

CERTIFIED PUBLIC ACCOUNTANT INTERMEDIATE LEVEL EXAMINATIONS

11.4: AUDITING

FRIDAY: 2 DECEMBER 2016

INSTRUCTIONS:

- 1. Time Allowed: 3 hours 15 minutes** (15 minutes reading and 3 hours writing).
- 2. This Examination is divided into two sections (A & B)**
- 3. Section A has three (3) Compulsory Questions while Section B has four (4) questions to choose two (2)**
- 4. Five (5) questions in total are to be attempted.**
- 5. All iCPAR Examination rules and regulations apply**

Section A

Attempt all questions in this section

QUESTION ONE

Rwamagana Ltd deals in dairy products and operates a number of outlets throughout the country with its head office in Kigali. The outlets are set up all over the country due to the high demand for dairy products. Each outlet is run by a manager who is assisted by a retail assistant. Retail assistants are in charge of invoicing, receipting and preparation of monthly sales reports which are sent to the head office.

The company has a credit policy manual which is supposed to be followed to the letter by all retail assistants in their outlets. Among other things, the credit policy states that the retail assistants should not offer credit to new customers in excess of Frw 100,000 except with the written consent of the manager.

Accordingly, all sales orders have to be approved by the manager before a sale is made. The managers are also in charge of updating the price lists which are reviewed quarterly and signed off, copies of which are given to the retail assistants for use when billing. The managers also review the monthly sales reports to ascertain whether all sales invoices are recorded in the daily sales reports.

All invoices are prepared in triplicate copies; one copy is given to the client, one is filed and third copy remains in the book. They are sequentially numbered for ease of reference. The invoices have to be supported by customer orders and delivery notes before they are dispatched.

The security personnel are in charge of checking goods dispatched against invoices and after checking, a record of the transaction is kept in a book at the gate.

The retail assistants record all goods sold in a sales day books from which monthly sales reports are extracted and sent to head office.

All customers are given monthly statements, copies of which are also sent to head office. The managers are in charge of reviewing the clients' statements before they are dispatched. In case a complaint arises, it is handled by the manager and retail assistant, and a response is sent to the customer.

Your audit firm, Biggs & Associates has been appointed to carry out the audit of Magana Ltd for the reporting period ended 30 June, 2016.

REQUIRED:

- Explain the controls over sales that should be in place at Magana Ltd. **(8 Marks)**
- Describe the audit tests Biggs & Associates would carry out to verify the sales of Magana Ltd for the reporting period ended 30 June, 2016. **(12 Marks)**

(Total 20 Marks)

QUESTION TWO

Timberco Ltd with its headquarters in Huye District, was incorporated in 2010 as a treatment plant for poles for electric transmission lines and fencing. Your firm Annabel & Co has been appointed to carry out an assessment of the company's governance structures for the reporting period ended 30 June, 2016. The following matters were discussed in the meeting held between a representative of Annabel & Co and management of Timberco Ltd:

The company is headed by seven board members, with a quorum of five for any meeting to take place. For the last five years, Timberco Ltd has held only two board meetings because the board members were very busy with other engagements.

The board chairman Mr. Gatoto (who is responsible for leadership of the board and ensuring its effectiveness), is also the managing director charged with the execution of company policies and the day-to-day management of the company.

All board members are certificate holders in carpentry, six of whom own carpentry workshops. The head of the finance committee, on his part has been trading in timber all his life and, even though he has never gone to school, he is a successful businessman.

Mr. Gatoto makes telephone calls to the board members inviting them for meetings. The agenda is usually availed to them at the time of the meetings.

None of the board members received induction on joining the board and no refresher trainings have been given to them since inception.

The board members are given a transport refund whenever they come to execute company business. However, there is no other allowance given to them in terms of retainer fees or monthly allowances.

Timberco Ltd has never held an annual general meeting (AGM) and Mr. Gatoto informed the representative of Annabel & Co that the AGM was to be held when the company makes enough profits for shareholders to receive dividends.

The board members are not concerned with establishing a formal and transparent arrangement for corporate reporting, risk management and internal control principles and for maintaining an appropriate relationship with the company auditor.

Mr. Gatoto appointed another board member whom he thought had experience in accounting and was to be of help to Timberco Ltd in interpreting the company financial statements. He was to communicate this new development to other members in the board meeting.

Lastly, it was revealed that the board chairman in his capacity as the managing director decides his remuneration and makes annual increments due to the positive progress of the company and increased profits.

REQUIRED:

- (a) Identify the corporate governance challenges faced by Timberco Ltd. **(10 Marks)**
- (b) As the audit senior, advise the management of Timberco Ltd on how they can overcome the above challenges. **(10 Marks)**

(Total 20 Marks)

QUESTION THREE

When carrying out his work, the auditor must exercise care and skill.

REQUIRED:

- (a) Discuss the circumstances under which the auditor may be held liable for negligence as defined by case law. **(12 Marks)**
- (b) Explain ways auditors can minimise their potential liability for professional negligence. **(8 Marks)**

(Total 20 Marks)

Section B

(Attempt ANY TWO questions in this section)

QUESTION FOUR

Maxwell & Co was appointed to audit the financial statements of Adonai Ltd for the reporting period ended 30 June, 2016. Adonai Ltd is located in Byumba in Burera district and deals in cosmetics.

Maxwell & Co need to do a background check on the new client to understand and assess the risk of material misstatements in their financial statements.

The cosmetics industry is currently undergoing a shake up from the quality assessment authorities. Products that do not measure up to the required standard will be suspended from the market. Rumours have it that some of Adonai Ltd's products may be suspended. As a result, the value of inventory of cosmetics is likely to be overstated given the changes the quality assessment authorities require.

For the period under review, Adonai Ltd admitted a new shareholder who wants the company to diversify from cosmetics to real estate. Adonai Ltd prepared financial statements for the reporting period ended 30 June, 2016 contrary to the requirements of International Financial Reporting Standards.

REQUIRED:

- (a) Discuss the matters Maxwell & Co should consider to obtain an understanding of Adonai Ltd. **(8 Marks)**
- (b) Explain why it is important for Maxwell & Co to understand Adonai Ltd and its operating environment. **(4 Marks)**
- (c) Explain the business risks Adonai Ltd is facing. **(8 Marks)**

(Total 20 Marks)

QUESTION FIVE

Kigali Clays Ltd (KCL) was incorporated in 2011 and deals in the manufacture of roofing materials and other related products. Your audit firm Kibbs & Co was appointed to carry out the audit of KCL for the reporting period ended 30 June, 2016. The audit manager has directed you to prepare the audit program and has further informed you that you will be in charge of the audit of bank balances.

During the pre-audit meeting with the management team, the following issues were discussed:

1. KCL operates three bank accounts in three different banks.
2. At the month end, the accountant picks bank statements from the three banks for purposes of carrying out monthly bank reconciliations.
3. KCL also maintains its books of account in a computerised accounting system (Quick Books).
4. The company procures clay from Masero Ltd and payment is made by a standing order by one of its banks of Frw 5 million on a monthly basis.
5. The company opened up a fixed deposit account of Frw 300 million on 1 January, 2016 for the period of one year at an interest of 18% per annum payable after one year.
6. KCL obtained a loan of Frw 500 million from one of its banks by pledging its fixed deposit account of Frw 300 million as security.

REQUIRED:

- (a) Design the audit program for auditing the bank balances of Kigali Clays Ltd. (10 Marks)
- (b) Identify the control activities Kigali Clays Ltd can adopt over cash at bank. (10 Marks)
- (Total 20 Marks)**

QUESTION SIX

- (a) Monte Holdings Ltd located in Kibungo in Ngoma district, deals in steel products and has been in business for the past year. Your firm Kalenzi & Associates was given the following information in regard to the audit of accounting estimates.
- The company uses the straight line method of depreciation.
 - The company acquired new machinery at Frw 15 million with an estimated useful life of 5 years.
 - There were no other acquisitions of non-current assets in the period under review.
 - Management feels that all their non-current assets were in good condition and their net book values were stated correctly.
 - The following is an extract of the schedule of non-current assets for the reporting period ended 30 June, 2016.

Asset	Motor vehicles	Furniture	Machinery	Total
Depreciation rate	25%	20%	20%	
	Frw '000'	Frw '000'	Frw '000'	Frw '000'
Cost	25,000	12,000	32,000	69,000
Additions			15,000	15,000
Total cost	25,000	12,000	47,000	84,000
Depreciation:				
balance b/ f	6,250	2,400	6,400	15,050
Charge for the period	6,250	2,400	6,400	15,050
Total depreciation	12,500	4,800	12,800	30,100
Net book value	12,500	7,200	34,200	53,900

REQUIRED:

- Discuss the audit procedures Kalenzi & Associates should design and perform to obtain sufficient appropriate audit evidence in relation to accounting estimates. (12 Marks)
- (b) You have recently been appointed auditor of Darnley Enterprises which deals in precious metals and their financial statements include a material amount of inventory which forms 99% of their current assets figure.
- You are planning the audit and considering the evidence you will need to verify the fair value of inventory of precious metals. One of the audit team members has brought to your attention, as audit manager, the absence of knowledge in the team of the business of precious metals and you are considering the need to use the work of an expert.

REQUIRED:

Explain the matters that should be considered by the audit team when evaluating the work of an expert.

(8 Marks)

(Total 20 Marks)

QUESTION SEVEN

- (a) In forming an opinion on the financial statements, the auditor needs to conclude as to whether the financial statements are fairly stated.

REQUIRED:

Explain the matters an auditor should consider before forming an opinion on the financial statements.

(10 Marks)

- (b) The office of the Auditor General of state finances is vested with legal personality and has financial and administrative autonomy. It is further provided in the constitution that no person shall be permitted to interfere in the functioning of the office of the Auditor General.

REQUIRED:

Discuss the responsibilities of the office of the Auditor General.

(6 Marks)

- (c) Auditors must treat all and any information gathered during the course of their audit as confidential and should not disclose any information to third parties without their clients' permission or unless there is a legal or professional duty to disclose.

REQUIRED:

Describe the circumstances under which the auditor should disclose client's information to third parties.

(4 Marks)

(Total 20 Marks)

End of question paper

BLANK PAGE

BLANK PAGE