CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATION

A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

DATE: FEBRUARY 2025

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

MARKING GUIDE AND MODEL ANSWER TO QUESTION ONE: KAMENGE Food Supply Ltd

a) Evaluate the risk of material misstatements to be considered in planning the audit of KAMENGE Food Supply Ltd. Make use of analytical procedures to identify the relevant risks.

Award 1 mark for each relevant calculated ratio up to a maximum of 5 marks.

Award 2 marks for each identified and evaluated risk up to a maximum of 10 marks.

NB: Only points that specifically relate to the scenario should be awarded marks. Generic points that do not refer to the case study should be awarded 1 mark. (Maximum 15 Marks)

b) Explain the use of analytical procedures in the audit of financial statements and its use at the various stages of an audit.

Award 1 mark for each procedure identified up to a Maximum of 5 Marks.

c) Describe the substantive procedures for the company's income generated from schools' food supply

Award 1 mark for each well-identified procedure up to a maximum of 6 Marks.

d) Briefly discuss matters to consider before relying on the work of internal auditors of KAMENGE Food Supply Ltd.

Award 2 marks for each relevant matter to consider (1 mark for identification and 1 mark for the explanation referring to the scenario (Maximum 10 Marks)

e) Advise the audit partner on why the auditor may decide not to seek re-election

Award 1 mark for each relevant consideration up to a maximum of 4 Marks.

f) Describe five additional audit procedures that may be performed to determine management's use of the going concern assumption while preparing the company's financial statements. *Award 1 mark for each procedure up to a maximum of 5 Marks*

g) Demonstrate governance matters that should be included in KAMENGE Food Supply Ltd.'s management letter. *Award 1 mark for each matter up to a maximum of 5 Marks*

Model Answers

Part (a) **10 Marks**

a) **Evaluate the risks of material misstatements to be considered in planning the audit of KAMENGE Food Supply Ltd. Make use of analytical procedures to identify the relevant risks**.

Analytical procedures will involve analyzing the trend from the previous financial year to the current financial year to assess whether any material variations may be a source of material misstatements in the financial statements:

Below are workings to identify any material variances that may occur:

	2023	**2022**
Operating margin	30,000/215,000*100 = 13.9%	37,000/190,000*100 = 19.4%
Return on capital employed	30,000/(229,000+110,000) = 8.8%	37,000/(201,000+82,000) = 13.07%
Interest cover	30,000/5,000 = 6	37,000/5,000 = 7.4
Current ratio	135,000/11,000 = 12.3	94,000/12,000 = 7.8
Gearing ratio	90,000/(90,000+229,000)*100 = 28.2%	80,000/(80,000+201,000)*100 = 28.5%

- The revenue is projected to increase by 13.2% in the year while the operating expenses will increase by 20.9%. This explains the corresponding reduction in the operating margin from 19.4% in 2022 to 13.9% in 2023. Consequently, the trend in the return on capital employed decreased from 13.07% to 8.8%.

- Based on additional note on impairment recognized during the year amounting to Frw 30,000,000, partly affects the operating expenses which are expected to increase by Frw 32,000,000. The operating expenses probably include Frw 30,000,000 impairment that was recognized yet the company policy does not amortize intangible assets based on its indefinite life policy. This does not seem to reflect the actual position of the company. This creates the risk that the operating expenses may be misstated and as a result the operating profit and profit for the year also misstated.

  Recommendation: Detailed audit procedures are needed to confirm possible omissions under the statement of profit or loss account and the financial statements in general.

- It is expected that revenues would decrease due to IYONGEZE rice being removed from the market. Contrary the revenues of the group increased. There is also the risk that the revenue may be overstated intentionally.

- The interest cover seems to be in the same range from 7.4 to 6, and the amount recognized is constant at Frw 5,000,000 each year. Since the group has taken a loan of FRW 10,000,000 at the start of the year, it is expected that the finance costs would increase on account of the interest accruing on the loan. Therefore, there is a high risk that the finance charges and the associated liability were omitted leading to an understatement of account balances.

- The current ratio has increased sharply from 7.8 to 12.3 and this could be indicative of possible misstatement under current liabilities and/or current assets.

  Recommendation: This needs to be discussed with management as part of the audit planning exercise to ensure that possible misstatements and/or misclassification are identified and rectified.

- The long-term loan account increased by Frw 10,000,000 owing to a loan that was taken by the company. The company agreed with Unguka Bank for a facility of Frw 14,000,000 as investment loan to acquire a subsidiary from a company competitor. This increase will impact the gearing ratio at an increasing rate, yet the financial statements indicate a gearing ratio of 28% in both years.

  Recommendation: There is a need to ensure compliance with IFRS 9 financial instruments to avoid understatement in liabilities. The company finances its assets from loans, and therefore loan omission may have a significant impact on the financial statements. Disclosure of these loans may not be done, and this presents a risk of non-compliance with the standards.

- A loan of Frw 10,000,000 was used to finance a specific new product development project. The development costs identified as intangible assets increased by Frw 15,000,000. The difference of Frw 5,000,000 is not explained by the analytical review made. Therefore, there is a risk that not all the amounts spent on the development costs have been capitalized thus understating assets.

  Recommendation: There is a need to obtain more clarification regarding development costs particularly the intangible assets recorded in the statement of financial position. The Frw 5,000,000 difference requires a thorough analysis.

- The retained earnings have increased by Frw 22,000,000 yet the group profit for the year is Frw 15,000,000, which creates an unexplained reconciling item between retained earnings brought forward and those carried forward. The difference may be due to the payment of dividends in the year, which appears unlikely. Besides, the annual investment in non-current assets was partly financed by undistributed dividends, which further validates the non-distribution of dividends.

Recommendation: This will require additional clarification from the company management to confirm the details and ensure there is no misstatement.

- The impaired amount of Frw 30,000,000 has been recognized as a result of a company product being removed from the market. However, the brand name intangible asset has reduced by Frw 15,000,000 in the year which means there is an unexplained difference of Frw 15,000,000 between actual variance and the expected variance.

  Recommendation: The audit team needs to verify whether the whole Frw 30,000,000 impairment recognized in the financial statements relates to the withdrawn brand. This will be highly material and a separate disclosure will be required which means there is a risk that the separate disclosures have not been done.

- There is a risk that the inventories are overstated if some of the items relating to the withdrawn brand are included within current assets. Any products relating to the withdrawn brand should be written down to the lower of cost and the net realizable value per IAS 2 – Inventories, which means that failure to do that will render inventories overstated as the net realizable value is likely to be zero.

- There is a possibility that the company failed to disclose impaired assets according to IAS 36 - Impairment of assets, due to non-current assets being used in the production of a product that is already withdrawn from the market.

  Recommendation: The audit team needs to check and confirm compliance with standards on impaired assets and, recommend accordingly.;

- If some legal action has been taken against the company by some customers, it is possible that some provisions have not been made as required by IAS 37 - Provisions, Contingent assets and Contingent Liabilities.

  Recommendation: The audit team needs to confirm whether there are no legal cases filed against the company over the claimed product. The result from the auditors' assessment will provide further guidance on what the company should do henceforth.

Part (b) 5 Marks

b) Explain the use of analytical procedures in the audit of financial statements and its use at the various stages of an audit.

Analytical procedures consist of the evaluations of financial information made by a study of plausible relationships among both financial and non-financial data.

Analytical procedures encompass the investigation of identified fluctuations and relationships that are consistent with other relevant information or deviate significantly from predicted amounts. Basically, using analytical procedures involves calculating ratios and analysing the meaning of changes in the ratios computed.

At the planning stage of the audit: Analytical procedures can be used at the planning stage of the audit. ISA 315 requires the use of analytical procedures during the risk assessment stage. Analytical procedures are used by the auditor to gain an understanding of the entity and its environment.

During the substantive stage of the audit:

Analytical procedures are an efficient tool used by auditors at the substantive audit stage where the objective is to detect material misstatements in the financial statements by comparing figures between the expected or trends with the calculated amounts. The process highlights where misstatements are likely to exist.

At the review stage of the audit:

At the review stage, analytical procedures are used to determine whether the financial statements make sense. Calculation of key ratios is done and any unusual ratios or fluctuations are investigated further.

Part (c) 6 Marks

Substantive procedures for the company's income generated from schools' food supply

- Obtain a list of purchase orders received and delivered from food bookings system to confirm the completeness and accuracy of the balance and agree to the trial balance.
- Compare the sales revenues per food bookings system and balance reported in the financial statements and investigate any significant difference.
- Compare sales per food booking system, sales per date from SAGE, and sales per financial statements and discuss with management any significant difference identified.
- For a sample of sales, obtain a purchase order, delivery note and sales invoices and reconcile them. Any significant variance should be discussed with management.
- For monthly donations, trace a sample of donations with their related supporting documents to ensure that they are recorded completely and accurately.
- Discuss with management and assess if there are no sales made out of food bookings system and/or cash received in hand. In case any transaction is found they should be assessed carefully including checking completeness of reported figures against those unusual transactions.
- Perform revenue analytical procedures based on orders received, prices and agree with reported balance. Any significant variance should be discussed with management.
- Cut-off should be tested under revenue collected. The focus should be on the few days before and after the cut-off date. As the audit team, you would request a detailed listing of

all transactions that occurred on the days around your cut-off date and request invoices to validate the transaction date.

Part (d) 10 Marks

Reliance on work of internal audit:

The internal audit division is one of the controls that are put in place by boards of most companies. The statutory auditors can place reliance on the work of the internal audit division depending on their assessment of the internal auditor's effectiveness. In placing reliance on the work of internal audit, the statutory auditors may reduce the amount of work they will carry out and thus reducing the total audit cost for the benefit of the client. The statutory auditors may also request the internal auditors to attend inventory count on their behalf in areas where they have not been able to attend.

Matters to consider before relying on the work of the internal audit dept of KAMENGE Food Supply Ltd.

Using the facts given in the scenario the following matters will be considered:

The technical competence of the internal audit team members: The internal audit division manager is a certified accounting technician. He failed to pass any CPA paper and this brings into question his understanding of the role and work of the internal audit division. Further, none of the other audit team members is professionally qualified. There is no requirement that internal auditors should be professionally qualified accountants but this is a good basis for assessing whether or not to rely on the work of the internal audit department.

The independence of the internal audit team and reporting: Internal auditors are employees of the entity and therefore lack the independence that the statutory auditors possess. Corporate governance guidance provides that in order to give the internal auditors some independence and hence objectivity they should report to the audit committee. Currently, the internal audit division reports to the Chief Financial Officer (CFO) and can only release reports on clearance from him. The CFO being the chief budget manager may dictate the work of the internal audit and hence doubt the reports of the internal audit. This brings more doubt on the quality of the work that the internal audit department will do.

Management's reaction to internal audit reports: If management implements the recommendations made by the internal audit department this will be a factor for the statutory auditors in deciding whether or not to rely on the work carried out by the department.

The quality of internal audit working papers and reports: If internal audit division has in place systems and maintains working papers for all its work the statutory auditor is more likely to place reliance on the work carried out by them. The audit reports produced by the internal audit division must be based on well documented evidence which can be verified.

How reliance on KAMENGE Food Supply Ltd Internal audit may be applied: If the firm concludes that the work of the internal audit division can be relied upon, the firm may reduce the extent of the substantive testing to be carried out. Further, the firm may rely on the work of internal audit in carrying out certain work such as ensuring perpetual inventory work is carried out per company regulations or having internal auditors attend inventory count in locations not visited by the statutory auditors.

Part (e) 4 Marks

Identify and explain why a firm may not seek re-election:

- The auditor may choose not to stand for ethical reasons, such as when he doubts the integrity of management. The auditor would be likely not to seek re-election (or to resign) in this case to avoid being associated with the client's poor decisions.
- Conflicts of interest may have arisen such as competition between clients or maybe he has been offered some lucrative work by the client and he may have to resign from the audit.
- The auditor may have a disagreement with the client such as in the formulation of accounting policies.
- The auditor may simply not want to reduce their audit fees.
- The auditor could have outstanding fees that may not be fully recovered due to a client's cash flow problem. The auditor may decide to chase for payment possibly affecting the relationship between the two businesses.
- The auditor could feel that he is no longer competent to perform an audit service and decide not to be considered for re-election.
- In the event of a potential breach of the guidelines, the auditor may decide not to seek re-election.
- An auditor may become involved in a situation where a conflict of interest arises between an existing audit client and another client of the firm and decide that stepping down as auditor of the existing audit client is the best course of action.
- A client could acquire one or several material overseas subsidiaries. If the audit firm does not have an associate office in the overseas location, the firm may feel that the risk and resources involved in relying on the work of other auditors is too great, and decide not to act for the client any longer.

Part (f) Additional audit procedures: 5 Marks

Review plans

The auditors should review management plans for future actions by gathering sufficient appropriate audit evidence to confirm whether a material uncertainty exists including evaluating any effects of management plans and other mitigating factors.

Reading minutes

The auditors should read shareholders, management, directors, and or any other relevant committee's minutes for reference to financing difficulties.

Inquiries

Inquiring of the company's lawyer should be conducted regarding the existence of litigation claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications,

Events after the period end
Review events after the period end to identify those that either mitigate or otherwise affect the company's ability to continue as a going concern.

Discuss with management
Analyse and discuss cash flow, profit, and other forecasts with management to ascertain their accuracy.

Written representation
Seek written representation from management regarding the company's plan and future actions.

Part (g) Management letter: 5 Marks

A management letter is a formal document typically issued by an external auditor to a company's management following an audit. It highlights the auditor's findings, areas of concern, and recommendations for improving internal controls, financial reporting, and operational efficiency.

The matters that should be included in KAMENGE Food Supply Ltd.'s management letter include the following:

Risks and exposures
The accounting software is not integrated with the food bookings system and the internal audit recommendations are not being implemented. These are some of the potential risks and exposures that should be included in the management letter including their potential effect.

Going concern
Since auditors already doubt the company's ability to continue as a going concern, this uncertainty should appear in the management letter backed up by their assessment.

Disagreements
It was observed that disagreements among staff exist within KAMENGE Food Supply Ltd. Besides, the financial statements were prepared based on a going concern basis with which the auditors disagree. This is a significant disagreement that must appear in the management letter.

Weaknesses
The weaknesses observed in the company's internal control system including non-implementation of the internal audit recommendations should be part of the management letter.

Scope
The company auditors should ensure that the general approach and scope of the audit are stipulated in the management letter including other matters mentioned in the engagement letter.

SECTION B

QUESTION TWO

Marking guide	**Marks**
Q2(a): Forensic auditing - its definition and its application to fraud investigations	
Award 1 mark for a reasonable/valid definition of "forensic auditing" (which should pick specifically the fact that this is a definition for "forensic auditing" NOT "forensic investigation" or "forensic accounting")	
Award 1 mark for each correct point where the answer provides an "application of forensic auditing" to a "fraud investigation". A maximum of 2 marks	
Maximum marks for Q2(a)	3
Q2(b): Ethical and professional issues raised by the request for your firm to investigate a suspected fraud	
Award 1 mark for correctly identifying that a fraud investigation is an example of a forensic investigation and therefore a "non-audit service" with ethical considerations for a firm of professional accountants.	
Award 1 mark for each valid point raised as a relevant ethical and/or professional issue arising from the firm conducting the fraud investigation requested by KSM.	
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 (to a maximum of 2 marks throughout this part of the question)	
Maximum marks for Q2(b)	7
Q2(c): Matters that should be discussed in the meeting with the management of KSM Ltd regarding the planning of the investigation into the suspected fraud.	
Award 1 mark for each valid matter/issue that needs to be discussed with KSM regarding the planning of the fraud investigation (a maximum of 6 marks). The 1 mark comprises of a 0.5 mark for correctly identifying "WHAT" issue is relevant for the discussion with KSM and the other 0.5 mark is awarded for "REASON/WHY" is the information needed.	
A maximum of 6 marks	6
Q2(d): Arguments for and against prohibiting auditors from providing non-audit services to their audit clients.	
Award 1 mark for every correct point explaining an "argument/reason why an audit firm should be prohibited from providing non-audit services to its audit client" (a maximum of 2 marks)	

Award 1 mark for every correct point explaining an "argument/reason why an audit firm should be allowed to provide non-audit services to its audit client" (a maximum of 2 marks)

Maximum marks for Q2(d)	4

Q2(e): Reliability of the systems on travel and customer entertainment expenses at KSM.

Award 1 mark for every correct procedure conducted to assess the reliability and integrity of systems at KSM for travel and customer entertainment expenses (maximum of 5 marks)	5
Total marks for Question Two	**25**

Model answer

Part (a): Forensic auditing - its definition and its application to fraud investigations

Definition

Forensic auditing is the process of gathering, analysing and reporting on data, in a pre-defined context, to find facts and/or evidence in the context of financial/legal disputes and/or irregularities and give preventative advice in this area.

Note: Credit will be awarded for a related definition deemed to be reasonable for example forensic auditing may be defined as 'applying auditing skills to situations that have legal consequences'.

Application to fraud investigation

Fraud is an example of an irregularity. A fraud investigation is just one of many applications of forensic auditing, where evidence about a suspected fraud is gathered that could be presented in a court of law. The pre-defined objective of a fraud audit is:

- to prove or disprove the suspicions;

and, if proven,

- to identify the persons involved; and
- to provide evidence for appropriate action, possibly criminal proceedings.

As well as being 'reactive', forensic auditing can be 'proactive' by being preventative where the techniques of forensic auditing can be used to identify fraud risks by managing them to an acceptable level.

Part (b): Ethical and professional issues raised by the request for your firm to investigate the suspected fraud.

An investigation into the alleged fraudulent activity is a forensic investigation. If Dushabe & Co CPA were to conduct the forensic investigation, this would be a non-audit service performed for an audit client. According to IFAC's *Code of Ethics for Professional Accountants*, before a firm accepts an engagement to provide a non-audit service to an audit client, a determination should be made as to whether providing such a service would create a threat to independence.

The self-review threat exists because the forensic investigation will determine the monetary amount of the fraud, and the amount which KSM Ltd will attempt to recover from the fraudsters. Given the potential scale of the fraud, it could be that the amounts involved are material to the financial statements and therefore, the audit team would be reviewing figures determined by members of the audit firm.

In addition, the forensic investigation team will review systems and controls over expenses claimed by KSM Ltd.'s employees. This means that the forensic investigation team is also exposed to a self-review threat, as they will be reviewing systems and controls that have been considered during the audit of KSM Ltd.'s financial statements.

The advocacy threat arises because going to court and speaking as an expert witness about the fraud would be seen as the audit firm promoting the interests of its client and supporting a position taken by management in an adversarial context.

A self-interest threat could also arise, as the forensic investigation may be a lucrative source of income for Dushabe & Co CPA. This could create the perception that Dushabe & Co CPA is reliant on KSM Ltd for income and this impairs the firm's objectivity.

The firm should evaluate the significance of these threats. In particular, the firm should consider the potential materiality of the amounts involved in the fraud, and the degree of subjectivity that may be involved in determining the amounts involved.

If the matter is material, and involves significant judgements, then no safeguards would reduce the threat to an acceptable level and the forensic investigation should therefore not be conducted by the audit firm.

It is likely, however, that the investigation would not involve a significant degree of judgement and the investigation could be performed as long as safeguards were used, such as:

- Having a senior member of the audit firm, who was not involved in the forensic investigation, review the results of the investigation and the impact on the financial statements;
- Performing a second partner review on the audit of KSM Ltd; and
- Ensuring that the forensic investigation is not performed by anyone involved in the audit engagement. Possibly the investigation could be performed by a different office of the firm.

The ethical situation must be discussed with those charged with governance of KSM Ltd. Depending on any relevant regulation in Rwanda, it may not be possible for the audit firm to carry out this non-audit assignment, or it may be permitted with the approval of those charged with governance (or an audit committee, if it exists).

Furthermore, the IFAC Code of fundamental ethical principles applies to all professional assignments, including forensic investigations. One of the fundamental principles is that of professional competence and due care. Forensic investigations are specialist assignments and may require very specific skills, which will not be possessed by individuals unless they have undergone specific training. Dushabe & Co CPA must consider whether any members of the firm possess the necessary skills before accepting the assignment.

Relatively senior staff will likely need to be assigned to the investigation, which will bring the necessary authority and experience to the investigation team. It should be considered whether Dushabe & Co CPA can divert senior staff from other assignments at short notice. Resourcing the team could be a problem.

In addition, confidentiality is a crucial issue in such investigations as members of the investigation team will have access to sensitive information which will be used as evidence in court. Any breach of confidentiality could jeopardize the integrity of the legal proceedings against the fraudsters. Anyone involved with the investigation should be aware of these issues including signing confidentiality agreements.

Part (c): Matters that should be discussed in the meeting with the management of KSM Ltd regarding planning of the suspected fraud investigation.

The following matters shall be discussed with KSM regarding the planning of the suspected fraud investigation:

- Discuss the purpose, nature and scope of the investigation. In particular, confirm whether the evidence gathered will be used in criminal proceedings and support of an insurance claim.
- Confirm that Dushabe & Co CPA's objectives are to identify those involved with the fraud, and to quantify the amount of fraud. This will help clarify the terms of the engagement, which will be detailed in an engagement letter.
- Determine the time scale involved, whether Augustin Habineza needs the investigation to commence as soon as possible and the deadline for completing the investigation. This is necessary to determine the resources needed to perform the investigation, and whether resources need to be diverted from other assignments.
- Enquire how many sales representatives have been suspended (i.e., those who are suspected of involvement in the fraud). This will help the firm to determine the potential scale of the investigation.
- Gain an understanding of the fraud came to light (e.g., was it uncovered by the internal audit team or a member of the sales department) and who reported their suspicions to Augustin Habineza. This information will indicate how the investigation should commence (e.g., by interviewing the whistle-blower).
- Determine whether KSM will provide resources to help with the investigation, e.g., members of the internal audit team could assist in obtaining evidence.

- Ask for Augustin Habineza's opinion on why the fraud had not been prevented or detected by the company's internal controls. In particular, enquire whether there has been a breakdown in controls over expenses authorisation.
- Determine whether recommendations to improve controls are required as an output of the investigative work.
- Discuss the investigative techniques that may be used (e.g., interviewing the alleged fraudsters, detailed review of all expense claims made by sales representatives, analytical review of expenses) and ensure that investigators will have unrestricted access to individuals and documentation.
- Enquire whether the police have been informed, and if so, the name and contact details of the person informed. A criminal investigation by the police will likely take place as well as KSM's investigations.
- Confirm that KSM grants permission to Dushabe & Co CPA's investigation team to communicate with third parties such as the police and the company's lawyers regarding the investigation.

Part (d): Arguments for and against prohibiting auditors from providing non-audit services to their audit clients.

Reasons why auditors should be prohibited from providing non-audit services to their audit clients:

- Prohibiting auditors from providing non-audit services would be a simple way to eliminate the threats to objectivity, which the provision of non-audit services to audit clients creates. Typically, management, self-interest, and self-review threats arise, which result in the perception that the auditor cannot be objective while performing such services.
- In particular, non-audit services can be very lucrative, leading potentially to a self-interest threat. The greater the volume and financial significance of the non-audit services provided, the greater the risk that the auditor will have a relationship and economic reasons not to challenge management's views and positions with the necessary degree of professional skepticism.
- It has also been argued that outright prohibition would benefit the market, allowing smaller audit firms to provide the services that larger firms would no longer be able to offer to their audit clients.

Reasons why auditors should be allowed to provide non-audit services to their audit clients.

- By having the same firm provide audit and non-audit services, the client benefits in two ways. The audit firm will already possess a good knowledge and understanding of the client and its operating environment, resulting in deeper insight and a better-quality service being provided. This will lead to cost benefits, as the non-audit service will be provided more efficiently.
- Audit firms would also argue that participation in services such as due diligence reviews and forensic investigations, allows the audit firm to understand their clients' business and

risks better, thereby obtaining insights into management's objectives and capabilities which are useful in an audit context.

- Non-audit services can be safely provided as long as steps are taken to assess potential threats to objectivity, and to adequately address those risks, for example, by use of separate teams to provide audit and non-audit services.

Part (e): Reliability of the systems on travel and customer entertainment expenses at KSM.

The approach to assess KSM's systems on travel and customer entertainment costs for reliability and integrity may be carried out along the following lines:

- Ascertain and assess the overall control environment of KSM in managing the travel and customer entertainment costs.
- Ascertain and assess the policies and procedures established by KSM to ensure, (as far as possible) that the specific entity objectives will be achieved and are explicitly reflected in the systems controls incorporated in the I.T systems design about the travel and customer entertainment costs.
- Ascertain and assess the methods and records established by KSM to identify, assemble, analyze, calculate, record and report the travel and customer entertainment costs to produce accurate, timely and reliable information.
- Perform a risk assessment exercise, including the business, inherent, control and detection risks regarding the management of KSM's travel and customer entertainment costs.
- Ascertain and assess the sufficiency of audit trails applied by the relevant personnel/departments at KSM for these expenses.
- Make inquiries of management, audit committee, and internal audit department of KSM in respect of systems reliability matters regarding expenses paid for by the company.
- Perform tests of control and substantive tests on a sample of the travel and customer entertainment costs (harnessing the use of CAATs where appropriate).

MARKING GUIDE AND MODEL ANSWER TO QUESTION THREE

MARKING GUIDE	**Marks**
Q3(a): Examination procedures that your team should undertake to provide reasonable assurance on Turaheza Developers Ltd.'s liabilities.	
Award 1 mark for each specific audit procedure that should be performed by the audit team to ensure reasonable assurance is provided on Turaheza Developers Ltd (3 marks on long-term loans, 3 marks on short-term loans, and 6 marks on provisions and contingent liabilities - a maximum of 12 marks).	12
Note: *- In addition to the matters raised in the model answer, any other valid matter raised in the student's answer that is relevant and specific to Turaheza Developers Ltd. shall qualify for a mark.*	
Q3(b): Examination of matters that Global Partner & Associates should consider in designing audit procedures to be performed on Turaheza Developers Ltd.'s liabilities.	
Award 0.5 mark for the challenge identified under the case study, 0.5 mark for the affected component identified, 0.5 for the correct effects identified, and 0.5 for correct consideration in designing audit procedures. A maximum of 8 marks to be awarded	8
Note: In addition to the consideration raised in the model answer, any other valid consideration/factor raised in the candidate's answer that is relevant and specific to consider in designing audit procedures of the Tubaheza Developers Ltd shall qualify for 1 mark (0.5 mark for challenge and 0.5 for factor to consider).	
Q3 (c): Award 3 marks for well-explained audit procedures and 2 marks for the correct audit opinion.	5
Total marks for Question Three	**25**

MODEL ANSWER TO QUESTION THREE

Part (a): Examination procedures that your team should undertake to provide reasonable assurance on Turaheza Developers Ltd.'s liabilities.

Specific audit procedures on liabilities

Provisions and contingencies

- Obtain a list of litigation cases under Turaheza Developers Ltd (TD Ltd) and their status as of 31st December 2023.
- Discuss with TD Ltd's management the rationale and basis of the provision's estimations.
- Obtain a representation from TD Ltd's management on the provisions made.
- Obtain minutes of TD Ltd's management meetings and correspondence with the entity's legal counsel.
- Request and assess management's assessment of the outcome of the litigation or claim and its estimate of the financial implications, including the costs involved.

- The Global Partner & Associates has to request and consider the status of legal matters up to the date of the audit report.

The audit manager should carry out additional audit procedures by seeking direct communication with the entity's legal counsel. Such communication will assist in obtaining sufficient appropriate audit evidence as to whether potential material litigation and claims are known and whether management's estimates of the financial implications, including costs, are reliable. When the auditor determines that the risk of material misstatement is significant, the auditor evaluates the design of the entity's related controls and determines whether they have been implemented.

Liabilities must always be tested for understatement. The audit objectives for liabilities are completeness, rights and obligations, and existence.

Long-term loans

- Obtain an analysis of long-term loan account balance and related interest of Turaheza Developers Ltd.

The analyses of long-term loans shall include:

  - Opening balance
  - Additional notes/bonds issued
  - Payments during the year
  - Closing balance

The schedule will also present the:

  - Opening balance of interest payable/ prepaid interest
  - Interest expense
  - Interest paid
  - Closing balance of interest payable/prepaid interest

- Review loan agreements and confirm with payees or appropriate third parties the principal, interest rates, maturity date, etc.
- Trace authorization for issuance of debt to credits to the long-term debt account.
- Review minutes of the board of directors' meetings for approval and/or progress in payments.
- Vouch loans and repayment transactions to supporting documents and review transactions occurring near year-end.
- Review payments of principal and renewals after the statement of financial position date.
- Recalculate interest expense and amortization of premium or discount.
- Ascertain the amount of long-term loans maturing within one year requiring current assets.
- Send confirmation letters to financial institutions to obtain information about financing arrangements.

- Evaluate the financial statement presentation and adequacy for disclosure of long-term loans.

Short-term loans

- Check whether all transactions falling under short-term loans under TD Ltd have been recorded in the financial statements and other necessary disclosures have been made.
- Confirm whether all transactions, events and other matters that have been recorded and actually took place during the year and relate to TD Ltd.
- Check whether all transactions including adjustments (if any) have been included in the financial statements at appropriate amounts accordingly and the relevant in the financial statements.
- Confirm if information is appropriately presented and disclosed, and disclosures are clearly expressed to make them understandable to the users.
- Confirm whether all transactions and events have been recorded in the correct accounting period.

Provisions and contingent liabilities

- Recalculate all provisions made and assess their reasonableness.
- Determine for each material provision whether the company has a present obligation as a result of past events by reviewing correspondences and discussions with directors.
- Obtain details of all provisions that have been included in the accounts and all contingencies that have been disclosed.
- Obtain a detailed analysis of all provisions showing the yearly movements.
- Determine for each material provision whether it is probable that a transfer of benefits will be required to settle the obligation by checking whether any payments have been made in the post balance sheet period in respect of the item and review of correspondence with solicitors, banks, customers insurance company, and suppliers.
- Compare the amount provided with post-year-end payments and with any amount paid in the past for similar items.
- If it is not possible to estimate the amount of the provision, check that there is disclosure in the accounts.
- Consider the nature of the client's business; for example, would you expect to see any other provisions such as warranties?
- Consider the adequacy of disclosure of provisions and contingencies.

General procedures under review of liabilities

The below are general audit procedures applied in auditing liabilities, with their corresponding audit assertions and objectives:

Assertions	Audit Objectives	Audit procedures
Existence or Occurrence Existence or Occurrence	To determine that long- term debts exist To determine that liabilities exist	Obtain an analysis of liabilities accounts and related interest, and premium.

Completeness	To determine that all transactions relating to long-term debts are properly recorded.	-Request authorization for issuance of debt to credits to the long-term debt account. -Vouch borrowing and repayment transactions and review transactions to supporting documents occurring near year-end.
Rights and Obligations	To determine that liabilities represent valid obligations of the entity.	-Review minutes of the board of directors' meetings. Review payments and renewals after the statement of financial position date.
Valuation or Allocation Valuation or Allocation	To determine that the liabilities are recorded at the proper amount.	-Recalculate interest expense and amortization of premium or discount if any. -Ascertain the amount of liabilities maturing within one year.
Presentation and Disclosure Presentation and Disclosure	To determine that liabilities are presented and disclosed accordingly.	-Send confirmation letters to financial institutions to obtain information about finance arrangements. -Evaluate liabilities presentation in the financial statement. -Examine the classification of obligation as either secured or unsecured.

Part (b): Examination of matters that Global Partner & Associates should consider in designing audit procedures to be performed on Turaheza Developers Ltd.'s liabilities.

The examination of matters and procedures have been arranged in a table below for easy tracking and presentation purposes *(note: this presentation format here is only for purposes of this model answer and therefore not a requirement for the candidates):*

#	Challenges/matters	Affected account	Effects on component	Consideration in designing procedures
1	Repayment delays from customers;	-Receivable -Long & short -term loans - Provisions	-Receivables increased more than twice (30,000 to 62,000 million) - Long and short-term loans also increased as the company relies on loans instead of cash received from customers. -Increase in provisions from 51,700 to 87,400 million.	Audit procedures should be designed in a way to ascertain this increase in receivables, long & short – term loans, and provisions.
2	Cashflow problems on the government side to pay back TD Ltd.	-Receivable -Long & short -term loans	-Receivables increased more than twice (30,000 to 62,000 million) - Long- and short-term loans also increased as the company relies on loans instead of cash received from customers.	Audit procedures should be designed in a way to ascertain this increase in receivables and long & short – term loans.

3	Delays under contract negotiation with prospective customers to buy completed houses	-Non-current assets -Cash -Short-term loans	- Non-current assets still belong to the company due to delays in selling. - Liquidity reduced from 44,000,000 to 1,200,000. - Short-term loans increased as the company relied on loans due to delays in finalizing contracts and realizing its own money.	Audit procedures should be designed in a way to ascertain this increase in non-current assets and short–term loans. Plus decrease in case to confirm any misstatement that may occur.
4	Failure from some customers to complete their payments and subsequently ending up in the auction process.	-Receivable -Long & short -term loans -Provisions	-Receivables increased more than twice (30,000 to 62,000 million) -Long & short-term loans continue accumulating due to failure from some customers. -The more the delays increase, the more provisions for bad debts for TD Ltd.	Audit procedures should be designed in a way to ascertain this increase in receivables and long & short – term loans and provisions.

Part (c): Additional audit procedures and auditor's opinion

To determine TD Ltd.'s ability to continue as a going concern, the following audit procedures should be performed:

- Analyse and discuss cash flow, profit, and other forecasts with TD Ltd.'s management,
- Inquire of the company's lawyer regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications,
- Confirm the existence, legality, and enforceability of arrangements to provide or maintain financial support with related and third parties and assess the financial ability of such parties to provide additional funds including owners' equity.
- Review events after period end to identify those that mitigate or otherwise affect the company's ability to continue as a going concern.

Audit opinion

In circumstances where TD Ltd. had made adequate disclosure in its financial statements, Global Partner & Associates should express an unqualified opinion but modify the report by adding an 'emphasis of matter' paragraph that highlights the existence of a material uncertainty and draw attention to this note in the financial statements.

QUESTION FOUR

MARKING GUIDE

a) Evaluate the benefits of outsourcing its internal audit function.

(i) Expertise and up-to-date knowledge	(2 Marks)
(ii) Authority/status	(2 Marks)
(iii)Resources	(2 Marks)
(iv)Reallocation of staff	(2 Marks)

Award 2 marks for any 4 well-explained points, **Maximum marks 8**

(b) Potential impacts on the external audit of Express Wedding Ltd.

(a) ISA 610 using the Work of Internal Auditors, and ISA 402 Audit Considerations Relating to an Entity Using a Service Organization.

(b) Extent of reliance on the work of Kigali Certified Public Accountants (KCPA) Ltd.

(c) The fees charged by the external audit providers could be affected.

(d)The internal auditors may suggest changes to accounting systems and controls.

(e)The control environment is likely to be improved over time.

(f) The external audit providers will need to consider access to records.

Award 2 marks for any 5 well-explained points up to a maximum of 10 marks.

(c) "Internal Audit and External Audit are not opposed to each other.

Award 1 mark on each well explained difference up to a maximum of 7 Marks.

QUESTION FOUR

MODEL ANSWER

a) **Evaluate the benefits specific to Express Wedding Ltd of outsourcing its internal audit function**.

(i) Expertise and up-to-date knowledge

The outsourcer should be able to provide expertise and up-to-date knowledge to enhance quality of work. This will be of benefit to Express Wedding Ltd as their current internal audit team has limited experience and qualifications so may not be fully competent.

(ii) Authority/status

The recommendations made by Rebecca are currently often ignored. By having anoutsourced internal audit function, their authority is less likely to be questioned.

(iii) Resources

The current size of the internal audit function of Express Wedding Ltd concerning the size of the business suggests that it is under-resourced. Outsourcing the function will allow an immediate increase in the resource base, meaning that more work can be quickly performed by the current staff.

(iv) Reallocation of staff

Rebecca and the rest of her team can be reallocated to other parts of the business. The finance team may benefit from extra resources if the company continues to grow.

(b) Explain the potential impacts on the external audit of Express Wedding Ltd if the decision is taken to outsource its internal audit function.

Impact of outsourcing on external audit

- The external audit providers should assess the impact of the outsourcing arrangement by reference to ISA 610 - Using the Work of Internal Auditors, and ISA 402 - Audit Considerations Relating to an Entity Using a Service Organization.

- The external audit providers should consider the extent of reliance they may wish to place on the work of Kigali Certified Public Accountants (KCPA) Ltd. More reliance will likely be placed on internal audit than previously,which should increase the efficiency of the external audit.

- The fees charged by the external audit providers could be affected by this reliance on internal audit. As Express Wedding Ltd is short of cash, the fee could be an important consideration for the company.

- The internal auditors may suggest changes to accounting systems and controls. When these changes occur, the external audit firm will need to document and evaluate the new procedures, which may be time-consuming.

- The control environment is likely to be improved over time. This means that external audit providers should reassess their audit strategy, which will probably mean a reduction in the extent of substantive procedures that need to be carried out.

- The external audit providers will need to consider access to records and working papers held by Kigali Certified Public Accountants (KCPA) Ltd, as information relevant to the external audit, especially with the testing of controls, is likely to be held by the service provider.

c) “Internal Audit and External Audit are not opposed to each other. Instead, they complement each other”.

BASIS FOR COMPARISON	INTERNAL AUDIT	EXTERNAL AUDIT
Meaning	Internal Audit refers to an ongoing audit function performed within an	External Audit is an audit function performed by an independent

	organization by a separate internal auditing department.	body which is not a part of the organization.
Objective	To review the routine activities and provide suggestions for improvement.	To analyze and verify the financial statements of the company.
Conducted by	Employees	Third Party
The auditor is appointed by	Management	Members
Users of Report	Management	Stakeholders
Opinion	Opinion is provided on the effectiveness of the operational activities of the organization.	Opinion is provided on the truthfulness and fairness of the financial statements of the company.
Scope	Decided by the management of the entity.	Decided by the statute.
Obligation	No, it is voluntary	Yes, according to the law relating to companies
Period	Continuous process	Once a year
Checks	Operational Efficiency	Accuracy and Validity of Financial Statement

End of marking guide and model answer