CERTIFIED ACCOUNTING TECHNICIAN

STAGE 3 EXAMINATION

S3.4: AUDIT AND ASSURANCE

DATE: TUESDAY 22, AUGUST 2023

INSTRUCTIONS:

1. Time allowed: **3 hours.**
2. This examination has **three** sections: **A, B and C.**
3. Section A has **10** multiple choice questions equal to 2 marks each.
4. Section B has **2** questions equal to 10 marks each.
5. Section C has **3** questions equal to 20 marks each.
6. All questions are compulsory.
7. The question paper should not be taken out of the examination room

SECTION A

QUESTION ONE

In accordance with the Ministerial Order Nº004/19/10/TC of 29/04/2019 determining the annual turnover required for certification of financial statements. Which among the following is true regarding the requirement to submit audited financial statements for corporate income tax (CIT) declaration to the Rwanda Revenue Authority?

A Companies with an annual turnover equivalent to or more than FRW 400 million.
B Companies with an annual turnover equivalent to or more than FRW 600 million.
C Companies with an annual turnover equivalent to or more than FRW 1 Billion.
D All the above

(2 Marks)

QUESTION TWO

During the audit of XYZ Ltd, you reviewed the inventory and you found that it was overstated by an amount which is material but not pervasive. The directors have refused to correct the financial statements. **Which type of audit opinion would the auditor express?**

A Unqualified opinion
B Qualified opinion
C Adverse opinion
D Disclaimer

(2 Marks)

QUESTION THREE

When unqualified opinion is issued to the financial statements, the opinion does not mean absolutely that the financial statements are 100% correct. **Auditors cannot say that financial statements are absolutely correct because:**

i. Financial statements are a combination of fact and judgement.
ii. An audit also includes judgements made by the auditors.
iii. Auditors do not test every transaction (or audits would be too expensive).
iv. Company management might tell lies/carry out hidden fraud which the auditors do not detect.

A (i) and (iii) only
B (i), (ii), and (iv)
C (i) and (iii) only
D All the above

(2 Marks)

QUESTION FOUR

Which of the following are recognised as threats to independence and objectivity as identified by the IESBA Code of Ethics?

(i) Familiarity
(ii) Self-interest
(iii) Integrity
(iv) Advocacy

A (i), (ii), (iii) and (iv)
B (i), (ii) and (iv)
C (ii), (iii) and (iv)
D (ii) and (iv) only

(2 Marks)

QUESTION FIVE

Which of the following statements about materiality are correct?

(i) Information is material if its omission or misstatement could influence the economic decisions of users of the financial statements.
(ii) Materiality is based on the auditor's experience and judgement.
(iii) Materiality is always based on turnover.
(iv) Materiality should only be calculated at the planning stage of the audit.

A (i), (ii) and (iii)
B (i), (iii) and (iv)
C (ii) and (iv)
D (i) and (ii)

(2 Marks)

QUESTION SIX

You are an auditor for Byiza Ltd, and the company has a stable asset base and steady revenue over the last few years but has only made a small pre-tax profit this year owing to a large one-off expense.

Which measures of a client's business are you likely to use when setting a level of materiality.

A Profit before tax
B Gross profit
C Revenue or total assets
D Net assets

(2 Marks)

QUESTION SEVEN

While testing for cut off assertion on revenue account balance, the auditor is expected to conduct which among the following procedures:

A Testing the revenue/sales account transactions for a month before the start and at the end of the financial statements period.
B Enquire from management if they checked of cut-off transactions.
C Check for the management minutes.
D All the above.

(2 Marks)

QUESTION EIGHT

While testing for controls on purchases accounting system, the auditor checks whether:

i) All expenditure is authorised and is for goods that are actually received.
ii) All expenditure that is made is recorded correctly in the general (nominal) and payables (purchase) ledgers.
iii) All invoices are captured in the system including even those invoices that were canceled before the delivery of goods or services.
iv) All credit notes that are received are recorded in the general and payables ledgers.
v) All entries in the payable's ledger are made to the correct payable's ledger accounts.

A (i) and (ii) only and (iii)

B (ii), (iii) only

C (i), (ii) and (iv)

D (i), (ii), (iv) and (v)

(2 Marks)

QUESTION NINE

Which of the following is the correct definition of net realisable value?

A Expenditure which has been incurred in the normal course of business in bringing inventory to its present location and condition.

B Estimated or actual selling price (net of trade discounts but before settlement discounts) less all further costs to completion and less all costs to be incurred in marketing, selling and distribution.

C Estimated or actual selling price (net of settlement discounts but before trade discounts) less all further costs to completion and less all costs to be incurred in marketing, selling and distribution.

D Purchase price including import duties, transport and handling costs and any other directly attributable costs, less trade discounts, rebates and subsidies.

(2 Marks)

QUESTION 10

"Ghost employee" relates to a fraudulent scheme whereby an existing or non-existing person (ghost) is paid for no services rendered to the employer and without the employer's knowledge. **Which among the following is not an audit procedures aimed at flagging out ghost employees?**

A Check whether there is segregation of payroll steps so no one person has authority over payroll preparation, disbursement, and distribution.

B Check for paychecks without deductions for taxes or Social Security.

C Request from management if there are any ghost workers and stop from there.

D Check for duplicate bank accounts for direct deposits.

(2 Marks)

SECTION B

QUESTION 11

You were recently recruited by NMP Associates Ltd, an ICPAR licensed firm. During your induction, the Managing Partner mentioned that the firm is currently in the process of acquiring a computerized audit software. While undertaking your audit course in CAT, you learnt about various challenges related to conducting an audit around the computer and many opportunities that are brought by auditing through the computer.

Your Managing Partner has entrusted you to lead the team that will conduct a cost benefit analysis of acquiring a new audit software for the firm. During your research, you also found an ICPAR Press release that read in part "As Rwanda has been at the forefront of adopting new technologies, the audit profession in Rwanda is expected to follow suit. The adoption of audit software will facilitate among others, customer satisfaction, enhanced compliance and efficiency".

Required:

a) **State the difference between auditing around the computer and auditing through the computer.** (3 Marks)

b) **Describe at least 4 benefits and 3 challenges that your firm is likely to have while implementing the adoption of the new audit software.** (7 Marks)

(Total: 10 Marks)

QUESTION 12

a) In accordance with ISA 315: *Identifying and assessing the risks of material misstatement through understanding the entity and its environment*, the auditor must use assertions for classes of transactions, account balances, and related disclosures in sufficient detail to form the basis for the assessment of the risk of material misstatement; and therefore, the design and performance of further audit procedures.

Required:

Describe any four assertions used by the auditor to design and perform audit procedures and give an example of an account balance of the financial statements suitable for the assertion. (8 Marks)

b) ISA 500: *Audit evidence* also states that the objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

Required:

Clearly explain the terms "Sufficiency' and 'appropriateness' of audit evidence in line with ISA 500. (2 Marks)

(Total: 10 Marks)

SECTION C

QUESTION 13

Your audit firm has recently accepted an appointment as external auditor of Refrigerated Haulage Limited (RHL) for the year ended 31 March 2023. It is now April 2023 and you are in charge of the audit and you have arranged a planning meeting with RHL's Finance Director, Gapfizi Anselme to discuss the current financial situation of the company and the forthcoming audit.

RHL is a road haulage company, operating throughout Rwanda from its base in Kigali City. Over the last two years the audit services were provided to RHL by Habineza CPA Ltd, a certified audit firm established in Gasabo district.

During financial year ended 31 March 2023, RHL was approached by a large pharmaceutical company to store and distribute its products throughout Rwanda. They agreed that RHL's holding and transport costs will be covered plus a flat fee of FRW 10 million to be received by RHL if it meets all the performance targets set. To manage this large contract, RHL requested a bank financing facility and bank approached has refused to offer a loan until it receives and reviews the cash flow forecasts for the three years ended 31 March 2026. Below is the management accounts submitted to bank for review:

Refrigerated Haulage Limited (RHL) Management Accounts

Income statement		
Items	**Actual FRW"000"**	**Budget FRW"000"**
Revenue	20,000	21,000
Cost of sales	(9,500)	(10,000)
Operating Loss/profit	10,500	11,000
Profit on sale of land	-	500
Interest payable	(2,000)	(2,000)
Profit/Loss for the period	**8,500**	**9,500**

During your planning meeting with Gapfizi Anselme, he mentioned that he was a little behind on getting ready for the audit due to the fact that Kawera Alice one of his three finance assistants had left the company. He believes that she left after he confronted her regarding why bank reconciliations had not been performed for the previous four months. He admitted that he had not reviewed any of her finance assistants' work and had relied on them telling him that they had everything under control. As a result of inadequate number of staff in finance department, he had asked the internal auditors to help but they were busy with a compliance audit of their annual plan.

When you queried about the sale of land in the management accounts, Anselme informed you that the land was sold during the year to the Managing Director's brother, who runs a construction company. In hindsight, he admits that RHL should not have sold it as the business strategy was for expansion and they could have used this land to expand the business. Now the company has to rely on a bank loan for this purpose.

You also noted from 2023's Financial Statements that the Directors' Report had the following commentary:

The company operations are capital intensive, characterized by significant investments in vehicles, technology, facilities, handling and sorting equipment. The amount and timing of capital additions depend on various factors, including pre-existing contractual commitments, anticipated volume growth, domestic and international economic conditions, new or enhanced services, geographical expansion of services, availability of satisfactory financing and actions of regulatory and port authorities. Capital expenditures during 2023 were higher than the prior year primarily due to the depreciation of the francs versus the dollar.

When you asked him how this would impact 2024's Financial Statements, he supplied you with the following information from the Board minutes and the annual budget for the year ended 31 March 2024:
"Capital expenditures are expected to be approximately FRW 30 million in 2024. We anticipate that our cash flow from operations will be sufficient to fund capital expenditures in 2024, which will include spending on modernizing our facilities.

Finally, you asked Anselme if he had any further concerns regarding the 2024 financial year. he hesitated before responding that he was concerned over the pension deficit and how the company plans to address this in the financial statements.

Required:

(a) In line with ISA 210 agreeing the terms of audit engagement, **discuss the term engagement letter and state eight contents that it incorporates** (6 Marks)

(b) State the matters that should have been considered and the procedures that should have been performed by your audit firm before accepting the audit of RHL. (6 Marks)

(c) Discuss the key matters that should be taken note of during the planning section of the audit file of RHL (8 Marks)

(Total: 20 Marks)

QUESTION 14

a) The objective of ISA 330: *The auditor's responses to assessed risks* is 'to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks.

Required:

Identify any four overall responses to risks of material misstatements that require changes to the audit strategy. (4 Marks)

b) You are an Audit Senior at KCP Associates Ltd and you have recently concluded the audit of Karemera Ltd financial statements for the year ended 31 December 2022. Your Audit Partner has requested you to review the work done by junior audit team members and to ensure that the audit file and working papers are properly archived after the completion of audit.

Required:

i) **Describe at least 4 audit procedures to be conducted while reviewing the work of junior audit team members.** (4 Marks)

ii) In line with ISA 230: *Audit documentation*, **identify any six factors that will affect the form and content of the working papers of your audit client.** (6 Marks)

c) **Define permanent and current audit files and give examples of which information they should contain.** (6 Marks)

(Total: 20 Marks)

QUESTION 15

CDF Company Ltd is a manufacturing company of health and beauty products with a financial year ending 30th September 2022. You are the senior audit manager at Cuzzo Professionals & Associates Ltd and currently preparing for the year-end audit of CDF Company Ltd. During your entry meeting with the finance director the following two material issues have been brought to your attention:

Depreciation

CDF Company Ltd has a large portfolio of property, plant & equipment (PPE). In December 2021, the company carried out a full review of all its PPE and updated the useful lives, residual values, depreciation rates, and methods for many categories of assets. The finance director felt the changes were necessary to better reflect the use of the assets. This resulted in the depreciation charge of some assets changing significantly for this year.

Bonus

The company's board is comprised of five directors. They are each entitled to a bonus based on the draft year-end net assets, excluding intangible assets. Details of the bonus entitlement are included in the directors' service contracts. You have been advised that in the current year, the company is developing four new health and beauty products, all of which are at different stages of development and once development expenditure meets the recognition criteria under IAS 38 "Intangible Assets" the cost is included within intangible assets. The bonus, which related to the 30 September 2022 year-end, was paid to each director in October 2022 and the costs were accrued and recognized within wages and salaries for the year ended 30th September 2022. Separate disclosure in the financial statements of the bonus paid to a director, is required by local legislation.

As an experienced auditor you already know that a considerable portion of the tests of controls and substantive tests of transactions are performed simultaneously as a matter of audit convenience. But the substantive tests of transactions procedures and sample size depend on the results of the tests of controls.

Required:

a) **Advise your junior auditor on how to resolve this apparent inconsistency before the commencement of CDF Company Ltd's audit.** (4 Marks)

b) Based on the information received at the entry meeting with the Finance Director, **describe any six substantive audit procedures to be conducted to obtain sufficient and appropriate audit evidence in relation to the:**

i) Depreciation of property, plant & equipment; and

ii) The bonus payments made to the Directors of the company. (12 Marks)

c) **Explain the responsibility of external auditors in the audit of financial statements where there is an indication of a client's non-compliance to laws and regulations.**

(4 Marks)

(Total: 20 Marks)

End of question paper

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