CERTIFIED PUBLIC ACCOUNTANT
STRATEGIC LEVEL EXAMINATIONS
AA3.1 ADVANCED AUDIT AND ASSURANCE
DATE: WEDNESDAY, 27 MAY 2026

INSTRUCTIONS:

1. Time allowed: **3 hours and 15 minutes (**15 minutes reading and 3 hours writing)
2. This examination has **Two** sections; **A&B**
3. Section **A** has one Compulsory Question while section **B** has Three optional questions to choose any Two
4. In summary attempt **Three** questions.
5. Marks allocated to each question are shown at the end of the question.
6. Show all your workings

SECTION A

QUESTION ONE

Company Background and Group Structure

Azureon Resorts Limited is a publicly listed luxury hotel group founded in 1998, operating 18 five-star resorts across Rwanda, Kenya, the UAE, and Seychelles. It offers premium accommodation, dining, wellness, events, and tailored leisure experiences under its "Azureon Signature Experiences" brand. The group runs through four country-level subsidiaries supported by a central services entity, reports financials under IFRS in Rwandan Francs, and is listed on both the Rwanda and Nairobi stock exchanges.

Financial Performance and Key Metrics

For the year ended 31 December 2014, Azureon reported revenue of FRW 612 billion (up 22.9% from FRW 498 billion in 2013) and profit before tax of FRW 74.3 billion (2013: FRW 41.8 billion), with total assets of FRW 1.84 trillion and net assets of FRW 680 billion. Growth was driven by post-pandemic tourism recovery across all four markets, two new property openings, and a full year of the dynamic pricing algorithm, which boosted average room rates by an estimated 14%.

Revenue is derived from four streams: room revenue (FRW 342 billion; 55.9%), food and beverage (FRW 138 billion; 22.5%), conference and events (FRW 76 billion; 12.4%), and wellness and ancillary services (FRW 56 billion; 9.2%). The Group employs 4,840 full-time equivalent staff across all jurisdictions and engages approximately 620 seasonal and contract workers during peak periods.

Audit Firm and Engagement Context

Sterling & Nkosi LLP, a mid-tier audit firm operating across Kigali, Nairobi, and Johannesburg, was appointed as Azureon's external auditor for the year ended 31 December 2014, following the unexplained resignation of predecessor auditors Fortis & Associates in March 2014. The resignation was vaguely attributed to a "difference of professional opinion," with no further public disclosure. Notably, Sterling & Nkosi accepted the engagement without obtaining a predecessor auditor communication, citing AGM deadline pressures - a significant departure from standard auditing practice.

During the competitive tender process, the Firm submitted a proposal quoting an audit fee of FRW 980 million, representing a reduction of 22% from the fee charged by Fortis & Associates in 2013. The proposal included the following representation: *"Sterling & Nkosi LLP's hospitality sector team has an unbroken record of clean audit opinions across all engagements - no material misstatements have ever been identified in any hotel group we have audited."* The Firm's total fee income from Azureon, including a separate tax advisory engagement awarded concurrently, amounts to FRW 1.44 billion for the year, representing 18% of the Firm's Kigali office total fee income.

The Firm also holds a recurring management consulting contract with Meridian Capital Partners, a private equity fund that is the single largest shareholder of Azureon with an 18.3% equity interest and two Board seat nominations. The consulting contract with Meridian Capital Partners generates annual fees of FRW 210 million for the Firm.

Ms Joanna Harlow serves as engagement partner with overall responsibility, having assigned two recently qualified associates Mr. Thierry Mugabo and Ms Claire Nkurunziza, both lacking hospitality industry experience to lead fieldwork. While Mr. Solomon Otieno was nominated as engagement quality reviewer at the outset, his review was deferred due to a scheduling conflict and remained incomplete when the draft auditor's report was presented to the Audit Committee.

Revenue Recognition and the AI-Driven Dynamic Pricing System

In Quarter 2, 2014, Azureon deployed a proprietary AI-driven Dynamic Pricing System (DPS) at a cost of FRW 8.4 billion, capitalized as an intangible asset. The DPS dynamically adjusts room rates using real-time data inputs and integrates with the revenue management, property management, and general ledger systems across all 18 properties. However, internal audit identified 23 unresolved reconciliation exceptions between the revenue management and the general ledger at year-end.

Management has acknowledged that approximately FRW 47 billion in revenue from algorithm-driven, multi-element bookings may have been prematurely recognised. IFRS 15 requires the transaction price to be allocated across each distinct performance obligation based on stand-alone selling prices, with recognition deferred until each is fulfilled. While management estimates the overstatement at FRW 6.2 billion, this figure lacks transaction-level support and is based on portfolio-wide weighted average assumptions, raising concerns about its reliability.
Management refused to provide detailed transaction-level booking data from the system, citing privacy policies and pending legal advice on cross-border data transfers. Consequently, the engagement team's revenue verification was limited to analytical review, management inquiry, and a brief walkthrough of the DPS interface, with no independent IT audit of the DPS conducted.

Property Revaluation, Capital Expenditure, and Lease Accounting

Azureon uses the revaluation model under IAS 16 for its hotel properties to ensure carrying amounts reflect fair value. Its two newest properties - Azureon Peninsula Resort in Seychelles (FRW 94.6 billion) and Azureon City Suites in Dubai (FRW 71.2 billion) - were commissioned in 2014 and initially recorded at cost.

In October 2014, management directed its internal property team, led by Mr. Augustin Rurangwa (Head of Asset Management, reporting to the CFO), to assess the fair value of two new properties internally rather than hiring an external valuer, citing cost and time constraints. Using a discounted cash flow methodology based on occupancy projections prepared by the same team behind the DPS revenue forecasts, the assessment produced an upward revaluation surplus of FRW 68 billion, recognised in other comprehensive income and credited to the revaluation reserve in equity.

In 2014, Azureon entered 14 new lease agreements for various equipment, which management classified as short-term or low-value operating leases under IFRS 16, recognising no right of use assets or liabilities. However, the engagement team found that 6 of these leases include bargain purchase options at nominal consideration, with terms of 8-14 years and annual payments of FRW 4.1 billion indicative of finance leases. Correct reclassification would require recognising approximately FRW 18.6 billion in right of use assets and FRW 22.4 billion in lease liabilities, meaning both are currently understated.

During the year, Azureon capitalized FRW 12.8 billion in property improvements across six resorts; however, the engagement team identified that FRW 3.6 billion of this relates to routine maintenance and repainting, which should have been expensed immediately under IAS 16 rather than capitalized.

Related Party Transactions and Undisclosed Arrangements

During fieldwork, the engagement team identified several transactions that may constitute related party transactions under IAS 24 but have not been disclosed in the financial statements. These include:

- A procurement contract worth FRW 6.7 billion was awarded to Keza Luxury Goods Ltd, a company in which the Group CEO’s spouse holds a 35% equity interest for luxury in-room amenities. Management claims the contract followed a competitive tender process, however the supporting tender evaluation documentation is incomplete, raising concerns over the transparency and validity of the related party transaction.
- A FRW 2.1 billion advisory fee was paid to Harlow Consulting Ltd, but the engagement team could not verify any potential connection to engagement partner Ms. Joanna Harlow, as the Company’s beneficial ownership register was withheld from inspection.
- Azureon Resorts Limited has undisclosed interest-free inter-company loans totaling FRW 31.4 billion with its subsidiary, Azureon Hospitality Services Ltd, which have been omitted from the related party note.

Going Concern and Post-Balance Sheet Events

The following events and circumstances came to the attention of the engagement team during the completion phase of the audit in February 2015:

- On 14 January 2015, Oceanic Bank plc issued a formal Notice of Covenant Breach after Azureon’s net debt-to-EBITDA ratio reached 4.5 at 31 December 2014, exceeding the 4.0 covenant threshold. This is significant given that Oceanic Bank holds a FRW 180 billion term loan, Azureon’s largest single financial liability which becomes immediately repayable if the breach remains unremedied. As of the engagement team’s review, it remained uncertain whether Oceanic Bank would grant a waiver or demand accelerated repayment.

- On 3 February 2015, a fire at the Azureon Grand Lakeview Resort (Rwanda) left the main building temporarily non-operational. The property carries a value of FRW 94 billion and generates FRW 38 billion in annual revenue and FRW 14 billion in EBITDA. Insurance claims for property damage and business interruption have been filed, with management estimating an 85% recovery of losses though no written confirmation from the insurer has been received.

- Management’s January 2015 going concern assessment projects positive free cash flows of FRW 38 billion over the next 12 months, but this is contingent on four key assumptions: full waiver of the Oceanic Bank covenant breach, continued occupancy recovery in line with 2014 performance, no material shortfall on the fire insurance claim, and no adverse regulatory developments. Notably, the assessment lacks any sensitivity analysis or stress-testing, limiting its robustness.

Management has not disclosed the covenant breach, the fire, or the going concern uncertainty in the notes to the financial statements, on the grounds that these events are *"post-year-end and therefore not material to the financial position as reported at 31 December 2014."*

In March 2015, CrystalArc Hotels a well-capitalised international luxury resort brand publicly announced a strategic expansion into Rwanda, Kenya, and the UAE, targeting the same customer segment as Azureon. Three CrystalArc properties are expected to open in these markets within 18 months.

Internal Audit Function and Use of the Work of Others

Azureon's Internal Audit Function (IAF) comprises four staff, Chief Internal Auditor (CIA) and three auditors operating under an Audit Committee-approved charter. While it reports functionally to the Audit Committee and administratively to CFO Bernard Hakizimana, the CIA has previously noted that the CFO exerts significant influence over the IAF's audit plan, resource allocation, and review scope, raising concerns about the function's independence.

In Quarter 3, 2014, the Internal Audit Function reviewed revenue recognition controls, identifying four significant deficiencies including gaps in automated exception reporting, segregation of duties, and documentation of bundled package allocations. Notably, the review relied solely on walkthroughs and inquiries, with no transaction-level substantive testing. Despite this, the CFO suggested the IAF's findings should be treated as equivalent to substantive audit evidence, potentially justifying a reduction in the engagement team's own revenue testing a position that warrants careful consideration given the limited nature of the procedures performed.

Management commissioned DataTech Analytics Ltd to independently assess the controls within the DPS, whose December 2014 report concluded the controls were sufficiently robust for financial reporting. However, the engagement team subsequently discovered that CFO Mr Hakizimana holds a 12% equity stake in DataTech and was a founding director before joining Azureon, a significant undisclosed conflict of interest. Despite this, the team has not evaluated DataTech's objectivity, independence, or competence, and has already relied on its findings as corroborating evidence in its working papers, raising serious concerns about the validity of that reliance.

The engagement team plans to rely on property valuations prepared by two external valuers, Meridian Property Valuers Ltd and East Africa Land Consultants for the annual revaluation of Azureon's 16 existing properties. Both firms hold multi-year contracts with Azureon and have consistently produced valuations aligned with management's expectations. Notably, the engagement team has not reviewed the valuers' assumptions, methodology, or professional standing, raising concerns around auditor independence and the sufficiency of audit evidence.

Additional Audit and Reporting Matters

The Group's balance sheet carries FRW 43.8 billion in goodwill from the 2011 acquisition of Azureon Island Resorts Ltd, subject to annual impairment testing under IAS 36. Management's value-in-use model used a discount rate of 8.2% and a growth rate of 6.5%, but the engagement team's independent assessment indicates more appropriate market-aligned assumptions of 10.5-11% discount rate and 4% growth rate. Applying these revised assumptions would reduce the recoverable amount below the cash generating unit's carrying value, triggering an impairment charge of approximately FRW 11.2 billion.

The Group's UAE and Seychelles subsidiaries operate in AED and SCR respectively, with their financials translated into FRW for consolidation. The FRW's appreciation of 9% against the AED and 11% against the SCR in 2014 generated FRW 14.6 billion in translation losses recognised in OCI. Notably, the engagement team has yet to independently verify the exchange rates used or the completeness of translation adjustments across all 18 properties.

Azureon faces two active legal matters. First, a labour dispute involving 214 former employees claiming unfair dismissal and unpaid benefits of FRW 3.8 billion, which management has not provisioned, deeming it unlikely to succeed. Second, an RRA investigation into transfer pricing on intra-group management fees between Azureon Resorts Limited and Azureon Gulf Properties LLC for 2010–2014, with an estimated tax exposure of FRW 7.4 billion that remains undisclosed in the financial statements pending negotiations. Both matters represent potential contingent liabilities requiring further assessment and appropriate disclosure.

Required:

a) **Critically evaluate the ethical threats arising from Sterling & Nkosi LLP's acceptance and conduct of this engagement of the Azureon. For each threat, assess its significance and state whether the firm should have accepted the engagement at all.** 12 Marks

b) **Discuss FIVE significant audit risks from the scenario. For each risk, explain why it could lead to a material misstatement and describe the audit procedures you would perform in response.** (15 Marks)

c) The engagement team has placed reliance on the Internal Audit Function, DataTech Analytics Ltd, and two external property valuers in forming its audit conclusions. **Critically assess the appropriateness of this reliance. For each third party, identify the specific concerns regarding objectivity, independence, and competence, and explain what additional procedures the engagement team should have performed before relying on their work.** (10 Marks)

d) The engagement team has become aware of several significant events and uncertainties arising after the balance sheet date. **Evaluate management's position on these events; assess the adequacy of management's going concern analysis, and set out the disclosures that should be included in the financial statements. Also consider the implications for the auditor's report if management refuses to make the necessary disclosures.** (8 Marks)

e) In light of all the issues identified throughout the engagement, **discuss the factors Ms Joanna Harlow, must consider in determining the appropriate form of audit opinion. Conclude with a recommendation on the audit opinion that should be issued.** (5 Marks)

(Total: 50 Marks)

SECTION B

QUESTION TWO

Kigali Harvest Limited (KHL) is a publicly listed agro-processing company incorporated under the Rwanda Companies Act and listed on the Rwanda Stock Exchange. KHL processes and exports dried fruits, herbal teas, and organic coffee. The company has recently experienced significant growth, with revenue increasing by 68% over the past two financial years, partly driven by a new major export contract with a European distributor - EuroBio GmbH.

You are the audit manager at Kirabo & Associates, a registered audit firm under ICPAR. Your firm has been the statutory auditor of KHL for the past six years. During the planning phase of the current year audit, the following matters have come to your attention:

Regulatory Compliance and Corporate Governance

KHL's Audit Committee, which was constituted three years ago, has not met in the past 18 months. The Board has recently appointed a new Finance Director who is the nephew of the CEO. The new Finance Director oversees all financial reporting and has restricted the internal audit team's access to certain supplier payment records, describing them as "commercially sensitive." KHL's external legal counsel has advised the Board that the company may be in breach of the Capital Market Authority's Corporate Governance Code, but this advice has not been formally disclosed to auditors.

Anti-Money Laundering (AML) Concerns

In reviewing KHL's bank statements, your audit team notices a series of large cash deposits totaling FRW 2.4 billion made across seven transactions over a four-month period, all attributed to "advance payments from new clients." These clients are registered in jurisdictions with weak AML frameworks and are not previously known to KHL. The corresponding client agreements appear to have been executed in a short period with minimal documented due diligence. The payments do not match any invoices on the debtors' ledger. The CEO explains that these are "legitimate prepayments from growing markets" and advises the audit team not to escalate the matter.

Threats to Professional Ethics

Kirabo & Associates has also been approached by the Board of KHL to provide the following additional services for the current year: preparation of KHL's financial statements, tax advisory services, and valuation of KHL's non-current assets for purposes of a planned rights issue. The firm's engagement partner has informally agreed to undertake preparation of KHL's financial statements and valuation of KHL's non-current assets, citing a desire to strengthen the client relationship. Audit fees for the current year represent 28% of the firm's total fee income.

Required:

a) **Critically, evaluate the corporate governance weaknesses identified at KHL and explain their implications on the planning of the statutory audit**. (8 Marks)

b) **Assess the anti-money laundering risks arising from the transactions described in case and explain the responsibilities of Kirabo & Associates under applicable AML legislation** including the specific steps the firm should take upon discovery of these suspicious transactions. (9 Marks)

c) **Identify and discuss the threats to the fundamental ethical principles of Kirabo & Associates arising from the proposed additional services and the level of fee dependence. For each threat, recommend an appropriate safeguard in accordance with the IESBA Code of Ethics.** (8 Marks)

(Total: 25 Marks)

QUESTION THREE

The Rwanda Development Infrastructure Authority (RDIA) is a public sector entity responsible for managing and executing large-scale national infrastructure projects, including road construction, water reticulation, and energy access programmes. RDIA is funded primarily through the national budget, supplemented by multilateral development grants.

You are an audit manager at Abeza Auditors, which has been appointed to carry out three separate engagements for RDIA during the current year:

Forensic Audit of the Northern Corridor Road Project

RDIA's internal audit function flagged irregular payments totaling FRW 4.7 billion related to the Northern Corridor Road Project, which is 60% complete after four years against an original two-year schedule. Investigations suggest fictitious sub-contractors, inflated unit costs, and possible collusion between a project manager and external vendors. RDIA's Board of Directors has requested that Abeza Auditors conduct a forensic audit to determine the extent of any financial irregularities, identify responsible parties, and recommend control improvements.

Review of Prospective Financial Information - Proposed Hydropower Station

RDIA is seeking financing from a development finance institution (DFI) for a proposed 80MW hydropower station. The DFI requires an independent practitioner's report on the prospective financial information (PFI) prepared by RDIA's management, which includes a 15-year revenue and expenditure forecast and key assumptions relating to electricity tariffs, population growth, and construction timelines. Management's best-estimate assumptions appear optimistic. The tariff assumptions are 30% above the current regulated rate and no sensitivity analysis has been prepared.

Audit of Performance Information - Public Sector Reporting

Under the Organic Budget Law, RDIA is required to report on key performance indicators (KPIs) each financial year. The KPIs for the current year include: kilometres of road constructed (target: 450km; reported: 412km); number of households connected to water (target: 80,000; reported: 76,300); and percentage of projects completed on schedule (target: 70%; reported: 74%). Your team has noted the inconsistencies between the reported KPI data and underlying project completion certificates. In two cases, projects reported as complete have not yet received sign-off from the Ministry of Infrastructure.

Required:

a) **Discuss the key matters Abeza Auditors should consider before accepting engagement of Forensic Audit. Explain the procedures for gathering sufficient and appropriate evidence,**

and describe the form and content of the report to be issued at the conclusion of the assignment. (9 Marks)

b) In respect of Engagement of Review of Prospective Financial Information, **Evaluate the challenges arising from management's assumptions and explain the nature and extent of procedures the practitioner should perform. Conclude on the level of assurance that can be provided and how this should be communicated in the practitioner's report.** (9 Marks)

c) **Identify the criteria that should be used to evaluate the reliability and usefulness of RDIA's KPI disclosures. Describe the examination procedures your team should apply, and explain the appropriate conclusion to include in the audit report given the inconsistencies identified.** (7 Marks)

(Total: 25 Marks)

QUESTION FOUR

Banque Populaire Intégrale (BPI) is a mid-sized commercial bank operating across Rwanda with over 280,000 customer accounts, 24 branches, and an extensive digital banking platform. BPI processes approximately 1.2 million transactions monthly. The bank's core banking system is SAP Banking Services, supplemented by a proprietary mobile banking application and a third-party payroll system for its 1,800 employees.

You are the audit manager at Hakizimana Certified Auditors (HCA), which has recently been appointed as BPI's statutory auditor. This is your firm's first year auditing BPI. During audit planning, you have obtained the following information:

Deployment of Computer-Assisted Audit Techniques (CAATs)

Given the high volume of transactions and the complexity of BPI's IT environment, your audit team is evaluating the use of CAATs. Specifically, the team is considering: using audit software to test the completeness and accuracy of interest income calculations across all loan accounts; deploying test data to evaluate whether the core banking system correctly applies credit approval controls, including loan limit overrides and dormant account reactivations; and performing analytical procedures using data extracts from the mobile banking application to identify unusual transaction patterns potentially indicative of fraud.

Electronic Working Papers - Transition and Risks

HCA recently migrated from a paper-based working paper system to a cloud-based electronic working paper platform, TeamMate+. For the BPI engagement, your team of seven members will work across two cities. The engagement partner is based in Kigali; the rest of the team is split between Kigali and Musanze. During the first week of fieldwork, the following issues have arisen:

- A junior auditor uploaded an unencrypted version of BPI's full customer loan data (covering 43,000 accounts) to a personal cloud storage service for ease of access during off-site work.
- Two working paper sections related to the payroll substantive testing and the IT general controls review have been marked as "reviewed and approved" by the senior without any documented review notes or queries.

- The engagement partner discovered that the version of TeamMate+ deployed does not automatically timestamp to working papers, nor does it enforce mandatory sign-off fields before a section can be closed.

Integrated Technology and Audit Standards

BPI's mobile banking platform generates a real-time transaction log stored in a separate database from the core banking system. Management represents that the two systems are reconciled nightly by an automated process. However, your team has not been able to obtain system-generated reconciliation reports, only a summary Excel file maintained by the IT department. There is no audit trail of manual adjustments made to reconciliation differences.

Required:

a) For each of the three CAAT applications, **explain its purpose, describe the specific procedures your team would perform, and evaluate the conditions under which each technique is most appropriate. Distinguish between the use of test data and audit software and explain how each contributes to audit evidence.** (10 Marks)

b) **Evaluate the risks arising from each of the electronic working paper issues identified. For each risk, explain the impact on audit quality and compliance with auditing standards, and recommend specific controls or corrective actions that HCA should implement immediately.** (9 Marks)

c) **Discuss how the absence of a system-generated reconciliation reports from mobile banking platform affects the auditor's ability to place reliance on BPI's transaction data. Recommend the specific audit procedures HCA should perform to address this gap and explain how findings should be documented in the electronic working papers to satisfy applicable auditing standards.** (6 Marks)

(Total: 25 Marks)

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