



CERTIFIED PUBLIC ACCOUNTANTS
ADVANCED LEVEL 1 EXAMINATIONS
A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES
DATE: FRIDAY 30, AUGUST 2024

INSTRUCTIONS:

1. **Time Allowed: 3 hours 45 minutes** (15 minutes reading and 3 hours 30 minutes writing).
2. This examination has **two** sections; **A & B**.
3. Section **A** has **one Compulsory Question** while section **B** has **three optional questions** to choose any **two**.
4. In summary attempt **three questions**.
5. Marks allocated to each question are shown at the end of the question.
6. Show all your workings where necessary.

SECTION A

QUESTION ONE

You work as a manager in Murukamana and associates, a firm of certified public accountants registered in Rwanda. Your firm is responsible for the audit of Ingabire limited, a listed public company on the Rwanda Stock Exchange which operates in food production industry. Ingabire limited manufactures food additives and other related products that are sold around East African countries. You have been managing the audit of Ingabire Ltd for the past three years and the following information is provided in relevance to the engagement:

1. The company licenses other companies to sell its products in the other east African countries where it does not have a strong business presence as a way of gaining market entry. The main production and research facility is located in Kigali where the bulk of the staff are employed. The company initially started as private company but as a result of its massive success, management decided to obtain listing on the Rwanda stock exchange. A lot of advertising is done to get customers due to the competitive nature of the industry and Ingabire limited has been able to successfully build a strong brand name over the years. New products are always introduced in the market and during the current year ended 31 December 2023, the company has two food additives that are undergoing research and development process. Due to the competitive nature of the industry, Ingabire limited normally obtains patents for its products. The company successfully took action against a competitor last year for breach of patent.
2. Ingabire limited seeks to continue the development of its new food additives and has recently applied for an extension of an existing loan of FRW 500 million. The bank requires a guarantee to be provided before such a loan can be granted. Part of the loan amounting to FRW 50 million shall be used to settle a court case where a group of customers from Uganda is seeking compensation for damages incurred after getting sick from consuming contaminated food additives made by Ingabire limited.
3. Starting from 1st January 2023, Ingabire Limited has been making a pilot program to sell its food additives in South Sudan together with the introduction of online sales on the company website. This contributed to an increase in the sales of the company by an average of 20% in the year under audit.
4. During the year ended 31st December 2023, Ingabire Ltd managed to acquire a competitor's brand "soft foods Uganda", a brand that was acquired at FRW 150 million and is estimated to have a remaining useful life of 20 years.
5. At the last board meeting, the information systems director highlighted that the company is still using systems that are considered to be outdated compared to the level of technology in the industry. Although currently there are no operational or control challenges being

experienced as a result of using the systems, the company board of directors is proposing that a new system is developed for implementation within the next one year. In the IT technical meeting over the roadmap on how the new system will be put live, IT director proposed that the system shall be introduced immediately to replace the current one without necessary running the two concurrently for some months after its introduction.

6. Key financial information and next year's projections relating to the company is given below:

Item	2024 Projections	2023 Actual
	(unaudited)	(audited)
	FRW "Million"	FRW "Million"
Revenue	55,000	49,000
Operating profit	10,500	12,000
Operating margin (%)	0.18	0.24
Net cash flow	(2,600)	8,000
Research and development spending in the year	(4,500)	(3,800)
Total development intangible asset at year end	75,000	69,000
Total assets	230,000	188,000
Gearing ratio	0.8	0.7

*Earning per share was FRW 10 in 2023 and it is expected to be FRW 5 in 2024.

During the year, Ingabire limited acquired Musanze limited on 1 July 2023 and the goodwill on acquisition is recognized in the financial statements at FRW 4.8 billion. The calculation of goodwill provided to your firm indicates the following:

	FRW "Million"
Cash consideration paid	5,500
Deferred consideration payable 2026	4,000
Contingent consideration	<u>1,800</u>
	11,300
Net assets acquired	(6,500)
Goodwill at acquisition	<u>4,800</u>

Required:

- Evaluate the computer assisted audit techniques that you would use to audit the website sales.** (10 Marks)
 - In line with information provided in the above case study, **Evaluate the business risks that Ingabire Ltd company is facing.** (14 Marks)
 - With reference to the information provided in the case, **Evaluate the risks of material misstatements to be considered in planning the audit of Ingabire Ltd.** (16 Marks)
 - Discuss the matters you will consider and the evidence you will obtain relating to the goodwill of Musanze Ltd.** (10 Marks)
- (Total: 50 Marks)**

SECTION B

QUESTION TWO

Akaliza and associates is a firm of certified public accountants registered and operating in Rwanda, offering audit and assurance services to a large portfolio of clients. You are a manager in the audit department responsible for the audit of two clients, Gitarama company and Kayonza Limited, both with financial year ended 31 July 2024. The audits of both clients are being completed and you are reviewing issues which have been raised by the audit seniors.

a) Kayonza Limited undertakes sale and installation of air conditioning and heating systems for both residential and office buildings in Rwanda. The draft financial statements for the year ended 31 December 2023 indicates revenue of FRW 3,000 million and profit before tax of FRW 250 million. The scale of charges for installing the heating systems have been increased by 40% starting on 1st July 2023 and this takes into consideration warranty that the company gives for any items that are installed that do not perform to the specifications and any defect within a period of three years. The company guarantees all installations but no provision has been recognized as the amount cannot be measured with sufficient certainty according to the directors. The installation fees for the year under review amounted to FRW 52 million of which FRW 12 million related to the last three months of the previous year.

Required:

Design and discuss the principal audit procedures to be performed in respect of the warranties given by Kayonza Limited. (10 Marks)

b) Gitarama company is a manufacturer of luxury food items including chocolate and other confectionary items that are often sold as gift items individually or in a food basket containing a selection of expensive items from the range of products. Due to the economic slowdown occasioned by the covid lockdown, sales fell sharply as parties and gatherings became restricted. As a result, measures have been implemented this year to support the company's cash flow. You have been informed by the finance director that the company only has FRW 1.5 million in cash at the year end. Other relevant information is given below:

1. On 1st July 2023, the financial controller, Jean Mugisha, left the company citing frustration with delayed payments and this position has not been substantively filled at the end of the year. All the accounting functions are now performed by Mutoni who used to be Mugisha's assistant, but she is yet to be confirmed as the financial controller.
2. Gitarama company is facing two court cases with claims amounting to FRW 35 million following a breach of contract terms with critical suppliers. The directors are worried that the company is likely to be placed under administration. A sales director who had been dismissed in January 2023 is seeking compensation for wrongful dismissal and has taken Gitarama company to court.

3. A fire that broke out in September 2023 in one of the company warehouses located at Gikondo destroyed 60% of the inventory items that were stored there, the inventory destroyed represents a half of the company's total inventory.
4. A cash flow forecast prepared by the management indicates that Gitarama company is in dire need of additional cash within the next six months to be able to maintain the current level of services, for which the company is planning to seek for a bank loan or overdraft. The directors are unsure whether the bank will approve the loan and are more inclined to ask for the overdraft. The overdraft limit given by the bank is FRW 6 million.

Required:

Evaluate the matters that may cast significant doubt on Gitarama Ltd.'s ability to continue as a going concern. (8 Marks)

- c) Gitarama company management have proposed the adoption of electronic reporting but some directors have no idea what this is. The managing director has requested you to write a briefing note for him that he will use to explain to the other board members so that they can approve the use of the electronic reporting.

Required:

Prepare the briefing note for the managing director explaining the meaning of electronic reporting and what procedures they should expect the external auditor to perform once the electronic reporting is adopted. (7 Marks)

(Total:25 Marks)

QUESTION THREE

- a) You are an audit manager in Mutabazi and associates, a firm of certified public accountants in Rwanda. You are responsible for the audit of Mugenzi company, and the final audit for year 31st December 2023 is nearing completion. Mugenzi limited is a company producing plastic materials and is located in Kigali. It also undertakes research and development projects in an attempt to keep up with changing trends in the market.

Mugenzi company is also one of the world's leading leisure travel providers, operating under several brand names to sell package holidays.

The following are issues that have been noted and brought to your attention by the audit senior:

The company catered for more than 8 million customers for the last one year. The draft figures for the year ended 31st December 2023 show revenue of FRW 3,200 million, profit before tax of FRW 1,500 million and total assets of FRW 41,000 million. The company's executives earn a bonus on the profit before tax of the company.

In January 2024, thousands of holiday makers were left stranded abroad after the company operating the main airline that was chartered by Mugenzi company went into liquidation.

Passengers were forced to wait an average of two weeks before they could be returned home using an alternative airline. They have formed a group which is claiming compensation for the damages over time they were forced to spend abroad, with the total claim amounting to FRW 200 million. The claim has not been recognized or disclosed as contingent liability in the draft financial statements because management argues that the full amount payable after settlement of possible litigations will be covered by insurance company.

One part of the Mugenzi company's activities, operating under Amahoro Tours brand, which provides tour holidays to various nature reserves and parks in Rwanda. Due to a period of recession overseas, the revenue of this tours segment of the business has fallen by 25% this year, and profit before tax has fallen by 35%. The Amahoro Tours contributed FRW 640 million to the total revenue for the year ended 31st December 2023 and had identifiable assets of FRW 2,350 million, including a lodge located in one of the game reserves. The Amahoro brand is not recognized as an intangible asset because it had been internally generated.

Required:

In the context of the information provided in the above case, **Comment on the matters that you should consider and the evidence you expect to find in the review of the audit working papers relating to the compensation claim by the passengers and for the Amahoro Tours business not recognized as an intangible asset.** (9 Marks)

a) You are a manager in the business advisory department of Nyanza and associates, a firm of certified public accountants in Rwanda. Your firm has been approached to provide assurance to Jean Limited, a company that is currently not your audit client regarding a potential acquisition.

Jean limited wishes to acquire Ngoma limited, a smaller competitor in Rwanda. Ngoma Ltd is a subsidiary of Rusizi group, another large company with a presence and operations in the whole East Africa. Your firm has been granted access to all information that will be needed to evaluate Ngoma limited and assess on behalf of Jean limited but the exclusive access has been granted for only a period of four weeks starting from the date the exercise commences. If an offer is not accepted within this four-week period, other companies will likely also bid to acquire Ngoma limited. The management of Jean limited are already negotiating with the bank for a loan to help with financing the acquisition.

From last year, Ngoma limited has started publishing sustainability report that encompasses non-financial performance and environmental data but they have also improved it to now include data on staff health and safety as well as customer satisfaction assessment. The directors of Jean limited are very impressed by this reporting and are also considering the same disclosures from the next financial year. If the plan to acquire Ngoma is successful, the directors wish that your firm also provide assurance report on sustainability report in addition to auditing their financial statements.

Required:

- i) Discuss the principal benefits to Jean Limited of a due diligence review being performed on Ngoma limited. (6 Marks)**
 - ii) Discuss the matters that you would focus on in your due diligence review, recommending any additional information that you will need to perform your work and evaluate the examination procedures that could be carried out to provide assurance on the non-financial data once the plan goes through. (10 Marks)**
- (Total: 25 Marks)**

QUESTION FOUR

a) You are a manager in the forensic investigation department of your audit firm. The directors of a local company that engages in manufacturing, Muhima Limited, have contacted your department regarding an incident of theft that took place at the company warehouse located in the outskirts of Kigali in September 2023.

Muhima limited does not have a fence around the warehouse and thieves were able to gain entry at night and stole various finished goods as well as electronic equipment in the administration office of the warehouse. Although no police investigation report has been made available to the management, there is no collusion that is suspected from the staff and the items of inventory that were stolen are not considered material to the financial statements. However, Muhima limited has an insurance cover against theft and they believe that the insurance company will settle the claim for loss of the items stolen.

During the year ended 31st December 2023, the internal auditor submitted a report to the audit committee in which he highlighted that the records maintained at the warehouse contained some serious inconsistencies.

The report indicated that a physical inventory count that had been done earlier in the year for each quarter before the theft took place had indicated that some items of inventory were getting lost at the warehouse, an indication that some items were being stolen. The report indicated that there was a need to investigate how it happened and quantify the loss arising. The directors of Muhima limited have asked whether your department would be able to provide a forensic investigation, but is unsure what this would involve. Muhima Limited is not an audit client of your firm.

Required:

- i) Identify and explain the matters that your firm will consider before accepting the engagement to perform the forensic investigation of Muhima Limited. (3 Marks)**
- ii) Describe the objectives of a forensic investigation and explain the steps involved in a forensic investigation into the inventory to quantify the loss, the inventory fraud, including the example of procedures that would be used to collect evidence. (12 Marks)**

b) Ruhengeri limited was established only two years ago but due to provision of quality goods and services, the company has been able to grow very fast and acquire a substantial market share within Rwanda. In previous years, a limited assurance review was performed on its financial statements by an unrelated audit firm. The company has one accountant and he uses tally accounting software to prepare financial statements.

The directors are seeking an audit firm to undertake the audit of the company for the year ended 31 December 2023 and have invited your firm to submit a tender for the audit. One of the directors indicated to you that the company is willing to offer a small fee with the hope of paying more for other non-audit services. He also indicated that the company would be willing to pay a fee linked to the success of the business in the next two years as a result of the advice to be offered by your firm.

Required:

- i) **Recommend and describe the principal matters to be included in your firm's tender document.** (5 Marks)
 - ii) **Evaluate matters to be considered before accepting the audit engagement, assuming that your firm is successful in the tender.** (5 Marks)
- (Total: 25 Marks)**

End of Question Paper