



**CERTIFIED PUBLIC ACCOUNTANT
ADVANCED LEVEL 1 EXAMINATIONS
A1.2 AUDIT PRACTICE AND ASSURANCE
SERVICES**

DATE: TUESDAY, 24 AUGUST 2021

INSTRUCTIONS:

1. Time allowed: **3 hours and 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.

SECTION A

QUESTION ONE

Rebelo Ltd is located in Rubavu, in north-western Rwanda and manufactures masks and sanitizers. It employs several part-time staff, experts and sales agents. Its main customer is the government through the Ministry of Health, and Education for supply of masks and sanitizers to both public hospitals and schools. Other clients are private hospitals, schools, restaurants and individual businesses. Its accounting system is partly computerized which is integrated with a computerized database for regular customers, suppliers, creditors and debtors”

Rebelo Ltd products are in high demand due to surging use necessitated by the increased Covid-19 health measures locally and internationally. This is evidenced by its increased exports from 5% in 2019 to 55% in 2020 however the profit margin dropped from 22% to 13% respectively.

The turnover for the year 2020 was Frw 12 billion with a quarter of this being credit sales consequently boosting commissions to sales agents who were taking advantage of a relaxed credit policy of 45 days. Rebelo Ltd is in conflict with Rwanda Revenue Authority for not filing tax returns regularly and failure to maintain a transfer pricing policy documentation as per ministerial order on transfer pricing. This arises from imports of raw materials from its holding company KOVID Ltd in Kenya which amounted to over 70% of all Rebelo Ltd supplies. Secondly there is a litigation case with a major supplier for default of interest on an outstanding debt.

The company recently ventured into manufacture of Covid-19 Testing Kits, as directed by experts who professed that such business is lucrative given the increased demand for testing due to the surging covid-19 pandemic. Rebelo Ltd has so far purchased land, constructed the factory, installed processing machinery and research is complete on the models of the testing Kits. Samples of the testing Kits have been taken to Rwanda Standards Bureau and others donated to health centers for initial testing. Ministry of Health data shows that there are at least two district hospitals and eight Health centers in addition to the private hospitals in each District. However due to Rebelo Ltd inadequate distribution network and logistical nightmare these testing kits may not be available to all the 30 Districts. These may have a negative effect on the government acceptance and approval for their commercialization. Nevertheless, Rebelo Ltd has been selling some testing Kits to walk-in-customers with information relating being recorded manually and not frequently updated in the computer system.

In preparation for its commercial production of the Covid-19 testing Kits Rebelo Ltd has assembled a team of consultants and experts from Rwanda Biomedical Center (RBC) and production experts from Dawa Pharmaceutical Ltd. Their initial engagement terms will be for three years with their key performance indicator being benchmarking the testing Kits to international standards and ability to produce in full capacity.

You are a partner in Lowen and Associates, a firm of Certified Public Accountants in Kigali. You have just successfully tendered for the audit of Rebelo Ltd and ready to accept nomination. Given the complexity of Rebelo Ltd operations and the fact that your team does not have sufficient experience on some aspects of Rebelo Ltd operations, you have decided to use the

work of other auditors with wide experience in audit of biometrics. As a point of reference for future audits, you want to use this engagement to train staff in carrying out analytical reviews, writing audit reports and compiling a proper current audit file.

Required:

Explain to your team the following:

- a) According to ISA 315 “Identifying and assessing risks of material misstatements through understanding the client’s business and environment”, **explain the main aspects that the auditor should take into account in understanding Rebelo Ltd’s business and its environment that impact on the risks of material misstatements.** (20 Marks)

- b) Given that it may not be practically possible to distribute the testing kits to all the hospital and health centers in Rwanda, **explain to your audit team how the audit sampling can be applied in ensuring that the testing kits are distributed to all hospitals, health centers and schools with an adequate representation of the country.** (8 Marks)

- c) ISA 550 (Related parties) specifies that the auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence regarding the identification and disclosure by management of related parties and the effects of related party transactions that are material to the financial statements, **explain the work your audit team should perform in relation to Rebelo Ltd’s related parties regarding identification of and specific procedures for Related parties.** (8 Marks)

- d) **Discuss the factors you are going to consider in evaluating the reliability of using the work of component auditors and experts.** (8 Marks)

- e) **Since the testing have reached the pilot stage, explain the audit tests on development costs.** (6 Marks)

(Total: 50 Marks)

SECTION B

QUESTION TWO

a) International Standard on Auditing (ISA) 700 (Revised), Forming an Opinion and Reporting on Financial Statements, deals with the form and content of the auditor's report issued as a result of an audit of financial statements. One of the sections under the content, is "Responsibilities for the Financial Statements".

Required:

Describe the items included under the responsibilities of management and responsibilities of auditors on audit of financial statement. (8 Marks)

b) The audit manager in Mugisha & Certified Accountants is deliberating on the correct audit opinion from nine completed jobs. **You are required to determine the most appropriate auditors' opinion to be included in the auditor's report for each case.** (6 Marks)

S/N	Client circumstances	Appropriate Opinion
1	The business has suffered as a result of low consumer spending and increased competition in the last few years. You have commenced work on the current year audit and discussions with staffs reveal that the inventory stocktake was performed a few days ago at the warehouse without prior notice. No documentation or feedback from that stock take, except for a Frw 70,000,000 stock adjustment in the books, is able to be relayed to the auditors. You have discussed the issue with senior management, and they are aware that audit evidence is missing regarding the Frw 1 billion inventory balance held in the Malika warehouse. No alternative methods to validate the inventory balance are available to the auditors at this time. Total assets of Malika are Frw 3.8 billion.	
2	The audit of Malenge Ltd has proved extremely difficult, as the client did not maintain appropriate financial records during the year. The financial records were not updated for the first 10 months of the year as Malenge Ltd had no accountant during that period. An accountant was employed in May 2020, and tried to reconstruct records from the details of receipts and payments available. They were unable to reconcile the bank account, and the financial statements. The operating loss recorded by Malenge Ltd in the year is Frw 22,190,000	
3	Malo Dosali Limited is a major management consulting firm in Rwanda and the audit for 30 June 2020 is now complete. You have noticed some disturbing trends, with a 200% increase in revenue since last year despite the economy being relatively flat year-on-year. You have also noticed that management consulting projects are being accounted for differently compared to last year,	

	and include a much more aggressive revenue recognition policy in place. You and the audit partner have spoken to senior management about the inappropriateness of the accounting treatment; however, they have refused to change the accounting treatment or make any adjustments relating to these accounting policy changes in their financial statements. You estimate that if the accounting policy were to be changed to comply with the appropriate financial reporting framework, a downward (debit) adjustment of Frw 450 million would be required on the current profit of Frw 600 million for the year.	
4	The auditor identified a non-adjusting event which he considers needs disclosure in the financial statements but the directors refuse to include the disclosure?	
5	If the use of the going concern assumption is appropriate but a material uncertainty exists which has been disclosed.	
6	The directors of an entity are refusing to amend the financial statements to take account of a customer who went bankrupt after the year-end and who owed the entity Frw 9,000,000 at the year-end. This amount is material.	
7	The auditors have been unable to verify the value of year-end inventory held by an entity due to a fire in one of its premises which destroyed some records. The value of inventory affected is thought to be around Frw 15 million. Materiality is Frw 20 million.	
8	Auditor's report when they have been unable to obtain sufficient appropriate audit evidence for an issue that is material and pervasive to the client's financial statements	
9	There is a misstatement arising from the accounting treatment of an item that is material and pervasive to the client's financial statements?	

c) In line with ISA 700, "The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework" **Discuss the process of forming an opinion.** (5 Marks)

d) As COVID-19 pandemic increases in both magnitude and duration, entities are experiencing conditions often associated with a general economic downturn. **Explain the auditor's consideration on the impact of COVID-19 on financial performance of the entity.**

(6 Marks)

(Total: 25 Marks)

QUESTION THREE

In your capacity as the audit manager of KIT & CO, you have been tasked with audit of Timau Technology Ltd in preparation for listing on the Rwanda stock exchange whose listing rules require compliance with corporate governance principles. Your engagement audit partner has been requested by the directors of Timau Technology Ltd to review whether they are following best practice in relation to this.

Timau Technology Ltd is comprised of six executive directors, a non-executive chairman and three other non-executive directors (NEDs). The chairman and one of the NEDs are former executive directors of Timau Technology Ltd and on reaching retirement age were asked to take on non-executive roles. The company has established an audit committee, and all NEDs are members including the chairman who chairs the committee. All four members of the audit committee were previously involved in sales or production related roles.

All of the directors have been members of the board for at least four years. As the chairman does not have an executive role, he has sole responsibility for liaising with the shareholders and answering any of their questions. The company has not established a proper internal audit function to monitor internal controls but maintains a small internal audit department. The directors feel that the team needs to increase in size and specialist skills are required, but they are unsure whether to recruit more internal auditors, or to outsource the whole function to their external auditors.

Once listed it is required to comply with corporate governance principles in order to maintain its listed status; hence the finance director has undertaken a review of whether or not the company complies.

Required:

- a) **In reference to Timau Technology Ltd, evaluate the corporate governance weaknesses currently suffered by Timau Technology and recommend how each of the weakness can be addressed by the company in preparation for the stock market listing corporate governance requirements.** (12 Marks)

- b) **Explain the role of the auditor in consideration of laws and regulations as per ISA 250(Consideration of Laws and regulation in audit of financial statements).** (8 Marks)

- c) **Discuss the management responsibilities over laws and regulations governing the entity.** (5 Marks)

(Total: 25 Marks)

QUESTION FOUR

You are a manager in the forensic department of Kawase Certified Accountants. You have been informed that fraud has been perpetuated by Chelimo Ltd marketing staff who have been inflating and creating fictitious expenses on travel and entertainment expenses then claiming reimbursement. Precisely, the marketing staff have claimed on expenses for items such as gifts for clients and office supplies which were never actually purchased, claimed for business-class airline tickets but in reality, had purchased economy tickets, claimed for non-existent business mileage and used the company credit card to purchase items for personal use.

The managing director of Chelimo Ltd is very worried about the scale of this fraud, as travel and client entertainment are one of its biggest expenses. He has already suspended the suspected marketing staff awaiting an investigation, to which Kawase Certified Accountants is expected to conduct. It's the intention of Chelimo Ltd to prosecute these marketing staff if an investigation proves culpability, and also to recover the losses hence it is expected the investigation should come up with water tight evidence capable of withstanding court case.

Chelimo Ltd has a small internal audit department and the internal auditors estimate that Frw 4,5 million has been stolen in a payroll fraud, which has been operating since May last year. The audit engagement partner commented that neither tests of controls nor substantive audit procedures were conducted on payroll in the audit of the latest financial statements as in previous years' audits there were no deficiencies found in controls over payroll.

Required:

- a) **Explain the factors that indicate fraud in a company and describe the auditor's approach in relation to fraud during the conduct of the audit of a company's financial statements.** (10 Marks)
- b) **Explain the steps involved into a forensic investigation into the nature of fraud committed by staff in the marketing staff and the payroll fraud in Chelimo Ltd including examination procedures that should be used to gather evidence.**

(15 Marks)

(Total: 25 Marks)

End of question paper

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