CERTIFIED PUBLIC ACCOUNTANT
INTERMEDIATE LEVEL EXAMINATIONS
A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES
DATE: FRIDAY 28 NOVEMBER, 2025
MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

Marking Guide

MUGABO INVESTMENTS	Marks
Part (a)(i): Application of professional skepticism the Finance Director's comment	**5**
Award 1 mark for each valid point raised in the discussion (includes a critical analysis of issues in Clement's comment that are assessed from a professional skepticism approach). Use the model answer as a guide	
Maximum marks for Q1(a)(i) - 5 marks	
Part (a)(ii): Audit procedures on the impairment of buildings of Mugabo investments	**4**
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 "audit procedure" and the other 0.5 marks for a valid "explanation" relating to the financial statement assertion being tested ***Note:*** *Marks will be awarded for other correct audit procedures (in addition to those provided in the model answer) as provided in the student's answer*	
Maximum marks for Q1(a)(ii) - 4 marks	
Part (b)(i) Forensic investigation procedures - the alleged bribery payments	
Award up to 1 mark for each valid forensic investigation procedure based on the model answer and/or any other forensic investigation procedure(s) provided by the student answers (where the 1 mark includes 0.5 marks for a correct "forensic investigation procedure" and the other 0.5 marks for a valid "explanation" relating to the objective of the forensic investigation being conducted ***Note:*** *Marks will be awarded for other correct forensic investigation procedures (in addition to those provided in the model answer) as provided in the student's answer.*	**4**
Maximum marks for Q1(b)(i) - 4 marks	
Part (b)(ii): information contents in the forensic investigation report and their importance to Mugabo Investments	
Award 1 mark for:	
- Each correct information included in a forensic investigation report (a maximum of 3 marks);	
- Each correct point explained as an illustration of the "importance to Mugabo Investments" of the information contents in a forensic investigation report (a maximum of 3 marks);	
Maximum marks for Q1(b)(ii) - 6 marks	**6**

Part (c): Preventative measures to be adopted by Kwizera & Co (an audit firm) to be protected from being used for money laundering purposes	
Award 1 mark for each well-explained point that briefly describes a relevant preventative measure that Kwizera & Co can apply to protect against being used for money laundering crimes.	**4**
Maximum marks for Q1(c)(ii) - 4 marks	
Jean Transporters Co (JTC).	
Part (d)(i): Calculation and justification for the preliminary materiality (to be used in the audit of JTC)	
Award 0.5 marks for each figure calculated including the lower limits and upper limits for the materiality benchmarks (i.e., revenue, profit before tax and total assets) Maximum 3 marks. In addition, 1 mark will be granted for a justified materiality range chosen (use the model answer as a guide for this mark allocation)	**6**
Award I mark each for a well-explained justification - including a reference to JTC being a new audit client (using the information scenario), including:	
- the justification for the lower limit	
- the justification for the upper limit	
Maximum marks for justification: 2 marks	
Maximum marks for Q1(d)(i) - 6 marks	
Part (d)(ii): Risks of material misstatements to be considered in the planning of the final audit of JTC (using analytical procedures)	
Award up to 3 marks (except where valid points raised are two or more) using the Risk of Material Misstatement (ROMM) marking guide provided below for the following ROMMs specific to the audit of JTC (but are not limited to):	
- Revenue	
- Trade receivables	
- Materials expense	
- Tangible non-current assets (owned and leased)	
- Depreciation and amortization charge	
- Lease liability	
- Finance costs	
- Other expenses ***Note:*** *Additional credit will be awarded where the student response assesses the potential risk of understatement for the other expenses from other reasonable grounds for example the potential underestimation of accrued expenses (e.g., it is possible that part of the restructuring liability brought forward from the prior year have been incorrectly reversed in the "other expenses" which will understate both the other expenses and restructuring provision in the liabilities)*	

or an incorrect capitalization of research expenses & development expenses in the internally-generated intangibles.	
- Restructuring provision	
- Intangible assets	
- Trade payables	
- Other liabilities	
-**Note:** *Credit will be given to other risks of material misstatements specific to the scenario. For example:* - *The 'time-sensitive delivery schedules might give rise to penalties or claims, that could result in understated provisions or undisclosed contingent liabilities.* - *The risks related to the disposal of the depots and assets in the closed deposits including the fact that the statement of profit or loss does not provide a separate presentation of any gain/loss from the disposal (but Do Not Award (i) where the student answer explains a need for a separate presentation for non-current assets held for sale as these assets had actually been disposed by the reporting date; (ii) where the student's answer is wrongly interpreting the disposal as a "discontinued operation")* - *Given that this is a new audit, and the result has changed significantly (from loss to profit), it might suggest a risk of misstatement in the opening balances (and hence comparative information).*	
The ROMM marking guide for each correctly identified ROMM 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) 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 JTC to "identify" the potential ROMM (taking 0.5 marks of the allocated 1 mark) and go ahead to explain or recognize 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)	

- Management bias (refer to the model answer). ***Note:*** *Credit will be given to other explained risks relating to management bias in other areas if the student correctly links them as additional risks related to management bias (all up to a maximum of 4 marks across the entire question).*	
Materiality marks: Award 1 mark for every correct reference to the student's justified materiality (as picked from part (d)(i)) and must make a correct conclusion. Maximum marks for materiality is 4 marks ***Note****: Credit will be awarded where the materiality for tangible non-current assets is* ***alternatively*** *assessed based on the figures provided as "additions of assets" during the year.*	
Other calculation marks (other than materiality): Award 0.5 marks for each correct calculation that has been USED in the answer. Note that the calculation mark is only awarded where the student goes ahead to use the figure in their explanation and this may be as part of analytical procedures (it does not matter whether the explanation is correct or wrong). The calculation marks will be awarded a maximum of 4 marks	
Note: Do Not Award:	
Generic (speculative) risks developed from rote-learning which are not supported by the information given in the scenario	
Detection risks points (e.g., opening balances) as the question is examining risks of material misstatements which do not extend to detection risks.	
Accounting applications for listed entities such as IFRS 8 "Segmental reporting", IAS 33 "Earnings per share" etc. as JTC is a private company (as mentioned in the scenario).	
Maximum marks for Q1(d)(ii) - 15 marks	15
Part (e) (i): Audit procedures on the carrying amount of Motor vehicles	
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. ***Note:*** *Marks will be awarded for other correct audit procedures (in addition to those provided in the model answer) as provided in the student's answer.*	3
Maximum marks for Q1(e)(i) - 3 marks	**3**
Part (e) (ii): Audit procedures on the carrying amount of (ii) Trade receivables	
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.	3

***Note:** Marks will be awarded for other correct audit procedures (in addition to those provided in the model answer) as provided in the student's answer*	
Maximum marks for Q1(e)(ii) - 3 marks	**3**
Total marks for Question One	**50**

Model Answers

a) Application of professional skepticism to the comment made by Clement

The Finance Director (Clement) stated that the audit team should not ask for additional evidence beyond the file documentation on the impairment loss computations and/or stating that the audit team should utilize the working papers for the prior year to confirm the adequacy of the assumptions applied by management which is evidence that Clement is attempting to direct how the audit work on the impairment loss calculations should be performed.

In an independent audit engagement, the audit manager should decide the extent of audit procedures in response to the risk of material misstatement identified in the measurement of the impairment loss and should not be directed by the client's management (in the case the client's Finance Director).

The audit manager should consider the probable reasons why Clement is insisting that the management-prepared file documentation should be the only source of audit evidence for the recognized impairment loss as he may be hiding something relevant to the impairment which would be revealed if the audit team reviews other sources of evidence.

In the financial statements for the year-ended 30 June 2024, the impairment loss recognised of FRW 50 million is 0.8% of the profit before tax and 0.06% of the total assets which makes it immaterial to the financial statements.
However, on further review, the company's profit before tax has fallen by 33.3% in 2024 compared to the prior year 2023, indicating that a significant impairment loss amounting to more than the FRW 50 million calculated by the client's management may need to be recognised. There is a risk of material misstatement in that the impairment loss is understated resulting in overstated assets. This may be due to management bias to report a high profit in the financial statements, which is not appropriate.

The auditor therefore needs to be skeptical and alert to factors that may indicate that the actual impairment loss is greater than that calculated by management. Impairment testing is a complex and subjective area and could be easily manipulated by management wishing to reduce the amount of the impairment loss recognised.

The audit manager should obtain corroboratory evidence regarding the assumptions used and not just confirm that the assumptions are in line with management's risk assessment. The reliability of this source of evidence is not strong as it is prepared by management. An important part of professional skepticism is challenging management's assumptions, especially in an area of high judgment such as impairment testing.

In addition, the auditor should not only rely of the information documented in prior year audit working papers as the circumstances / indicators that triggered an impairment loss review on the buildings may have changed from those of the prior year.

The chief internal auditor checking the figures is also not a reliable source of evidence on grounds that the chief internal auditor is an employee of the client making his review a type of a client-generated evidence which cannot be as reliable as the auditor's own generated evidence. On the basis that the Finance Director is proving to be a domineering person, it is also possible that the chief internal auditor may have been pressured to confirm the management's calculations.

Professional skepticism should also be applied to Clement's comment that the management assumptions applied in the computation of the impairment loss on the buildings are the same as assumptions applied in the prior years.

New factors impacting on impairment may have arisen during this year, affecting the determination of the impairment loss and the audit team should seek for up-to-date evidence on the assumptions used in this year's calculation.
The audit team should also remain alert when auditing balances and transactions other than the non-current assets in case there are other areas where Clement does not appear to be providing all evidence required or where he is directing the audit approach to be taken.

While his comment does not seem to be intimidating in nature, the audit team should recognise that if Clement does have something to hide in relation to the impairment loss of the buildings, he may become more aggressive during the audit process, in which case the matter should be brought to the attention of the Kwizera & Co.'s ethics partner and in addition should be discussed with those charged with governance of Mugabo Investments.

Part (a)(ii): Audit procedures to be performed on the impairment of buildings

- Confirm that the assumptions used in the impairment test are consistent with the auditor's understanding of the business based on the current year's risk assessment procedures (e.g. assess the reasonableness of assumptions on cash flow projections).
- Confirm that the impairment review includes all the buildings and other related assets affected by the indicators to ensure completeness of the impairment loss computation.
- Obtain an understanding of the controls over management's process of performing the impairment test including tests of the operating effectiveness of any controls in place (e.g. over the review and approval of assumptions or inputs by appropriate levels of management and, where appropriate, those charged with governance).
- Evaluate management competence in computing the impairment loss by assessing the accuracy of management calculations in the prior years
- If management used an expert to assess the impairment loss, evaluate the independence, experience and competence of the expert in relation to the impairment loss review of the type of buildings of the client.

- Review the Board meetings to confirm the discussions of the details of the impairment loss and the amount of impairment loss approved by the Board for recognition in the financial statements.
- The methodology applied to the impairment review should be checked by the auditor, with inputs to calculations (e.g. discount rates, agreed to auditor-obtained information).
- Develop an independent estimate of the impairment loss and compare it to that prepared by management.
- Confirm that the impairment calculations exclude cash flows relating to tax and finance items.
- Perform sensitivity analysis to consider whether, and if so how, management has considered alternative assumptions and the impact of any alternative assumptions on the impairment calculations.
- Check the arithmetic accuracy of the calculations used in the impairment calculations.

Part (b)(i): Procedures to be used in performing a forensic investigation on the alleged fraud committed (bribery payments)

- Interview the suspect (the senior marketing officer) and inquiring about the nature of and the rationale for making cash payments to the customers prior to the signing of the contracts.
- Use automated tools and techniques (e.g., CAATs) to identify all new customers in the year and any payments made to these customers and total the amounts to determine the amount of potential financial loss suffered by Mugabo Investments.
- Review the terms of the contracts with customers for any details of payments included in the contract and understand the business rationale for any such payments.
- Review the email and other correspondence entered into by the senior marketing officer and the new customers for any further information about the cash payments (e.g. specifically who the payments were discussed with).
- Perform tests of control on the authorisation of cash payments to find out if these payments were known to anyone operating in a supervisory capacity.

Part (b)(ii): information contents that will be included in the forensic investigation report
The report on the foreign investigations reported to Mugabo Investments shall include the following:

- Executive summary and scope of investigation: This shall include the information regarding the background of the suspected bribery case, objectives of the investigation, and the period and documents examined. This section includes the methodology used, and a summary of the conclusion reached. This information will help Mugabo Investment Management to have a clear picture of the bribery case has occurred and the auditor's conclusion in this regard.
- Findings and their analysis: This indicates in details the evidence gathered during the review of the case and show whether or not bribes occurred and how they were executed (if occurred). The information under this section will enable Mugabo Investment to

understand in details how bribery to customers was committed and how possible controls that can be put in place to avoid future occurrence.

- A findings regarding who was involved in the fraud and how the fraud was committed by the fraudster (e.g., due to poor internal controls) with a summarized list of evidence supporting these findings. This will help the company identify any internal controls gaps that allowed the fraud to occur.
- A computation of the potential financial loss suffered by the company. This will enable the company take actions for a recovery of a known amount of a financial loss including a legal action against the fraudster(s) and/or a claim for an insurance compensation.

- Recommendations on the improvement of the internal controls which will be applied by management to avoid a reoccurrence of the fraud in the future

Part (c): Preventative measures to be adopted by Kwizera & Co in combating money laundering exposure as a firm of accountants

Developing programs

– Kwizera & Co should establish and document internal policies, procedures and controls including:

- Compliance management arrangements (including appointment of a compliance officer);
- An ongoing employee training program.
- An audit function within the firm to test the system.

Money Laundering Reporting Officer (MLRO)

– Kwizera & Co. should appoint a MLRO who should have a suitable level of seniority in the firm (at a partner level) and experience.

– The MLRO should be responsible for receiving and assessing money laundering reports from firm's personnel, make a report to the regulators and ensure that individuals are adequately trained.

– The firm should make alternative arrangements (e.g. appointing a deputy) when the MLRO is unavailable for a period of time as the money laundering reports have to be made as soon as is reasonably practicable.

Employee training program

– Kwizera & Co should provide an employee training program on the relevant legislation regarding money laundering (e.g. the main money laundering offences), the ethical guidance (e.g. IFAC's guidance for accountants') and the firm's procedures to anticipate and prevent money laundering.

– The firm may apply training methods for the firm's personnel that will include attending conferences, seminars and training courses on anti-money laundering with such trainings conducted by external organizations.

– Kwizera & Co should maintain documentation on the money laundering training provided to the firm's personnel (to demonstrate compliance).

– Kwizera & Co should establish a culture within the firm where the firm's personnel should always ensure compliance with money laundering requirements.

Customer due diligence (CDD)

– Kwizera & Co should always verify the identity of its clients, when:
  - o Establishing business relations.
  - o Carrying out occasional transactions (e.g. an engagement with a client whose fees are set at an amount above a designated threshold);
  - o There is a suspicion of money laundering or terrorist financing; or
  - o There is doubt about the reliability or adequacy of previously obtained customer identification data.
- Kwizera & Co should implement CDD the following measures to both its new clients and existing clients on the basis of materiality and risk:
  - o Identifying the client and verifying that customer's identity using reliable, independent source documents, data or information.
  - o Obtaining information on the purpose and intended nature of the business relationship.
  - o Conducting ongoing due diligence in business relationships by scrutinizing transactions to ensure that they are consistent with the firm's knowledge of the customer, their business and risk profile and the source of funds.

Record keeping

Kwizera & Co should:

– Maintain a full audit trail record for each of its clients that includes full client identification records together with a record of all transactions with each client.

– Maintain records of transactions for both domestic and international clients in a readily retrievable form for a period of at least five years to facilitate swift compliance with information requests from the competent authorities. Such records must be sufficient to permit reconstruction of individual transactions (including the amounts and types of currency involved, if any) so as to provide, if necessary, evidence for prosecution of criminal activity.

- Retain client verification records throughout the period of the relationship and for at least five years after termination of the relationship.
- Make available to the relevant authorities the firm's client identification data and transaction records when required by the authorities.
- Apply IFAC's Rules of Professional Conduct regarding to the 'Retention of books, files, working papers and other documents'.
- Pay special attention to all transactions identified during its engagements with the client where such transactions are complex, unusual large transactions, unusual patterns of transactions, which have no apparent economic or visible lawful purpose (in accordance with ISA 240 'The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements').

Client identification

In terms of client identification, the following measures will be important for the different types of clients of the firm:

- For an individual (e.g., a director of an audit client): Kwizera & Co should inspect official documents like a driving license or passport and a recent utility bill (with a photograph) to establish the client's full name and permanent address.
- For the entity: Kwizera & Co should obtain from the Registrar of Companies the company's certificate of incorporation, the registered address and a list of shareholders and directors. Kwizera & Co should check the names of new clients against lists of known terrorists and other sanctions information.
- For trusts: Kwizera & Co should ascertain the nature and purpose of the trust, the original source of funding; and the identities of the trustees/controllers, principal settlers and beneficiaries.

Suspicion reporting

- Kwizera & Co should ensure the firm promptly reports money laundering suspicions to an appropriate authority by submitting a suspicion transaction report. The reporting should be done irrespective of the amount involved or whether tax matters are involved.
- The firm must ensure confidentiality of the source of suspicion transaction report by not naming the personnel making reports to the MLRO.
- Kwizera & Co should disclose additional information only if this is legally required or if this is justified (e.g., this is done in the public interest).

Maintain firm-wide anti-money laundering (AML) policies and the related staff training:

- Kwizera & Co should have strong AML procedures including internal reporting lines, whistleblowing channels, and regular staff training so that employees understand how to identify and report ML red flags such as bribes, unexplained cash payments, or attempts to conceal transactions.

Continually monitoring of the client activities:

During the engagement, Kwizera & Co should continuously monitor transactions, unusual cash movements, and high-risk behaviors. Any suspicious cash payments made by the marketing officer should trigger internal escalation and further investigation.

Note: The question only required four measures to be briefly discussed.

Part (d)(i): Determination of the preliminary materiality and its justification

Preliminary materiality calculation		
Sales Revenue	**0.5%**	**1%**
Year to 30 June 2024: Based on sale revenue of FRW 12,920 million *(computed in FRW million)*	65	129
Profit before tax	**5%**	**10%**
Year to 30 June 2024: Based on the profit before tax of FRW 288 million *(computed in FRW million)*	14	29

Total assets	**1%**	**2%**
Year to 30 June 2024: Based on total assets of FRW 8,304 million *(computed in FRW million)*	83	166

A suitable range for preliminary materiality is FRW 83 million – FRW 129 million.
Justification for the amount considered as the preliminary materiality

- Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues. ISA 320

- Therefore, as revenue are stable (Frw 12,920 million of 2024 vs Frw 11,552 million of 2023) compared to profit before tax (a profit of Frw 288 million in 2024 compared to a loss of Frw (64) million in 2023. Hence a materiality beck mark was chosen to be of total sales Revenue.
- Sales revenue was used as benchmark as it large, stable and less volatile compared to profit. Compared to profit before tax which fluctuated significantly year-on-year. Therefore, using Profit before tax may give a misleadingly threshold.

We shall use 1% is due to fact that:

- It is conservative but reasonable
- It is within the ISA acceptable range
- It avoids over- or under-stating materiality

Part (d)(ii) Risks of material misstatements

Increase in sales revenue: Sales revenue increased by Frw 1,368 million representing 12%. Revenue is recognized after deduction of trade discount that have been granted during the year. Given, that this discount calculated on cumulative basis and awarded on quarterly basis and in arrears, there is a possibility that these were not considered as at the year end and recorded in the next financial year. In addition, cumulative quarterly performance may be complex and pose risk of incorrect deduction of trade discounts if no proper filing and reconciliation is in place. Further, there is a possibility of overstatement of revenue and discount payable due to Cut-off issues from recognizing discounts quarterly in arrears.

Management bias
There is a risk of management bias applied in the preparation of the financial statements especially the reported profit before tax which has significantly increased from a loss in the prior year to a profit amount in the current year. This may be due to management pressure to report a profit from which the senior management team earns a bonus. Management may have intentionally misstated the financial statements through creative accounting practices for example deliberately understating the provision for doubtful debts through a significant reduction of the rate from the 5% applied in the prior year to a 2% in the current year for the doubtful debts.

Revenue and trade receivables

In accordance with IFRS 15 *Revenue from contracts with customers*, revenue is recognized at an amount that takes into consideration the trade discount and volume rebates granted to the customers. Revenue has increased by 11.8%. The risk is that the trade discounts granted to customers may not appropriately computed and /or the discounts may not have been accounted for in full especially as the discounts are calculated in arrears every quarter with the potential the trade discounts for the last quarter (April-June 2024) not having been recognized yet. This will result in overstated revenue and trade receivables.

In accordance with IFRS 9 *Financial instruments*, a trade receivable is adjusted by an appropriately supported estimated rate for a doubtful debt which is recognized in full at the reporting date with the estimated bad debt recognized in the profit or loss. The risk is the provision for doubtful debts may have incorrectly been underestimated at a lower rate of 2% compared to the 5% rate applied in the prior year especially if JTC has only commenced the application of the revised credit terms with the customers where no evidence of improvement on debt collection is registered. This will lead to an overstated trade receivable balance and an understated expense if sufficient allowances have not been made for the impairment of individually significant balances.

Trade receivables have increased by just 2.2% (although sales increased by 11.8%) and may be understated due to a cutoff error resulting in an overstatement of cash receipts.

The trade receivables balance of FRW 1,096 million is above the upper materiality limit set at FRW 129 million and therefore material to the financial statements.

Materials expense

IAS 1 Presentation of financial statements requires an entity to appropriately present its transactions in the appropriate transaction categories on the face of the financial statements for example expenses should be correctly presented in their right expense categories. The draft financial statements.

Materials expenses have increased by 17.8%. This is more than the increase in revenue of 11.8%. This could be legitimate (e.g. if fuel costs have increased significantly). However, there is a risk that the increase in the materials expense may be due to misclassification of expenditure for example where JTC may have incorrectly charged capital expenditure (e.g. on overhauls or major refurbishment) as revenue expenditure which will result into overstated expenses and understated assets.

Material expenses of FRW 7,040 million are above the upper materiality limit set at FRW 129 million and therefore material to the financial statements.

Tangible non-current assets (owned and leased), depreciation and amortization charge

IAS 16 Property, plant and equipment requires an entity to charge a depreciation on an asset in the reporting period based on systematic rate of entity's consumption of the related asset with the depreciation charge recognized in the profit or loss. IFRS 16 Leases requires the entity to depreciate the right-of-use asset on a straight-line method over the shorter of the lease period and the estimated economic useful life of the asset.

This depreciation and amortization charge has decreased significantly by 28.4% when compared to the prior year. This could be valid (e.g. if JTC has significant assets already fully depreciated or the asset base is lower since the closure of some distribution depots and the disposal of the assets in the closed depots. However, there is a risk of understatement if not all assets have been depreciated or assets have been depreciated at the wrong rates / wrong useful lives for example if depreciation for the right-of-use assets is not correctly based on the lower of the lease period and the useful life of the related assets. This will result in understated expenses and overstated assets.
The depreciation charge for motor vehicles represents only 7% of the cost. If all items were being depreciated on a straight-line basis over eight years this should be 12.5%. The depreciation on other PPE items is more reasonable as it amounts to 14%, which would be consistent with an average age of vehicles of seven years.

The significant decrease in the depreciation / amortization charge will be driven by management bias where management could have deliberately under recognized the expense in order to report a high profit linked to the bonus payable to the senior management.
The depreciation and amortization charge of FRW 544 million is above the upper materiality limit set at FRW 129 million and therefore material to the financial statements.

The net carrying value of the tangible non-current assets fell from FRW 6,648 million to FRW 6,312 million representing a 5% decrease. The 5% total decrease is seen to be represented by a decrease in Land and buildings of 4.7%, an increase in motor vehicles of 2.5% and a significant decrease in the "other PPE items" of 20.4%. The significant rate of decrease in the "other PPE items" raises suspicion since it is the PPE category with the least amount of value compared to the other categories of the tangible non-current assets and therefore, there is a possibility of overstated depreciation charge on the "other PPE item" category that may have overstated the depreciation expense. In addition, the motor vehicles that have instead increased in their net carrying amount may be overstated if the disposed vehicles have not been fully de-recognized or depreciation of the vehicles has been undercharged for example if it is not charged for a whole year.

Lease liability and finance costs
In accordance with IFRS 16, a liability is initially measured using the present value of the future lease payments which is based on an interest rate implicit in the lease contract or in its absence, using the incremental borrowing rate of the lessee.

There is a risk that the initial measure of the lease liability may have been computed incorrectly for example if an incorrect interest rate was used in the absence of an interest rate implicit in the contract or if wrong cash flows have been applied in the calculation especially since this is the first time JTC is engaging in a lease arrangement. This will have resulted in an over / under stated lease liability and right-of-use asset on the initial recognition that took place on 1 July 2023.

IFRS 16 further requires the entity to subsequently measure the lease liability by an increase based on the finance charge and a decrease based on the lease rental payment made in the year. The risk is that an incorrect lease liability balance may be reported in the financial statements if either a wrong finance charge has been added on the lease liability (using a wrong interest rate) or if the lease liability has been reduced by the lease rental (when the lease contract stipulates that the first lease payment will be made on 1 July 2024 which will be after the end of the financial year). The increase in the finance costs in the profit or loss of 31.8% is significantly higher than the 22.7% increase in the lease liability balance and this significant variation may partly have related to this misstatement resulting in an overstated expense and lease liability.

However, although the lease liabilities have increased by 22.7%, there is a greater risk of understatement than overstatement if some of the leased assets are not capitalized and recognized on the statement of financial position. This will imply that the assets and liabilities are understated.

The lease liability balance of FRW 432 million is above the upper materiality limit set at FRW 129 million and therefore material to the financial statements. In addition, the finance costs of FRW 232 million are also above the upper materiality limit set at FRW 129 million and therefore material to the financial statements.

Other expenses and restructuring provision

The other expenses have fallen by 15.5%. They may have fallen (e.g. following a reversal of the restructuring liability brought forward from the prior year) or may be understated due to expenses being misclassified as materials expense for example if JTC has incorrectly reported indirect costs like administration fuel expenses in the "materials expense" category rather than reporting these in the "other expense category" category resulting in an understated amount in the "other expenses"

The restructuring provision that was made last year has fallen/been utilised by 10.2%. There is a risk of overstatement if the provision is under-utilised/not needed for the purpose for which it was established.

The other expenses of FRW 1,568 million are above the upper materiality limit set at FRW 129 million and therefore material to the financial statements. Also, the restructuring provision balance of FRW 776 million is above the upper materiality limit set at FRW 129 million and therefore material to the financial statements

Intangible assets

In accordance with IAS 38 Intangible assets, development costs are only capitalized as intangible assets if the recognition criteria in IAS 38 is satisfied.

The intangible assets have increased by 16% in the year compared to the prior year. There is a risk that the expenditures on development for the internally generated intangibles have incorrectly been capitalized when these have not satisfied the recognition criteria of IAS 38 for example if JTC is not yet certain that it will successfully complete the development of the project for internal use or for sale. This will result in overstated assets and may also be the reason why the “other expenses” are understated.

The intangible assets balance of FRW 576 million is above the upper materiality limit set at FRW 129 million and therefore material to the financial statements.

Trade payables
These have increased by only 5.3% compared with the 17.8% increase in the materials expense. There is a risk that not all the trade payables for the accounting period have been recognized due to cut-off procedures not fully done if for example, some suppliers’ invoices for payables that should be accrued at the reporting are received and recognized after the reporting date of 30 June 2024. This will result in understated liabilities and expenses.

The trade payables balance of FRW 1,104 million is above the upper materiality limit set at FRW 129 million and therefore material to the financial statements.

Other liabilities
The other liabilities all relate to payables for employee costs including unpaid amounts for accrued wages and salaries, overtime, and a profit-based bonus payable to senior management staff. These liabilities may be understated as they have increased by only 7.5% although staff costs have increased by 14%. For example, balances owing in respect of bonus entitlement to the senior management at the year-end may not have been accurately estimated or are not recognized in the financial statements until the completion of the audit of the financial statements (to support the basis for the calculation of the bonus) which will result in understated liabilities and expenses.

(d) Principal audit work
(i) Motor vehicles
- Agreeing opening ledger balances of cost and accumulated depreciation of the non-current assets to prior year audited closing balances.
- For assets acquired during the year, review supporting documents to confirm they were recorded at the correct amounts
- Recalculate depreciation charge for the for the year to confirm it was correctly computed
- Obtain the Fixed assets Register and agree with schedule of the reported motor vehicle to confirm completeness
- Physically inspecting a sample of vehicles (selected from the asset register) to confirm existence and condition (for evidence of accumulated depreciation and /or appropriateness of the depreciation rate used).
- Reviewing the terms of all lease contracts entered into during the year to ensure that all right-of-use assets have been correctly included in the tangible non-current assets.
- Agreeing the depreciation rates applied to the company’s policy on depreciation.

- Reviewing repairs and maintenance accounts (included in materials expense) to ensure that there are no material items of capital nature that have been expensed (i.e. a test for completeness).

(ii) Trade receivables

- Review the sales agreements to determine the terms for any discounts given to the customers. For example,
  - The % discounts.
  - The volumes to which the discounts apply.
  - The period over which they accumulate.
  - settlement method (e.g. by credit note or other off-set or repayment).
- Direct positive confirmation of a value-weighted sample of balances (i.e. larger amounts) to identify potential overstatement (e.g. due to discounts earned not being awarded).
- Monitoring of after-date cash receipts and matching against amounts due since a shortfall may indicate a disputed amount.
- Review of after-date credit notes to ensure adequate allowance (accrual) is made for discounts earned in the year to 30 June 2024.
- Credit risk analysis of individually significant balances and assessment of impairment losses (where carrying value is less than the present value of the estimated cash flows discounted at the effective interest rate).

SECTION B

QUESTION TWO

Marking Guide

Part (a): Ethical and other professional issues raised in the audit of RTS	11
Award up to 1 mark for each valid point raised as a relevant ethical and/or professional issue arising from the firm planning the final audit of RTS.	
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"*	
Note: *Other ethical considerations will earn credit as long as they are related to the scenario e.g., a potential self-interest threat due the high income being earned from the same client arising from the audit fees and non-audit fees*	
Award 1 mark for any correct safeguard proposed to manage the ethical threats in each of the two situations regarding the audit of RTS	
Note*: Credit will be awarded for other relevant safeguards for example the use of an independent second partner reviewer (or an external quality control reviewer) based on the materiality of the results of the due diligence work on the audited financial statements (for example if the reason is linked on the impact of the impaired assets of Swift Tours leading to the low profits registered)*	
Note: Credit will be given for other points relevant to the question and based on the information in the scenario that the student raises in their answer for example, a reference to a potential lack of integrity by the client's management that the firm may need to address during the audit (for example integrity implications arising from the Finance Director's potential influence over the audit process)	
Maximum marks for Q2(a) - based on the mark allocation for each of the two situations (total of 11 marks)	
Part (b): Global Hotels Co	
Part (b)(i): Matters to consider before accepting the engagement to audit Global Hotels Co	
Award up to 2 marks for each well explained matter / issue to consider before accepting to audit the financial statements of Global Hotels. Where the two marks are awarded as 1 mark for a valid "what" and another 1 mark is awarded for a justified "why" (reason) for the issue. The points that will earn a credit must be specific to the information provided in the scenario as guided by the model answer. Maximum of five (5) matters shall be accepted with a maximum available 10 marks	10
Note: Credit will be awarded for other valid points referring to ethical threats for Murenzi & Partners for example the exposure to a self-interest threat if the total income	

earned from the RTS group exceeds the 15% of the firm's total income for the first year and the next year making it two consecutive years	
Part (b)(ii): How Murenzi & Associates will determine whether the preconditions for the audit of Global Hotels are present	
Award 1 mark for explaining (or defining) what constitutes the "preconditions for an audit"	
Award 1 mark for each point made explaining how the firm will determine that the preconditions for the audit of Global Hotels are present as a pre-requisite for accepting the engagement to audit the financial statements of Global Hotels (maximum of 3 marks)	4
Maximum marks for Q2(b)(ii) - 4 marks	
Total marks for Question Two	**25**

MODEL ANSWER FOR QUESTION TWO

Part (a): Consideration of ethical and professional issues
(1) RTS's reported low profits

Ethical and professional issues

- An intimidation threat may arise if a dispute arises between RTS and Murenzi & Partners for example if a potential legal case is raised by RTS regarding the firm's failure to have reported the impairment of assets in the due diligence report on Swift Tours. In this case, this will impair the firm's objectivity during the audit engagement due to the actual threat arising from the potential legal proceedings.
- Murenzi & Partners should undertake a review of the due diligence work to ensure there were no findings which should have alerted them to the problems in Swift Tours has caused the low profit reported by RTS.
- A 'self-review threat' may arise in that the prior year-end audit, which followed the purchase, may have lacked objectivity. For example, the involvement of some audit personnel supporting the corporate finance department in the due diligence assignment may have resulted in less audit work being carried out on Swift Tours' assets and operating results than would otherwise have been performed as the audit team was reviewing work done by our firm's personnel (including some audit staff) and hence may not have exercised appropriate professional skepticism.

Implications for staffing

- As a safeguard for the provision of the due diligence engagement, the audit staff that were seconded to the corporate finance department during the due diligence work should not participate in the final audit of RTS for the year ending 30 June 2024.
- However, as junior personnel, the two audit assistants can be assigned to the audit team for the RTS audit with appropriate safeguards in place for example they should not be

assigned to audit areas that are closely associated with due diligence work they were involved with.

- In addition, if the two-audit assistant are involved in the audit of RTS's financial statements, a close monitoring and review of their work should be done by the audit manager.
- More senior and experienced audit personnel should be assigned to the audit of RTS to ensure appropriate application of professional skepticism is applied for example on the areas in the financial statements where the due diligence work has significant impact.

Request for Bosco's inclusion to the audit team

- The allocation of staff to an audit team is a decision of the audit firm and should not be influenced by the client. The audit manager should meet with RTS's Finance Director and bring this to their attention to eliminate any confusion and potential challenge of the client's management directing the audit work being conducted by our firm during the audit process.
- Staff should be allocated to an audit team based on the needs of the audit. The team should comprise staff that have a mix of skills, experience and technical knowledge appropriate to the size and complexity of the audit, as well as logistical issues such as location and deadlines. Bosco has no previous experience on the audit of RTS and therefore, adding him to the audit team as an "audit senior" may lead to ineffective leadership of the team under his supervision, and could jeopardise the quality of the audit.
- On the other hand, if Bosco is assigned to be part of the audit team working on the audit of RTS which to Bosco will be a new client, this will provide Bosco with more experience and broaden his knowledge and expertise in the industry sector in which RTS operates. This will be a benefit to the firm as Bosco can be added to the audit teams for the audits of other clients in the same sector as RTS.
- A further issue is that Bosco is a close family member to the Managing Director (MD) of RTS. A close family or personal relationship between a member of the audit team, and an officer or employee of the audit client can create threats to objectivity especially as the MD is a senior position at RTS with a significant influence over the company's financial statements.
- In addition, there will be a potential intimidation threat created as the MD may be able to exert influence on Bosco during the audit process, for example, the MD may influence Bosco's professional judgments and his conclusions on the audit work performed and this will adversely the sufficient and appropriate audit evidence including the quality of the audit.
- There will be a self-interest threat which may arise if Bosco is unwilling to challenge the client's MD regarding accounting matters in the financial statements for fear of causing problems for his relative including fear for a loss of employment of the MD.

- The degree of threat depends on the level of seniority of the close family member. Where they are in a position to exert direct and significant influence over the financial statements then the threat is significant. In this case, Bosco's relative is the Managing Director of the company and therefore the MD roles is clearly an influential position in the process of the preparation of RTS' financial statements. In addition, Bosco is also in a position of some influence over the audit process, as he would take the position of audit senior, therefore responsible for the day-to-day supervision and direction of the junior members of the audit team.

- The most appropriate courses of action would be:
  - Bosco is not assigned to the audit of RTS, and the reasons for this should be explained to the client.
  - Meet those charged with governance at RTS and explain the reasons why Bosco cannot be included on the audit team and giving the audit committee an assurance that the firm will assign an audit team with the adequate experience and skills to conduct the audit of RTS

Part (b)(i): Matters to consider before accepting to audit the financial statements of Global Hotels

- Murenzi & Partners should assess whether as a firm, it has sufficient experience to undertake the audit of Global Hotels especially if Murenzi & Partners have not recently audited clients in the hotels industry and this sector may have specific regulations and industry-specific tax-related laws for the hotel business with a significant impact on the financial statements.
- It is important to consider any factors that might impair Murenzi & Partners' objectivity in forming an opinion on the financial statements of Global Hotels (and the consolidated financial statements of RTS). For example, a self-review threat will be created as the due diligence work on Global Hotels will have been conducted by Murenzi & Partners and the results of the due diligence work may have a significant impact on the financial statements which subsequently will be audited by Murenzi & Partners. In this case, the audit team may not exercise appropriate professional skepticism during the audit process.
- In addition, a familiarity threat will arise if the same senior audit staff that were involved in the due diligence review developed a close relationship with the senior management of Global Hotels during the review work. If these senior audit staff are involved in the subsequent audit exercise, they will not appropriately challenge the senior staff at Global Hotels who are part of the preparation of the financial statements due to the close relationship and this will impact adversely on the quality of the audit.

- If Murenzi & Partners accept the engagement to audit Global Hotels, the team of senior audit personnel that were involved in the due diligence review work should not be used in the audit assignment.

- It is important to consider whether Murenzi & Partners has sufficient human resources that will be able to travel to visit / conduct relevant audit tests in the sampled locations where Global Hotels operates hotels.
- The timeframe or duration for the conduct of the audit on Global Hotels will be important to consider if for example the audit exercise for Global Hotels is required to be conducted in a peak period where a number of concurrent audits are taking place for other existing

clients. Before accepting the audit engagement, Murenzi & Partners must ensure the firm will have sufficient time to report on Global Hotels within the timeframe for reporting on the consolidated financial statements of RTS.

- Murenzi & Partners need to consider if the client has any limitations to information and/or documents that are important for the auditor to conduct the audit of the financial statements as the auditor should not accept the audit engagement if any limitation imposed by management would be likely to result in the need to issue a disclaimer of opinion on Global Hotels' financial statements.
- Murenzi needs to evaluate whether the proposed restriction in audit fee will compromise the quality of the audit of Global Hotels and/or the audit for RTS group. The 20% audit fee increase needs to be sufficient to cover the cost of the audit of Global Hotels and the incremental costs associated with auditing RTS's consolidated financial statements (as well as any general annual price increase that might be applied to audit fees).
- Murenzi needs to assess the reason why the current auditors of Global Hotels have been withdrawn. It is possible that RTS has a group policy that all the subsidiaries are audited by the same firm but still this needs to be confirmed especially considering that Global Hotels is in a different business line compared to the parent company (RTS) and Swift Tours that both are in the tourist industry and therefore the current auditors of Global Hotels will have obtained experience in auditing clients in the hotel business. Global Hotels should give Murenzi & Partners written permission to communicate with their current auditor to enquire if there is any professional reason why they should not accept this assignment.
- In addition, Global Hotels is material for the RTS group. At acquisition (1 July 2024), Global Hotels' revenue, profits before tax and total assets are 14%, 13% and 18% respectively to the related items of the RTS Group. It is usual that a parent company should want its auditors to audit its subsidiaries. If Murenzi & Partners were to decline the role as auditors of Global Hotels, RTS's management may seek an alternative auditor for the entire RTS group.
- Murenzi & Partners may have to consider other potential non-audit assignments that may come with the engagement to audit Global Hotels as it is possible that RTS may provide Murenzi & Partners with additional fee-earning opportunities (e.g. due diligence reviews, tax consultancy, etc.) if it continues to expand in future. This is already evidenced with the two assignments of due diligence reviews done on Swift Tours and Global Hotels which implies that Murenzi & Partners may want to continue with future opportunities. However, it is important to be cautious of any potential financial dependency on the same client and other ethical threats that can arise.

Part (b)(ii): Preconditions for the audit of Global Hotels

Murenzi & Partners should only accept a new audit engagement when it is confirmed that the preconditions for an audit are present.

In this case, Murenzi & Partners will have to inquire from the management of the RTS Group and Global Hotels whether the financial statements of Global Hotels are prepared using an acceptable financial reporting framework.

In addition, Murenzi & Partners will have to obtain an agreement from management and, where appropriate, those charged with governance of RTS Group and Global Hotels in which they state that they acknowledge and understand their management responsibilities for:

- Preparing the financial statements in accordance with the applicable financial reporting framework.
- The internal controls that are necessary to enable the preparation of financial statements which are free from material misstatement
- Providing the auditor with access to all relevant information, with additional information that the auditor may request, and with unrestricted access to relevant entity staff

QUESTION THREE
Marking Guide

Part (a): Nyanza Industries Ltd	
Appraisal of an extract of the draft assurance report on the forecast cash flows	
Award up to 2 marks for each well-explained point critiqued in the draft assurance report on PFI. The 2 marks represent 1 mark for a valid item/issue correctly picked from the draft 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 assurance report) - maximum of 9 marks	9
Part (b): Muhanga Minerals Co	
KPIs used to monitor MMC's social and environmental performance and the nature of evidence available	
Award up to 2 marks for each correct KPI split as below:	**10**
- 1 mark for a correct recommended KPI relevant to MMC (based on the information in the scenario); and	
- 1 mark for a correct nature/type of evidence related to the KPI	
Use the model answer as a guide. ***Note:*** *Marks will be awarded for other correct items of evidence (in addition to those provided in the model answer) as provided in the student's answer*	
Take note of the following:	
(i) Other valid points should be awarded as long as they relate to the information provided in the scenario	
(ii) Where the same nature/type of evidence can be used for more than one KPI, the evidence shall only be marked once across this question	
(iii) A tabular format is acceptable	
Maximum marks for Q3(b) - 10 marks	
Part (c): Hardware Hub	
Benefits of using CAATs to obtain sufficient & appropriate audit evidence	

Award up to 2 marks for each well-explained benefit of applying CAATs in obtaining sufficient and appropriate evidence - where the 2 marks are split as below:	**6**
- 1 mark for a generic benefit of using CAATs; and	
- 1 mark for an application of the benefit to the case of Hardware Hub	
Note: A maximum of 3 benefits are required	
Maximum marks for Q3(c) - 10 marks	
Total marks for Question Three	**25**

Model Answers

Part (a): Appraisal of the draft assurance report on NIL's forecast cash flows

Addressee

The report is currently addressed to the shareholders of Nyanza Industries Ltd (NIL) which is not appropriate. The intended users for the report are more likely to be the board of directors, who wishes to use it in conjunction with a loan application, and the report should be addressed as such.

Type of forecast

The report fails to specify what forecast the assurance relates to. The prospective financial information being reviewed is NIL's forecast cash flows. It is important to specify that the assurance report is for the results of the review of the forecast cash flows of NIL rather than leaving this general as it may create confusion for the users of the assurance report.

Period covered

The assurance report fails to specify the period covered by the forecast cash flow. This is important because the bank (as the user of the assurance report) will be interested to make their decision based on such information provided like the relationship of the 12-month period length covered by the cash flow forecast (i.e., 1 January 2025 to 31 December 2025) and NIL's request for long-term loan (with a loan maturity period of more than 12-months loan).

Specific document and page reference

The assurance report simply refers to the forecast "contained in the loan proposal". This is not specific enough. This increases the risk that NIL can re-issue the same cash flow forecast with the same assurance report in other loan proposals. The assurance report should state the title of the document the cash flow forecast is included in and the page numbers upon which assurance is provided.

Relevant standards

The report simply refers to "relevant standards"; it should state which standards have been followed by Dusabe & Co. Given the nature of the assignment, the assurance report should state that the engagement to examine NIL's forecast cash flows has been conducted in accordance with International Standard on Assurance Engagements (ISAE) 3400 *The Examination of Prospective Financial Information*. This will provide confidence to the user of the assurance report that the firm has applied professional standards relevant to the review of NIL's forecast cash flows.

Responsibility for preparation

The respective responsibilities of the practitioner (i.e., Dusabe & Co) and the responsible party (i.e., Nyanza Industries Ltd) are not correctly stated. Rather than state that the practitioner is not responsible for the preparation of the forecast, the assurance report should state that management is responsible for the information provided and the assumptions upon which it is based (ISAE 3400).

Detail regarding the relevant assumptions

The assurance report should make it clear what assumptions the forecast cash flows is based upon and what assumptions the assurance report relates to. To this end the report should refer to the note in the forecast cash flows where the underlying assumptions are presented.

Negative statement of assurance needed

The assurance provided in the draft assurance report is worded "positively"; however, an examination in accordance with the relevant standard (ISAE 3400) provides only a moderate level of assurance that should be expressed in a statement of negative assurance and this should be worded "negatively".

For an unmodified opinion, such as that presented in the draft assurance report, the wording used should state that "based upon our examination of the evidence supporting the assumptions, nothing has come to our attention which causes us to believe…………"

IFRS

The use of an abbreviation such as "IFRS" in this case may be misleading the user of the assurance report if such an abbreviation is not understood by the user of the report. The report should appropriately refer to "International Financial Reporting Standards" rather than "IFRS".

Inappropriate caveat

The caveat at the end of the report should be reworded as it somewhat undermines the credibility of the cash flow forecast and the assurance provided by stating that the cash flow forecast is unlikely to be accurate.

A more appropriate statement would refer to the uncertainty in relation to the nature of cash flow forecast and that the actual results may vary from those anticipated.

Reference to the purpose and distribution of the report

It is common practice for a report on prospective financial information to include a reference to the purpose of the information and on its distribution. Dusabe & Co should consider the need to include such a reference as a means of limiting the distribution of the report to the intended parties that were brought to the firm's knowledge at the start and during the examination of NIL's forecast cash flows.

Part (b): Social and environmental responsibilities

Key Performance indicators

- Absolute amount (in FRWs) and relative (%) level of MMC's investment in the community sports sponsorship, and funding to the MMC Clinic as compared to the company's profits (in FRWs and as a %).
- Increasing number of championship events and participating individuals' / groups as compared with prior year.
- Number of medals/trophies sponsored at the sports events and/or number awarded to MMC sponsored community groups / individuals involved in the sports activities.
- Number of patients treated (successfully) a week/month.
- Average bed occupancy in the in-patient wing of the MMC clinic (daily/weekly/monthly and cumulative number to date).
- Staffing levels (e.g. number of MMC volunteers for sports events, number of MMC Clinic staff):
- Ratio of starters to leavers/staff turnover.
- Absenteeism (average number of days per person per annum).
- Number of free health talks conducted per week/month
- Number and range of topics covered in the free health talks at the MMC clinic.
- In terms of health and safety for the MMC staff, the number of:
- Breaches of health and safety regulations and environmental regulations.
- Accidents and employee fatalities.
- Insurance claims.

Evidence

- Minutes of the MMC Board meetings should contain evidence of the authorization of the investments in the community sports events and the MMC clinic including the subsidized prices charged to the public for the MMC clinic services.
- The cash book will show the value of any payments made by MMC on the community sport events and the MMC clinic.
- The actual level of investment (in FRW and in %) on the social and environmental activities compared with budget.
- The current year's budget (in FRW and in %) compared with the prior period's budget.
- A register of the MMC funded community sporting events and the free health talks at the MMC clinic maintained by MMC as a diary or timetable indicating the schedule of events planned or conducted in a month/quarter/year.
- Physical evidence of favorable increases as compared to the prior year, in the numbers of (say):
- Sports medals/cups sponsored.
- number of the MMC clinic beds available.
- Number of free health talks made to the public per week/month
- Number or range of health-related topics delivered at the health talks in the MMC clinic
- Increase in favorable press coverage/reports of the MMC sponsored events and/or the decrease in adverse press about staff accidents at MMC.

- Independent surveys (e.g. by the RMB, labor trade unions, etc.) comparing MMC favorably with other mineral producers in Rwanda.
- A reduction in fines imposed on MMC compared with budget (and against the payments of fines made in the prior year).
- Reduction in legal fees and compensation claims being settled as evidenced by a reduction in the fee notes and correspondence files.
- Amounts settled on insurance claims and level of insurance cover as compared with prior period.

Part (c): Benefits of using Computer-Assisted Audit Techniques (CAATs) to obtain sufficient and appropriate audit evidence

Testing programmed controls
Reliance on CAATs will force the auditor to rely on programmed controls during an audit; in fact, using CAATs may be the only way to test controls within a computer system. Use of the CAAT enables the auditor to meet the auditing standard requirement of obtaining appropriate audit evidence. For example, in Hardware Hub, an overtime report is generated by the computer, although this can also be overridden / reversed by the payroll accountant. Test data can be used to check that the overtime report is being created correctly and audit software can monitor that only the payroll accountant's password can be used to reverse the overtime payment.

Test a larger number of items
Using CAATs enables the auditor to test a larger number of items quickly and accurately, meeting the auditing standard requirement of obtaining sufficient audit evidence.

By using an audit software in the audit of Hardware Hub payroll computations, the auditor can check the deduction and net pay calculations of a significant proportion of wages calculations or all of them, if necessary, yet checking each payroll calculation manually would take a long time.

Test actual accounting records
Using CAATs enables the auditor to test the actual accounting records (the electronic version) rather than relying on printouts or other copies of the data. It is always appropriate for the auditor to test original documentation where possible.

In the case of Hardware Hub, the actual wages will be tested rather than any paper copies.

Cost
After initial set-up costs, using CAATs is likely to be cost-effective as the same audit software programs can be run each year as long as the client does not change the accounting systems.
In Hardware Hub, since the computerized wages system has just been implemented, it is likely the system will be used by the client for a number of years in the future, making the use of CAATs cost-effective for the audit firm.

QUESTION FOUR

MARKING GUIDE

Going concern matters are based on:

a) Revenue, operating margins and profitability
b) Bank loan
c) Trade payables
d) Borrowing facility
e) Contingent liability

Award 2 marks for matter identified and discussed, Maximum of 12 marks

(ii) Audit procedures in respect of going concern matters

1. Obtain and review management accounts, perform analytical review
2. Read the minutes of the meetings for reference to trading and financing difficulties
3. Discuss with management the strategy which is being developed to halt the trend
4. Review the company's current order book and assess the level of future turnover
5. Analyse and discuss the cash flow, profit and other relevant forecasts
6. Obtain the bank loan agreement to confirm the amount of the loan,
7. Review the bank loan agreement for any clauses or covenants to determine any breaches
8. Calculate the average payment period for trade payables
9. Obtain the contract in relation to the borrowing facility to confirm the covenant measures
10. Discuss correspondence with the bank in relation to the loan and the borrowing facility
11. Obtain any further documentation available in relation to the letter of support.

Award 1 mark for each well explained procedure: Maximum marks 7

Application analytical procedures

1. Assist in identifying potential problems and important areas of audit.
2. Assist in assessing risk of material misstatements
3. Used as substantive procedures in the circumstances where they are more efficient and effective
4. Assist in evaluation whether the amounts in financial statements are reasonable

Award 1 mark for each application: Maximum marks 3

Limitations analytical procedures

1. Conclusions may be misleading because of adoption of diverse policies
2. The ability to interpret financial data is affected by the manner in which the data is presented.
3. Manipulation of the financial statements due to pressures on management
4. Accounts distorted due to complex estimates.
5. Where business is diversified, a change in the sales mix would distort ratios.
6. Ratios which are computed from data which is not ordinarily related may be misleading.
7. If price level changes are not considered, ratios of two entities which are not comparable.
8. No two companies, even in the same industry are exactly similar.
9. When ratios reflect unusual fluctuations, additional investigation is required to ascertain causes
10. Analytical procedures performed without obtaining understanding the business may be misleading

11. Inquiry from management alone on unusual fluctuations as indicated by analytical procedures, may be insufficient or misleading.
12. Ratio analysis may be misleading if the data on which ratios computed is incomplete or inaccurate.

Award 1 mark for each limitation: Maximum marks 3

MODEL ANSWER

(a) (i) Going concern matters

- ✓ **Revenue and profitability**
  The extract financial statements show that revenue has fallen by 38·2%. Based on the information provided,
- ✓ Profit before tax have fallen by 461.1% during the year and the fall in revenue and margin has caused Aliko Rwanda Ltd to become loss-making this year.
- ✓ The loss-making position does not in itself mean that the company is not a going concern, however, the trend is extremely worrying and if Aliko Rwanda Ltd does not return to profit in the 2023 financial year, then this would be a major concern. Few companies can sustain many consecutive loss-making periods.

Bank loan

- ✓ The bank loan is significant, amounting to 33·7% of total assets this year end, and it has increased by FRW 500,000 during the year.
- ✓ Aliko Rwanda Ltd appears to be supporting operations using long-term finance because short-term finances are very low, which may be strategically unsound.
- ✓ The loan is secured on the Aliko Rwanda Ltd properties, so if it defaults on the payment due in June 2023, the bank has the right to seize the assets in order to recoup their funds.

If this were to happen, Aliko Rwanda Ltd would be left without operational facilities and it is difficult to see how it could survive. There is also a risk that there is insufficient cash to meet interest payments due on the loan.

Trade payables

- ✓ The trade payables balance has increased by 38·5%, probably due in part to the change in terms of trade with its major supplier of raw materials.
- ✓ An extension to the payable payment period indicates that Aliko Rwanda Ltd is struggling to manage its operating cycle, with the cash being generated from sales being insufficient to meet working capital requirements.
- ✓ Relations with suppliers could be damaged if Aliko Rwanda Ltd cannot make payments to them within agreed credit terms, with the result that suppliers could stop supplying the company or withdraw credit which would severely damage Aliko Rwanda Ltd operations.
- ✓ There is also a risk that suppliers could bring legal action against Aliko Rwanda Ltd in an attempt to recover the amounts owed.

Borrowing facility

- ✓ Aliko Rwanda Ltd has FRW 500,000 available in an undrawn borrowing facility, which does provide a buffer as there is a source of cash which is available, somewhat easing the going concern pressures which it is facing.
- ✓ However, the availability of the borrowing facility depends on certain covenants being maintained. The calculations below show that the covenants have now been breached, so the bank is within its right to withdraw the facility, leaving Aliko Rwanda Ltd exposed to cash shortages and possibly unable to make payments as they fall due.

	Covenant	**2022**	**2021**
Interest cover	2	340/520 = 0·65	1150/500 = 2·3
Borrowings to operating profit	4:1	3,500/340 = 10·3:1	3,000/1,150 = 2·6:1

Contingent liability

- ✓ The letter of support offered to a supplier of raw materials exposes Aliko Rwanda Ltd to a possible cash outflow of FRW 120,000, the timing of which cannot be predicted.
- ✓ Given Aliko Rwanda Ltd precarious trading position and lack of cash, satisfying the terms of the letter would result in it utilizing 80% of their current cash reserve. Providing such support seems unwise, though it may have been done for a strategic reason, i.e., to secure the supply of a particular ingredient.
- ✓ If the financial support is called upon, it is not certain that Aliko Rwanda Ltd would have the means to make the cash available to its supplier, which may create going concern issues for that company and would affect the supply of cotton and silk material to Aliko Rwanda Ltd.
- ✓ There may also be legal implications for Aliko Rwanda Ltd if the cash could not be made available if or when requested by the supplier.

(ii)Audit procedures in relation to going concern matters identified

- ✓ Obtain and review management accounts for the period after the reporting date and any interim financial accounts which have been prepared.
- ✓ Perform analytical review to ascertain the trends in profitability and cash flows since the year end.
- ✓ Read the minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to trading and financing difficulties.
- ✓ Discuss with management the strategy which is being developed to halt the trend in declining sales and evaluate the reasonableness of the strategy in light of the economic recession and auditor's knowledge of the business.
- ✓ Review the company's current order book and assess the level of future turnover required to break-even / make a profit.
- ✓ Analyse and discuss the cash flow, profit and other relevant forecasts with management and review assumptions to ensure they are in line with management's strategy and auditor's knowledge of the business.
- ✓ Perform sensitivity analysis on the forecast financial information to evaluate the impact of changes in key variables such as interest rates, predictions of sales patterns and the timing of cash receipts from customers.
- ✓ Calculate the average payment period for trade payables and consider whether any increase is due to lack of cash or changes in the terms of trade.
- ✓ Obtain the contract in relation to the borrowing facility to confirm the covenant measures and to see if any further covenants are included in the agreement.

- ✓ Review correspondence with the bank in relation to the loan and the borrowing facility to gauge the bank's level of support for Aliko Rwanda Ltd and for evidence of deteriorating relationships between the bank and the company's management.
- ✓ Obtain the bank loan agreement to confirm the amount of the loan, the interest rate and repayment dates and whether the charge over assets is specific or general in nature.
- ✓ Review the bank loan agreement for any clauses or covenants to determine whether there are any breaches.
- ✓ Obtain the letter of support in relation to the supplier to confirm the conditions under which Aliko Rwanda Ltd would become liable for payment of the FRW 120,000.
- ✓ Discuss with management the reason for the letter of support being given to the supplier to understand the business rationale and its implications, including why the supplier approached Aliko Rwanda Ltd for the letter of support.
- ✓ Inspect minutes of management meetings where those charged with governance discussed the letter of support and authorized its issuance.
- ✓ Obtain any further documentation available in relation to the letter of support, for example, legal documentation and correspondence with the supplier, to confirm the extent of Aliko Rwanda Ltd involvement with the supplier and that no further amounts could become payable.

(a) Analyze the application and limitations of analytical procedures

Application analytical procedures

1. Analytical procedures assist auditors in identifying potential problems and important areas of audit.
2. Assist in assessing risk of material misstatements
3. Analytical procedures may be used as substantive procedures in the circumstances where they are more efficient and effective than tests of details, to detect material misstatements (for example in testing completeness assertion)
4. At the final review stage, analytical procedures assist in evaluation whether the amounts in financial statements are reasonable and consistent with the auditor's knowledge of the business.

Limitations analytical procedures

1. Conclusions drawn from a comparison of ratios of one entity with others even in the same industry may be misleading because of adoption of diverse policies in numerous areas of accounting. Although the International Accounting Standards have narrowed down the options to a large extent, still there is no single set of accepted accounting principles, which the users may refer. The adoption of diverse accounting policies allowed by International Accounting Standards and also by local regulations may produce financial statements, which are different in material respect.

Examples of areas where different accounting policies are being used include allocation of costs to inventories, depreciation expense, research and development, employee end of service benefits, investments and intangibles.

2. Comparison of ratios of two entities may also be misleading if one entity records the transactions and events in accordance with legal form and the other entity recognizes the principle of substance over form.

3. The ability to interpret financial data is affected by the manner in which the data is presented. For example, if adequate disclosures have not been made, misleading conclusions may be drawn.

4. Manipulation of the financial statements due to pressures on management to produce predetermined results will obviously distort the ratios. For example, the management may be under pressure declare a certain percentage of dividends. Also, due to bank. convents, the management may be influenced to produce financial statements, which will meet the minimum ratios required by bank e.g., restriction of debt ratio to a predetermined limit.

5. Sometimes the accounts are not intentionally distorted but the financial statements may not be reliable due to inherent difficulties of making some complex estimates. Such estimates are sometimes quite material and pervasive. For instance, estimated cost of completion of uncompleted contracts.

6. The usual requirements of reporting information on a timely basis and maintaining balance between costs and benefits may impair reliability of the financial statements on which ratios are based.

7. In isolation, ratios could be of limited value. These should be considered in relation to other ratios.

8. Where business is diversified, a change in the sales mix would distort ratios.

9. Ratios which are computed from data which is not ordinarily related may be misleading. For example, a comparison of sales to research and development expenses or sales to advertisement does not make much sense. Research and development costs depend upon management discretion and will not have relationship with sales. Likewise, if advertisement expense is incurred in one-year, full benefits of such expense may not accrue in the same accounting year.

10. If price level changes are not considered, ratios of two entities which are set up in different years are not comparable. For example, Company A was established in 1980 and Company B was established in 1997. Depreciation charge on plant and machinery in case of Company A will be substantially lower than that of Company B.

11. Ratio analysis is based on the expectation that relationship among data exists and expected results can be predicted. However, events which cannot be measured in monetary terms are not reflected in the financial statements, (for example, changes in management of the company). Such events may have far reaching effect on future performance of the entity.

12. No two companies, even in the same industry are exactly similar. It is possible that both the companies have similar capacity, same suppliers and customers, but one has leased major assets and another owns the assets.

13. In most of the cases, when ratios reflect unusual fluctuations. additional investigation is required to ascertain causes of such fluctuations.

14. Analytical procedures performed without obtaining understanding the business may be misleading
15. Inquiry from management alone on unusual fluctuations as indicated by analytical procedures, may be insufficient or misleading.

16. Ratio analysis may be misleading if the data on which ratios computed is incomplete or inaccurate.

END OF MARKING GUIDE AND MODEL ANSWERS