS 37 *Provisions, contingent liabilities and assets*, as non-settlement of a payable beyond the due date gives rise to an obligation for a repayment and a legal penalty as a result of a past event. Judgement needs to be exercised as to whether there is a probable outflow of economic resources. The fact that in the past companies being sued for similar legal cases have lost the legal cases and are subjected to high legal penalties could indicate that a provision for a legal penalty is necessary to be recognized in the financial statements of STB Group. If the outflow of economic resources is considered possible rather than probable, then a contingent liability should be disclosed in the notes to the Group financial statements. The risk is that liabilities will be understated and the profit overstated if any necessary provision for the legal claims / penalty is not recognized, or that disclosures in the notes to the financial statements are not sufficient to meet the disclosure requirements for a contingent liability of IAS 37.

Going concern

As mentioned in the business risk evaluation, there is a potential going concern implication arising from the financial liquidity challenges faced by STB Group for example the failure to settle the audit fees for the previous audit and the legal claim with legal penalties for a long outstanding lease rental payment which is highly probable will require to be settled. In addition, the legal claim and other potential cash flow drains may create a significant doubt over the future of the STB Group, for example, if there is a possibility that its operating license of STB is revoked due to uncertainties of STB financial stability to keep the funds of the bank customers, then the details should be disclosed in the notes to the financial statements in accordance with IAS 1 *Presentation of Financial Statements*. There may be reluctance to make any necessary disclosure, as this may have a further negative impact on the Group in terms of its market share and customer loyalty. Therefore, there is a risk of incomplete disclosure in relation to material uncertainties over going concern.

Deficiencies in internal controls

The internal audit report of STB Group has revealed deficiencies in internal controls relating to payroll. Several different control risks have been identified. The report indicated that the current payroll system used to calculate tax deductions from staff salaries is producing inaccurate results and specifically under deducting PAYE from the staff salaries. This could mean that amounts owed to the tax authorities are understated, and fines or penalties may be due if the tax authority is alerted to the significant underpayment of tax due to this error in the payroll system. On the basis that the payroll system is integrated with the accounting software that provides the information in the financial statements of STB Group, then errors in the payroll system could indicate possible errors in other figures reported in the financial statements.

There were also control deficiencies identified in how starters and leavers are dealt with. It seems that when staff leave, their data is kept on the system; this would make it relatively easy for a payroll fraud to be set up, whereby payments could be made in relation to these employees, or to someone else's bank account, despite the fact that they no longer work for the Group.

These factors indicate that there is a high risk of material misstatement in relation to personnel costs posted from the payroll to the financial statements.

Management bias

This financial year, STB Group commenced the implementation of the expansion plan where they opened new bank branches in Kenya and Uganda and in additional acquired 100% of BIC as their first acquisition of a subsidiary. In addition, STB and BIC achieved a stock listing on the Rwanda stock exchange. All these developments will be a basis for management pressure to present financial statements with a bias to report a better financial performance that the actual reality especially if the management of STB Group are under pressure to report an achievement of key performance indicators that are a requirement of the stock listing and /or pressure to report a favorable financial performance and position as a result of the approved expansion plan. This will result in a high risk of material misstatement in both the individual entity and the STB Group financial statements.

Note: Credit will be provided to other valid and well-developed points relating to ROMMs for example the computation of and initial recognition of Goodwill on the acquisition of BIC, potential impairment losses of STB Group assets due to the declining financial performance etc.

Part (c) Analytical procedures to be applied on the incomes and expenses reported in the Group financial performance

Incomes:

- Obtain a breakdown of the Group incomes and assess reasonableness of the periodic (e.g., monthly) incomes in relation to:
  - o Different income categories (e.g., different bank service products, insurance service products etc);
  - o Incomes generated from different geographical locations (e.g., incomes earned in the different countries like Rwanda, Kenya and Uganda)
- On a sample basis, assess the reasonableness of the actual fees charged per service product line by comparison to formal fees price list / structure.
- Compare the service price lists for each income category in the current year to the equivalent price lists of the prior year to confirm any changes in the prices / fees charged for the different service products offered to the customers.

Expenses:

- Calculate the loan interest income earned on a sample of the loans issued to major customers by applying the applied interest rates in the loan agreements and confirm the reasonableness of the interest income recognized in the accounting journals.
- Calculate the total income earned per service product line in comparison to the total incomes recognized in the accounting journals per service product line to confirm accuracy of the total recognized income in the Group financial statements

- Calculate the total commission paid to a sample of the bank and insurance agents using the unit cost in the agency contracts to confirm the accuracy of the agency expenses recognized in the group financial statements.
- For each expense category, agree purchase prices of the other major operating expenses to the supplier's quotations and compare with the actual total expenses recognized in the group financial statements.
- Calculate the total franchise fees payable for the use of the Lions Finance trade name using the 15% rate for incomes earned for the period the new trade name has been used to assess the reasonableness of the total franchise fees expense recognized in the Group financial statements.
- Compare the operating profit margins per service product line to the specific industry reports to confirm reasonableness of the reported operating profit margins

Note: Credit will be granted to other / additional valid analytical procedures applicable to the incomes and expenses reported in the Group financial performance.

Part (d) Audit procedures on the opening balances of the individual financial statements of STB for the year ended 30th June 2025

Note: "Opening balances" means those account balances which exist at the beginning of the period. The scenario clearly states that the prior year auditor's report was unmodified therefore any digression into the prior period opinion for STB's individual financial statements being other than unmodified or the prior period not having been audited will not earn marks.

The following audit procedures will be applied in testing the opening balances of the individual financial statements for the year ended 30th June 2024:

- Review of the application of appropriate accounting policies in the individual financial statements of STB for the year ended 30th June 2024 to ensure consistent with those applied in the year ended 30th June 2025.

- Where permitted (e.g., if there is a reciprocal arrangement with the predecessor auditor to share audit working papers on a change of appointment), a review of the prior period audit working papers to confirm the reasonableness of the opening balances recognized in STB's financial statements in the year ended 30th June 2025.

  Note: *There is no legal, ethical or other professional duty that requires a predecessor auditor to make available its working papers.*

- Current period audit procedures that provide evidence concerning the existence, measurement and completeness of rights and obligations - for example after-date payments confirming the completeness of trade and other payables (for services).

- Analytical procedures on ratios calculated month-on-month from 30 June 2024 to date and further investigation of any distortions identified at the beginning of the current reporting period - for example profitability margins per service products offered by STB, average payment period for suppliers etc.

- Examination of historic accounting records for non-current assets and liabilities (if necessary). For example:
  - agreeing balances on asset registers to the client's trial balance as at 30 June 2024;
  - agreeing statements of balances on loan assets to the financial statements as at 30 June 2024.

Note: Credit will be granted for any other relevant audit procedure applied on the specific opening account balances in STB's individual financial statements - for example, additional evidence required concerning cash reserves at 30 June 2024 may include obtaining audit reviewed cash count certificates from the predecessor auditor to confirm the opening cash balance, obtaining audit assets listing of the prior year to confirm the opening balance for PPE, applicable cut-off tests for account balances through a review of transactions recorded in the accounting journals at the end of the prior year and at the start of the current year etc.

Part (e) Ethical and other professional issues

An ethical issue arises from the Group audit committee requesting Kwizera & Co to provide assistance with the development of a new payroll system. According to the IESBA *International Code of Ethics for Professional Accountants* (the *Code*), providing assistance in the implementation of a new payroll system is similar to an IT systems service and this can result into a self-review threat to objectivity, depending on the nature of the services which are provided.

The self-review threat arises because the payroll system will play a significant role in determining the value of transactions and balances which will form part of the financial statements, including operating expenses and payroll tax liabilities. If the audit firm helps to design the system and controls, they will be auditing a system which they have helped to develop; the audit team would be unlikely to criticise the system and related controls, or not apply sufficient professional skepticism if they are too trusting of strength of controls and accuracy of the system.

In addition to the self-review threat, there is a risk of assuming a management responsibility, as it is management who is ultimately responsible for the design and implementation of systems and controls and here the audit firm would have a direct involvement in determining the nature and scope of the system. This means that the firm will be involved in making management decisions when advising on the design of the new payroll system including deciding the nature and type of internal controls that will be applied in the application of the payroll system and getting involved in making management decisions is prohibited by *the international code of ethics*.

The Group is a listed entity, and the international *Code of ethics* prohibits the audit firm from providing services to listed audit clients which involve the design or implementation of IT systems which form a significant part of internal control over financial reporting, or generate information which is significant to the client's accounting records or financial statements on which the auditor will express an opinion.

It is likely that payroll is material to the financial statements, in which case the service should not be provided to the Group. The audit firm should confirm the materiality of payroll, and assuming that it is a significant class of transaction, the audit firm should meet with the STB Audit Committee to explain the reasons why the service cannot be provided.

Note: Credit will be awarded where the student assesses providing the requested service to STB Group presents a significant risk because the payroll system is considered to be material by its nature

Finally, the Audit Committee of the STB Group has suggested that the audit fee should be reduced once the new payroll system is introduced, although it should be noted that this is only over one area of the financial statements. It may well be the case that the audit becomes more efficient once the audit firm has tested the new controls and obtained the necessary evidence to be able to rely on the controls. However, there will be additional and ongoing work involved in documenting the new system and controls and testing them, so the audit fee is not likely to be reduced on the basis suggested by the STB Group Audit Committee. This should be discussed with the STB Group Audit Committee and the basis for the audit fee should be reiterated to ensure that there are no misunderstandings.

The Group audit committee should have responsibility for overseeing and making recommendations regarding the appointment of the auditor including the negotiation of the audit fee. It is therefore appropriate for the Group audit committee to comment on the audit fee and discuss with the audit firm. However, the audit committee should not intimidate the audit firm into a lower fee. This would have consequences for the quality of the audit and is a threat to objectivity.

Part (f): Factors to consider and procedures to apply - Relying on the work of Pickman & Co as a component auditor

Introduction

ISA 600 *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)* provides guidance on the factors that should be considered in relation to the work of component auditors. Pickman & Co will be the auditor of a significant component of the STB group. ISA 600 requires that Kwizera & Co as the group engagement auditor obtains an understanding of the component auditor when it plans to request the component auditor to perform work on the financial information of a component for the group audit.

ISA 600 defines a "Component" as an entity or business activity for which financial information is included in the group financial statements. In this case, Exodus Bank is a wholly owned subsidiary, so meets the definition of a component. Pickman & Co, the auditors of Exodus Bank, are component auditors using the ISA 600 terminology.

The following factors to be considered and procedures to be conducted by Kwizera & Co in relying on the work of Pickman & Co as a component auditor when planning the audit of the financial statements of Exodus Bank and the Group financial statements for the next financial year ending 30 June 2026:

Ethical status

The ethical status of Pickman & Co will have to be considered in particular, the independence of the firm. According to ISA 600, the component auditors are subject to the same ethical requirements that are relevant to the group audit. This means that because Kwizera & Co, the group auditor, is bound by IFAC's *Code of Ethics for Professional Accountants*, then Pickman & Co as a component auditor should be bound by the same ethical rules, irrespective of the ethical code that exists in Cyprus.

If the ethical rules and principles are found to be less stringent in Cyprus, then less reliance can be placed on the work of Pickman & Co during the group audit. This is because there may be doubts over the objectivity and integrity of Pickman & Co, and also over firm's competence to conduct the audit.

Qualifications and professional competence

The professional competence of Pickman & Co must be considered. The qualifications of Pickman & Co may not be of the same standard as those of Kwizera & Co. The quality management on the audit work conducted by Pickman & Co could therefore be questionable.

In addition, audit personnel at Pickman & Co may not have the necessary skills or resources to be involved in a group audit. For example, Kwizera & Co as the group auditor may instruct Pickman & Co to perform work necessary for the group audit, such as verification of fair value measurements where the audit personnel at Pickman & Co have not heard previous experience in conducting such procedures, and indeed they may not have been previously involved in any group audit.

We are informed that ISAs are not followed in Cyprus, meaning that the audit work conducted by Pickman & Co may be less rigorous than required by the ISAs and evidently the audit evidence gathered by Pickman & Co may not be sufficient to support the group auditor's opinion.

Monitoring
There should be a consideration of whether Pickman & Co operates in a regulatory environment that actively oversees and monitors auditors. This would enhance not only Pickman & Co's ethical status, but also adds credibility to the firm's competence.

Audit Evidence
There should be an evaluation as to whether the group engagement team from Kwizera & Co will be able to be involved in the work of Pickman & Co, the component auditor to the extent necessary to obtain sufficient appropriate audit evidence on material matters.

Procedures could include:
- Obtaining and reviewing the ethical code followed by audit firms in Cyprus, and comparing it to ethical code used by Kwizera & Co.
- Obtaining a statement from Pickman & Co that the firm has adhered to any local ethical code and the IFAC Code.
- Establishing through discussion or questionnaire whether Pickman & Co is a member of an auditing regulatory body, and the professional qualifications issued by that body.
- Obtaining confirmations from the professional body to which Pickman & Co belongs, or the authorities by which it is licensed.
- Determining through discussion or questionnaire whether Pickman & Co is a member of an affiliation or network of audit firms.
- Discussion of the audit methodology used by Pickman & Co in the audit of Exodus Bank, and compare it to those used under ISAs (e.g., how the risk of material misstatement is assessed, how materiality is calculated, the type of sampling procedures used etc).
- A questionnaire or checklist could be used to provide a summary of audit procedures used by Pickman & Co.
- Ascertaining the quality management policies and procedures applied by Pickman & Co, both firm-wide and those applied to the individual audit engagements.
- Requesting any results of monitoring or inspection visits conducted by the regulatory authority under which Pickman & Co operates.
- Communicating to Pickman & Co an understanding of the assurances that Kwizera & Co will expect to receive, to avoid any subsequent misunderstandings.

SECTION B

QUESTION TWO
MARKING GUIDE –

QUESTION TWO: SPICE LTD	Marks
Q2(a): Matters to consider and audit evidence expected to be available:	
Revaluation of property	
Award 1 mark for "materiality" where both the calculation and conclusion are correct - maximum 1 mark	
Award 1 mark for every valid point made referring to the accounting and other implications (other than an impact on the auditor's opinion) that will be considered for the evaluation and review of the audit work that has been done on the revaluation of Spice Ltd.'s own properties	
Award up to 1 mark for each valid audit evidence based on the model answer and/or any other valid points of audit evidence provided by the student answers (where the 1 mark includes 0.5 marks for a correct "what - supported a valid source where applicable" and the other 0.5 marks for a valid "why or reason" relating to the financial statement assertion tested	
Maximum marks - Revaluation of property	8
Trade receivable balance - as a related party transaction	
Award 1 mark for "materiality" where both the calculation and conclusion are correct or a justification for concluding that the receivable is between related parties and so its material by nature - maximum 1 mark. Note a separate 1 mark should be granted for a reasoned conclusion that this is a related party transaction	
Award 1 mark for every valid point made referring to the accounting and other implications (other than an impact on the auditor's opinion) that will be considered for the evaluation and review of the audit work that has been done on the Spice Ltd.'s trade receivable from Trundy Co	
Award up to 1 mark for each valid audit evidence based on the model answer and/or any other valid points of audit evidence provided by the student answers (where the 1 mark includes 0.5 marks for a correct "what - supported a valid source where applicable" and the other 0.5 marks for a valid "why or reason" relating to the financial statement assertion tested	
Maximum marks - Revaluation of property	8
Q2(b): Matters to consider before expressing an opinion on the consolidated financial statements of the Spice Ltd	

Award up to 2 marks for each well explained point critiqued in the proposed draft auditor's report on the financial statements of Spice Ltd. The two marks represent 1 mark for a valid item/issue correctly picked from the draft auditor's report as a "what" and the second 1 mark is for a reason "why" this is incorrect (alternatively the second 1 mark is given for the student's answer proposing how/what the correct presentation of the incorrect issue/item should be made" - but NOT redrafting the auditor's) - maximum of 9 marks	9
Total marks for Question Two	**25**

MODEL ANSWER TO QUESTION TWO

Part (a): Matters to consider and audit evidence expected to be available

Revaluation of owned properties

Matters to consider

The revaluations are clearly material as FRW 1,700 million and FRW 5,400 million represent 5·5% and 17·6% of total assets, respectively.

The change in accounting policy, from a cost model to a revaluation model, should be accounted for in accordance with IAS 16 'Property, Plant and Equipment' (i.e. as a revaluation).

IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' does not apply to the initial application of a policy to revalue assets in accordance with IAS 16. Therefore, we need to consider whether Spice Ltd on the change of its accounting policy by adopting a revaluation model from the cost model for the first time, has correctly not adjusted the opening balance for PPE as a prior-year adjustment (under retrospective treatment) will not be required in the financial statements for the year ended 30 June 2025.

We need to consider the basis on which the valuations have been carried out, for example, whether Spice Ltd has applied the market-based fair value (under IAS 16).

We need to consider the Independence, qualifications and expertise of valuer(s).

IAS 16 does not permit the "selective revaluation" of assets thus the whole class of properties should have been revalued.

The valuations of the fifteen properties on 15 July 2025 (after the year end) before the financial statements were approved qualify as an adjusting event (i.e., this provides additional evidence of conditions existing at the year-end) per IAS 10 *Events After the End of the Reporting Period*.

The revaluation surplus of FRW 5,400 million for the fifteen properties should be added to the net amount of revaluation surpluses in the year ended 30 June 2025 so that the credit to revaluation reserve in equity reflects the sum of the surpluses.

The revaluation exercise is incomplete. If the revaluations on the remaining three properties are expected to be material and cannot be reasonably estimated for inclusion in the financial statements for the year ended 30 June 2025 perhaps the change in policy should be deferred and all the revaluation adjustments recognized in the next year ending 30 June 2026.

We need to consider whether Spice Ltd has correctly calculated the depreciation charge for the year ended 30 June 2026 based on the historical cost as usual to establish carrying amount of the properties before revaluation.

We need to consider whether any "leased properties" used by Spice Ltd for the same purpose as the owned properties have been similarly revalued.

Audit evidence expected to be available

- A schedule of depreciated cost of Spice Ltd.'s owned premises extracted from the non-current asset register.
- A calculation of the difference between valuation and depreciated cost by property with a separate summation of surpluses and deficits.
- A copy of valuation certificate for each property.
- A physical inspection of properties with the largest surpluses (including the two properties valued before the year-end) to confirm their condition.
- Extracts from local property guides/magazines indicating a range of values of similarly styled/sized properties.
- A separate presentation of the revaluation surpluses (gross) in:
    - the statement of changes in equity; and
    - reconciliation of carrying amount at the beginning and end of the period.
- A schedule of the IAS 16 required disclosures in the notes to the financial statements including:
    - the effective date of revaluation;
    - whether an independent valuer was involved;
    - the methods and significant assumptions applied in estimating fair values; and
    - the carrying amount that would have been recognized under the cost model.

Receivable balance
Matters to consider:

Materiality

The receivable represents only 0.07% (25m / 30,700m x 100) of total assets so is immaterial in monetary terms. However, the details of the transaction indicating this as a related party transaction makes it material by nature.

The amount is outstanding from Trundy Co, a company under the control of Spice Ltd's chairman, Fred Mutabazi and therefore as further explained below, this qualifies as a related party transaction to Spice Ltd. Readers of the financial statements would be interested to know the details of this transaction, which currently is not disclosed. Elements of the transaction could be subject to bias, specifically the repayment terms, which appear to be beyond normal commercial credit terms.

Fred Mutabazi may have used his influence over the two companies to 'engineer' the transaction. Under IAS 24 *Related Party Disclosures*, a disclosure of the receivable balance is necessary due to the nature of the transaction regardless of its monetary value.

A further matter to consider is whether this is a one-off transaction, or an indication that there may be other transactions between the two companies.

Relevant accounting standard
The definitions in IAS 24 must be carefully considered to establish whether the receivable actually constitutes a related party transaction. IAS 24 specifically states that two entities are not necessarily related parties just because they have a director or other member of key management in common. It has been noted that Trundy Co is controlled by Fred Mutabazi, who is also the chairman of Spice Ltd. It seems that Fred Mutabazi is in a position of control/significant influence over the two companies (though this would have to be clarified through further audit procedures), and thus the two companies are likely to be perceived as related.

IAS 24 requires full disclosure of the following in respect of related party transactions:
- the nature of the related party relationship,
- the amount of the transaction,
- the amount of any balances outstanding including terms and conditions, details of a security offered, and the nature of consideration to be provided in settlement,
- any allowances for receivables and associated expense.

Valuation and classification of the receivable
A receivable should only be recognized if it will give rise to a flow of future economic benefits to the entity, i.e., a future cash inflow. It appears that the receivable is long outstanding as it been outstanding for more than one accounting period. If the amount is unlikely to be recovered then it should be written off as a bad debt and the associated expense recognized. It is possible that assets and profits are overstated.

Although a representation has been received indicating that the amount will be paid to Spice Ltd, the auditor should be skeptical of this claim given that the same representation was given last year, and the amount was not subsequently recovered. It is also possible that the FRW 25 million could be recoverable in the long term, in which case the receivable should be reclassified as a non-current asset.

The amount advanced to Trundy Co could effectively be an investment rather than a short-term receivable. Correct classification on the statement of financial position is crucial for the financial statements to properly show the liquidity position of the company at the year end.

Note: No credit will be provided where a student indicates a management imposing a limitation in scope by withholding evidence as this is irrelevant in this case, because the scenario states that the only evidence that the auditors have asked for is a management representation. There is no indication in the scenario that the auditors have asked for, and been refused any other evidence.

Audit evidence expected to be available

- An auditor's request to Fred Mutabazi for a written representation detailing:
    - the exact nature of his control over Trundy Co, i.e. if he is a shareholder then a confirmation of his percentage shareholding, if he is a member of senior management then state a confirmation of his exact position within the entity,
    - a comment on whether in his opinion the balance is recoverable,
    - a specific date by which the amount should be expected to be repaid, and
    - a confirmation that there are no further balances outstanding from Trundy Co, or any further transactions between Trundy Co and Spice Ltd.
- A review the terms of any written confirmation of the amount, such as a signed agreement or invoice, checking whether any interest is due to Spice Ltd. The terms should be reviewed for details of any security offered, and the nature of the consideration to be provided in settlement.
- The auditor's evaluation of the business purpose / logic for the transaction, particularly to understand whether the balance is a trade receivable or an investment.
- A review of the board minutes for evidence of any Board's discussion of the transaction and the recoverability of the balance outstanding.
- A copy of the most recent audited financial statements of Trundy Co to:
    - ascertain whether Fred Mutabazi is disclosed as the ultimate controlling party or disclosed as a member of key management personnel,
    - scrutinise the disclosure notes to find any disclosure of the transaction, where it should be described as a related party liability, and
    - perform a liquidity analysis to establish whether the amount can be repaid from liquid assets.

Part (b): Matters to consider before expression an audit opinion

Note: *In broad terms these include the assessments of materiality, what the draft auditor's report and note disclosures mean, the implications for the financial statements of the Spice Ltd and the auditor's report thereon.*

Materiality

- The present value of the right of use assets in the lease arrangement of FRW 7,900 million is (7,900m / 30,700m x 100) 25,7% of the total assets of Spice Ltd and is therefore material to the financial statements.

Draft auditor's report

- The meaning of the basis of opinion paragraph (extract) is unclear in the following respects:
  - o there is no reference to non-compliance with relevant IFRS Accounting Standards (IFRS 16 *Leases* and IAS 12 *Income Taxes*);
  - o there is no clarity as to what 'is in accordance with local tax regulations' – for example whether this is in reference to the treatment of the lease payments and/or the non-provision of deferred taxation;
  - o The draft audit report does not expressly state whether or not the auditor is in agreement with the accounting treatment of the leased properties and the deferred taxation.
- By stating that the opinion paragraph is unqualified implies that the auditor has agreed with the accounting treatments. Since the matter is material, at least in relation to the leased assets, The auditor would have to qualify the opinion if they disagree with the accounting treatment.
- If the auditor agrees with the accounting treatment and the disclosure note, then the references to the notes (7 and 8) should amount to an "emphasis of matter". As such it should be presented in a separate after the basis of opinion paragraph – to make it quite clear that the audit opinion is not qualified in this respect.

Spice Ltd draft financial statements

- The note disclosures appear inadequate because, for example:

  - o it is unclear whether some or all lease payments relate leases with a short-term lease period not exceeding 12 months from the inception of the lease and Spice Ltd has elected to apply the simplified accounting treatment in IFRS 16 by recognizing the lease rental payments in the profit or loss (which may have been correctly accounted for). However, depending on the business of Spice Ltd where properties are needed for example for use as restaurants it is highly probable that the lease period exceed 12 months and by the nature of their customers (e.g., corporate customers), these properties

may not have a low value and hence recognizing them as a right of use assets in the statement of financial position will have been the appropriate accounting treatment;
  - in addition, no reference is made as to whether the lease obligation was recognized but it is highly that the lease obligation has also not been recognized in the financial statements of Spice Ltd.
  - no reference is made to the relevant IFRS Accounting Standards from which Spice Ltd has departed – in this case Spice Ltd has not complied to the accounting requirements for IFRS 16 *Leases* and IAS 12 *Income Taxes*;
  - no reason is given for non-compliance with either IFRS 16 or IAS 12 (see below);
  - it is usually practical to determine (i.e. calculate) taxable temporary differences and therefore it is not true that Spice Ltd was unable to calculate the deferred tax liabilities that need to be recognized in the financial statements.
- Although unclear, the draft basis of opinion paragraph (extract) gives a reason for non-compliance with the IFRS Accounting standards which is the fact that these deviations are in compliance with the local tax regulations and yet there are not in compliance with IFRS 16 and IAS 12. This reason should have also been added to the client's disclosure notes 7 and 8 and the non-disclosure of the reason for the deviations in the notes results into a "material misstatement" in the financial statements. This cannot therefore be an emphasis of matter paragraph if it is 'making good' a lack of disclosure in the financial statements of Spice Ltd.

Implications for the financial statements and the auditor's report thereon

- An accounting adjustment to correct account for the leased properties and a recognition of a deferred tax liability should be made by the client in the financial statements in which case if the adjustment is correctly made, then the auditor's opinion would then be unmodified.
- If both accounting adjustments are not made in the financial statements, the auditor's report should be a qualified / "except for" opinion for the non- compliance with IFRS 16 and IAS 12. The effect of non-compliance with IAS 12 should have to be quantified.

QUESTION THREE
MARKING GUIDE –

QUESTION THREE: KIGALI FURNITURE COMPANY (KFC)	**Marks**
Q3(a): Money laundering - client screening procedures Award up to 1 mark for each valid procedure applied in the client screening specific to a money laundering review of a potential new audit client - based on the model answer and/or any other valid procedure(s) provided by the student answers (where the 1 mark includes 0.5 marks for a correct "what - supported a valid source where	5

applicable" and the other 0.5 marks for a valid "why or reason" for the procedure. A maximum of 5 marks	
Q3(b): Meaning of "Forensic accounting" and its relevance to the statement reported in the internal auditor's report Award 1 mark for a reasonable definition of forensic accounting (the 1 mark can be granted as an alternative where the student's answer provides a definition of "forensic auditing" or "forensic investigation) and 1 mark for extending the definition to "providing a preventative advise" in a forensic accountant's report Award 1 mark for any valid point supporting the relevance of forensic accountancy / forensic investigation to the potential inventory loss (as potential fraud) taking place at KFC store. The mark should only be awarded to a point related to the information in the scenario (not generic points)	
Total marks for Q3(b)	7
Q3(c) (i): An audit committee's role in improving the effectiveness of the external auditor’s work Award up to 2 marks for each point correctly raised (with a justification) that supports the role of an audit committee in ensuring / improving the effectiveness of an external auditor's work - this can be based on the points given in the model answer and any other valid point in the student's answer. Maximum of 10 marks	10
Q3(c) (ii): Challenges of ensuring the “independence” of the members of the audit committee Award 1 mark for every valid point discussing challenges / problems limiting the "independence" of the members of the audit committee - using the model answer as a guide and also considering any other valid points raised in the student's answer. Maximum of 3 marks	3
Total marks for Question Three	**25**

MODEL ANSWER TO QUESTION THREE

Part (a): Client screening procedures relating money laundering - Kigali Furniture Co (KFC)

Money laundering is the process by which criminals attempt to conceal the true origin and ownership of the proceeds of criminal activity, allowing them to maintain control over the proceeds, and ultimately providing a legitimate cover for their sources of income. The objective of money laundering is to break the connection between the money, and the crime
that it resulted from. It is widely defined, to include possession of, or concealment of, the proceeds of any crime.

Examples include proceeds of fraud, tax evasion and benefits of bribery and corruption.

Client screening procedures related to money laundering specific to KFC should include the following:

Client identification:

- Establish the identity of the entity and its business activity e.g. by requesting management of KFC to share for your review the company's certificate of incorporation.
- Establish through inquiry and other independent verification (for example from the registrar of companies) the current list of principal shareholders and directors of KFC.
- Obtain official documentation of the individuals owning (or directors of) KFC, including for each individual, their full names and address – for example by looking at photographic identification such as their copies of national identity cards, passports and driving licenses.
- Consider and confirm that the commercial activity of KFC makes business sense – for example the company is not just a 'front' for illegal activities.
- Obtain evidence of the KFC's registered physical address e.g. by obtaining headed letter paper or through a review of the company's website (or by a physical visit of the offices of KFC).

Client understanding:

- Pre-engagement communication will have to be considered, to explain to Boaz Munezero and the other directors the nature and reason for initial client acceptance procedures before confirmation of a formal engagement.
- Best practice recommends that the engagement letter for the audit engagement of KFC's financial statements should also include a paragraph outlining the auditor's responsibilities in relation to money laundering.

Part (b): Forensic accounting – meaning and application to the KFC internal auditor's report

Forensic accounting is where an assurance provider investigates a specific issue, often with a legal consequence, such as a suspected fraud. Specifically, it is the process of gathering, analysing and reporting on data for the purpose of finding facts and/or evidence in the context of financial/legal disputes and/or irregularities.

The forensic accountant will also give preventative advice based on evidence gathered. This advice is based usually on recommendations to improve the internal control systems to prevent and detect fraud.

The relevance here is that our firm Manzi & Co, will likely to be asked to provide a forensic accounting service to KFC on the basis that the firm has a specialized department that among others services provides forensic accountancy services including where fraud is suspected.

If Manzi & Co is engaged to provide a forensic accountancy service to KFC regarding the potential fraud taking place at the KFC's store, the forensic investigation will consider two issues:

- Firstly, whether the fraud involving the theft of the chairs and tables is actually happening; and
- secondly, if a fraud has taken place, the financial value of the fraud.

The forensic investigation should determine the parties who have perpetrated the fraud at KFC store, and should therefore collect evidence to help prosecute those involved in the fraud.

In this case the suspicion that inventory is being stolen should be investigated, as there could be other reasons for the discrepancy found in the inventory records at the KFC store. For example, the discrepancy could be caused by:
- Obsolete or damaged inventory thrown away but not eliminated from the inventory records
- Dispatches from the warehouse not recorded in the inventory management system
- Incoming inventory being recorded incorrectly (e.g. recorded twice in the inventory management system)
- Inventory being held at a separate location and therefore not included in the count.

If it is found that thefts of the furniture have taken place, then our firm, Manzi & Co as the forensic accountant should gather evidence to:
- Prove the identity of the person(s) involved; and
- Quantify the value of inventory taken.

The evidence gathered and presented in our firm's report to the management of KFC could also be used to start criminal proceedings against those found to have been involved in the fraud.

Part (c)

(i) Role of the audit committee in improving the effectiveness of the external audit

The following are the roles and importance of a company's audit committee in improving the effectiveness / success of the external audit:

- Audit committees afford a means of strengthening the external auditor's independence. An audit committee is a committee of the governing body of a corporate entity which has delegated responsibility for the external financial reporting process and system of internal control.

- The development of audit committees which has varied from country to country has often been stimulated by corporate failure. Audit committees should assist the audit process by pre-empting unexpected corporate failure and undetected misconduct by senior officials.
- An audit committee can improve the effectiveness of the external auditor's work by increasing the assurance that the external auditors can derive from systems of corporate governance and internal financial controls.
- The audit committee will be involved in ensuring that the external auditor is independent and will participate in the selection of the auditor by recommending certain firms who have knowledge of their industry and reviewing the source and rationale for selecting certain firms of auditors.
- The terms and scope of the external audit and corporate governance engagement will be discussed, as will the management letter and its effect on the current year's audit.
- The audit committee will encourage discussions with the external auditor about how controls might be improved and the rationale for using specialist departments of the audit firm and specialist advisors.
- A meeting of internal auditors, external auditors and the audit committee will review the audit plan with a view to minimising duplication of work, the effect of new auditing standards and providing value for money for the company.
- The timing and nature of reports from the external auditors will be reviewed by the audit committee to assess the effectiveness of the auditor's reports and any contentious accounting issues discussed.
- The audit committee will make suggestions for the problem areas which the audit can address. The external audit partner and the chairman of the audit committee will discuss differences of opinion and attitudes of committee members and feedback on the performance of the auditors. The opening up of communication channels between the external auditor and the audit committee and two-way discussions enhances the quality of the audit and adds value to the audit process.
- The audit committee will further discuss with the internal and external auditor the intended scope of their work with a view to satisfying itself that no unjustified restrictions have been imposed by executive management.
- Additionally, the following duties of the audit committee may assist in the external audit process:
    - o dealing with difficulties in the performance of the audit such as non-availability of client personnel;
    - o reviewing the findings of the internal and external auditors;
    - o reviewing the company's financial statements and annual report prior to the submission to the board;
    - o reviewing public announcements that have a financial impact;
    - o reviewing and monitoring compliance with the corporate code of conduct and legal and statutory requirements.

Conclusion: Audit committees are seen as valuable not only for overseeing the external reporting process and external audit but as a means of ensuring responsible corporate governance. They are an aid in ensuring the professional independence of auditors and the efficiency and effectiveness of the audit and the system of corporate governance.

(ii) Independence of audit committee members where only a voluntary code is in place

The following problems create challenges for the audit committee to maintain their independence:

- The members of the audit committee generally comprise Non-Executive Directors (NEDs) and although they should be independent of the company and declare any interests in the company, the general absence of regulations in this area means that independence is often hard to achieve - for example, the NEDs often sit on committees of several companies and there are often no regulations as regards conflicts of interest in this area.
- The company pays the NEDs salaries and this fact ensures that independence is difficult to achieve under a voluntary code.
- The NEDs often sit not only on the audit committee but also on several other board committees making strategic contributions to the running of the business. They have to balance their role as audit committee member and the monitoring of executive directors and management with their role as corporate strategist. They are acting in several capacities and therefore their source of influence is somewhat diffused and because of the complexity of the NEDs' role it is difficult to imagine that they can act independently in exercising their corporate governance role.
- The internal structure of the company and the perception of the role of the audit committee by the main board will determine the ability of the NEDs'to exercise independent judgment which implies that their independence is driven by the main Board.
- NEDs may have previous executive involvement with the company and have participation in for example earning a financial performance bonus, share option schemes etc. which is inconsistent with the exercise of independent judgment. It is extremely difficult for an NED to exercise independent judgment when they have any interest in the company (e.g., retired executive director or significant shareholder), are appointed directly by executive directors and are remunerated by the company beyond a basic salary (e.g., bonus).

QUESTION FOUR

MARKING GUIDE –

QUESTION FOUR: TICK GAS CO ("TICK")	Marks
Q4(a): Tick's social and environmental performance indicators and evidence to provide assurance on their accuracy Award 1 mark for each valid social and environmental KPI relevant to Tick (should be linked to the information regarding Tick in the scenario and not merely generic points)	

Award up 1 mark for reasonable evidence that should be available to support Tick's social and environmental indicators *Note: It is acceptable for a student to justifiably adopt a tabular layout where they can indicate the performance indicators with the evidence alongside. In such a case where measures may be expressed as evidence (e.g. trophies awarded) marks will be awarded only once.*	
Total marks for Q4(a)	10
Q4(b)(i): The audit risks arising from Tick 's outsourced payroll and the auditor's response to the risk Award 1 mark for each well-explained audit risk related to Tick's outsourced payroll management and 1 mark for every valid point explaining the auditor's response. This should be specific to the information provided in the scenario and can be presented in a tabular format. Maximum of 4 marks	4
Q4(b)(ii): Additional factors to be considered during the audit of the payroll expense of Tick Award 1 mark for each well-explained point presenting an additional factor / matter that should be considered during the audit of the payroll expense (use the model answer provided as a guide and any other valid point raised in the student's answer shall be awarded). Maximum of 3 marks	3
Q4(c): Audit procedures - Presentation of Tick's segmental revenue information in the financial statements Award up to 1 mark for each valid audit procedure based on the model answer and/or any other valid audit procedure(s) provided by the student answers (where the 1 mark includes 0.5 marks for a correct "what - supported a valid source where applicable" and the other 0.5 marks for a valid "why or reason" relating to the financial statement assertion being tested	8
Total marks for Question Four	**25**

MODEL ANSWER TO QUESTION FOUR

a) Social and environmental responsibilities

Performance indicators

- Absolute amount (in FRWs) and relative (%) level of investment in sports sponsorship, and funding to the cancer ward.
- Increasing number of championship events and participating schools/students as compared with prior year(s).
- Number of medals/trophies sponsored at events and/or number awarded to Tick sponsored schools/students.
- Number of patients treated (successfully) at the cancer ward periodically (say) per week/month.

- Average bed occupancy of the cancer patients at the cancer ward periodically for example per day / week / month and the cumulative number to date.
- Staffing levels for example the number of Tick staffs volunteering at the sports events and at the cancer ward
  - For the Tick's staffs directly working in the production of the gas products:
    - ratio of starters to leavers / staff turnover;
    - absenteeism (average number of days per person per annum).
  - Number of:
    - breaches of health and safety regulations and environmental regulations;
    - gas spills;
    - accidents and employee fatalities;
    - insurance claims by Tick personnel and the general public relating to adverse effects suffered due to (say) Tick's gas production.

Evidence

- Actual level of investment (in FRWs) compared with budget and budget compared with prior period(s). You would expect actual to be at least greater than prior year if performance in these areas (health and safety) has improved.
- Physical evidence of favorable increases on prior year, for example:
  - medals/cups sponsored;
  - number of beds available.
- Increase in favorable press coverage/reports of Tick's sponsored sports and other events. Alternatively, a decrease in adverse press about accidents/fatalities at Tick's facilities.
- Independent surveys (e.g. by marine conservation organisations, welfare groups, etc.) comparing Tick favorably with other gas producers in Rwanda and/or other countries where Tick's operates from.
- A reduction in fines imposed on / paid by Tick compared with budget and the prior year.
- Reduction in legal fees and claims being settled by Tick as evidenced by legal fee notes and correspondence files.
- Amounts settled on insurance claims and level of insurance cover as compared with prior period.

Part (b)(i): Outsourcing the payroll – the related audit risks and the auditor's response to risk in planning the audit of Tick

Audit risk	Auditor's response
A detection risk arises as to whether sufficient appropriate audit evidence is available at Tick to confirm the completeness and accuracy of controls over payroll. If not, other procedures will be required to provide the necessary information	- Discuss with management the extent of records maintained at Tick and any monitoring of controls undertaken by management over the payroll expense. - Obtain a copy of the service organisation's Type 1 report (on description and design of controls) or Type 2 report (on description, design and operating effectiveness of controls), if available. - Consider the need, if any, to contact the service organization (Kobe), through Tick, to obtain specific information.
The payroll processing was transferred from 1 January 2025. Any errors occurring during the transfer process could result in misstatement in the payroll expense and related employment tax liabilities.	- Discuss with management how the transfer process was managed and any controls implemented to ensure the completeness and accuracy of the data. - If possible, perform tests of controls to confirm the effectiveness of the transfer controls. - Perform tests of details on the transfer of information from the old to the new system.

Part (b)(ii): Additional factors to be considered during the audit

- The auditor should determine the materiality of the payroll expense and related account balances and obtain an understanding of the services provided by Kobe (e.g., from the outsourcing contract and service level agreement).
- The auditor must identify controls in Tick's control activities that relate to the service provided by Kobe (including those that are applied to the transactions processed by Kobe) and evaluate their design and determine whether they have been implemented.
- If planning to use a type 1 report (on description and design of controls) or type 2 report (on description, design and operating effectiveness of controls), the auditor must evaluate the sufficiency and appropriateness of the information provided by the report.
- The auditor is responsible for obtaining sufficient appropriate audit evidence; therefore, no reference may be made in the auditor's report regarding the use of information from an assurance report provided by Kobe's auditors.

Part (c): Audit procedures for segmental revenue presentation of Tick

- Review the financial reports sent to the highest level of management to confirm the basis of segmental information that is reported internally and confirm that this basis is used in the notes to the published financial statements.
- Review Tick's organisational structure to confirm the identity of the chief operating decision maker (CODM).
- Discuss with management the means by which segmental information is reviewed by the CODM (e.g., through monthly financial reports and discussion at board meetings).
- Review board minutes to confirm that the segments as disclosed are used as the basis for monitoring financial performance.
- Discuss with management whether the incomes earned from installations and maintenance of gas equipment (under "other incomes") should be reported separately given that it appears to constitute a reportable segment contributing more than 10% of total company sales and is actively monitored.
- Obtain a breakdown of the revenue (e.g., by product line), to confirm that revenue has been appropriately allocated between the reportable segments.
- Perform analytical procedures to determine trends for each segment and discuss unusual patterns with management.
- Recalculate the revenue totals from the breakdown provided to confirm that they are reportable segments (i.e., that they each contribute more than 10% of revenues).
- Discuss with management the rationale and basis for the presentation of revenues based on product lines as the "primary" segmental information rather than the geographical revenue earned from the seven different countries (Rwanda and the six other African countries)
- Obtain a draft schedule of the disclosure notes to confirm a presentation of the segmental information based on product lines as the primary information and the geographical incomes as the secondary information.