
CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

TUESDAY: 4 DECEMBER 2018

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.

SECTION A (COMPULSORY)

QUESTION ONE

RWANDA MEDIA LIMITED

Rwanda Media Limited (RML) is a public entity registered and domiciled in Rwanda. RML is a holding company comprised of Ganza Newspaper Limited (GNL), Ganza Television Limited. (GTL), Ganza Radio Limited. (GRL) and Ganza Printing & Publishing House Limited. (GPPL). Information about these companies is tabulated below:

Company	Principal activity/ business	Shareholding (%)	Date of incorporation/ acquisition
GNL	Production and sale of daily newspapers	100	1 January, 2005
GTL	Broadcasting of news & entertainment through cable/ satellite networks	70	1 April, 2016
GRL	Broadcasting of news & entertainment through radio waves	60	10 July, 2017
GPPL	Printing and publishing of magazines, books, journals, etc.	100	1 March, 2010

Your firm, Wapa & Co. (Wapa) has been appointed the group and component auditor of RML for the year ended 30 June, 2018. You are the audit manager in-charge of the RML audit. RML's financial statements are prepared in accordance with International Financial Reporting Standards (IFRS)

The group's revenue for the year under review was RWF 10.1 billion, profit before tax was RWF 700 million and total assets were RWF 20 billion.

Notes from the pre- audit meeting between Wapa and RML management:

1. RML acquired 60% shareholding in GRL at the start of the financial year. RML has the majority shareholding in GRL and management has therefore decided to consolidate GRL in the group accounts.
2. Due to the high demand for printing and publishing services, GPPL receives revenue from clients in advance. The majority of the clients have to book and pay 3 months in advance in order to be able to get their products on time.
3. The group companies trade amongst themselves, especially in circumstances where a service is needed by one company and this can be provided by another company within the group. For example, GPPL advertises its services using GNL and GTL while GRL's newspapers are printed by GPPL.
4. The group operates a foreign currency fixed deposit account of RWF 1.25 billion to hedge against the fluctuations of Rwanda francs against the dollar. There is no change in this figure as compared to the previous year. RML's presentation currency is Rwanda francs.
5. The group's trade and other receivables amount is RWF 5 billion. Some clients have not honored their obligation to pay their balances for the last 2 years due to financial

- difficulties. Management has taken some measures including making a provision of 5% for bad debts and also writing to the clients reminding them to pay or risk legal action.
6. The group borrowed RWF 8 billion for construction of a multipurpose newsroom and office space for all the group staff. The group was previously renting part of their space. The loan is payable over a period of 5 years. The construction started on 2 August, 2017 and was completed on 30 May, 2018. The borrowing costs incurred during the year in relation to the construction were capitalized.

Notes prepared by the engagement partner for the audit manager:

1. The audit team is expected to be alert to issues to be included in our audit report in relation to key audit matters that will be identified. Inclusion of key audit matters in RML's audit report will require a description of how each of the matters was addressed during the audit.
2. All key audit matters should be clearly documented to avoid negligence on our part. The documentation must be sufficient to enable any experienced auditor, having no previous connection with the audit, to understand, among other things, significant professional judgments we have made.

Prospective financial information for financial year 2019:

	Actual 2017 RWF 'billion'	Actual 2018 RWF 'billion'	Forecast 2019 RWF 'billion'
Revenue	8.4	10.1	15.4
Direct costs	<u>(5.9)</u>	<u>(7.2)</u>	<u>(9.3)</u>
Gross profit	2.5	2.9	6.1
Other operating income	0.5	0.1	2.0
Distribution expenses	(0.2)	(0.2)	(0.1)
Administrative expenses	(1.7)	(2.0)	(1.8)
Finance costs	<u>(0.1)</u>	<u>(0.1)</u>	<u>(2.0)</u>
Profit before tax	<u>1.0</u>	<u>0.7</u>	<u>4.2</u>

The forecast information for the financial year 2019 needs to be reviewed thoroughly as the figures projected by RML as cash flow forecasts are some of the requirements for obtaining loans from financial institutions. These are basically projections based on hypothetical assumptions about the future events and management action which are not necessarily expected to occur.

Notes to the prospective financial information for the financial year 2019:

1. The forecasted increase in revenue for 2019 is because of the projected increase in production capacity due to newly acquired printing machinery.
2. Direct costs are expected to reduce due to the new printing machinery that requires less repairs and maintenance.
3. Other operating income is likely to increase as management plans to dispose of the old printing machines.
4. Administration costs are expected to reduce because of an expected restructuring exercise due in the 2019 financial year.
5. The finance costs are expected to increase due to the loan facility obtained to finance the purchase of new printing machinery.

REQUIRED:

- (a) Prepare brief notes for the audit team on the significant risks of material misstatements of the financial statements that need to be evaluated at the planning stage of RML audit.
(12 Marks)
 - (b) Recommend to the audit team the audit procedures to be carried out on transactions occurring amongst the four group companies.
(7 Marks)
 - (c) Advise the team on the indicators of the determinants of key audit matters that may be included in the audit report.
(12 Marks)
 - (d) Discuss with the audit team the audit evidence expected on the audit file in relation to key audit matters.
(4 Marks)
 - (e) In case the audit team comes across key audit matters; explain the details that are necessary to be included in the audit report in relation to each of the key audit matters identified.
(6 Marks)
 - (f) Prepare a report to RML's management detailing your comments on their prospective financial information.
(9 Marks)
- (Total 50 Marks)**

SECTION B (CHOOSE ANY TWO QUESTIONS)

QUESTION TWO

RWANDA PUBLIC UNIVERSITY (RPU)

You are the Principal Auditor at the Office of the Auditor General (OAG) in charge of the audit of Rwanda Public University (RPU) for the year ended 30 June, 2018. RPU is a government-owned university.

Tom, a senior member of the audit team, is a nephew to the Head of Internal Audit at the RPU and he has made this known to you. You plan to rely on the work of the internal audit department during the audit as the Head of Internal Audit is highly qualified and having attained all the relevant qualifications including certification in internal audit and fraud examination. Sarah is another member of the team. She has been part of this audit engagement for the two previous financial years. In this regard, she was contacted by the Finance department of RPU on several occasions during the financial year to give advice on the accounting treatment of complex transactions. This consultation was aimed at reducing on the journal entries that are always made during the audit to correct errors. RPU is grateful for the support rendered by Sarah.

During the pre-audit meeting, the University management requested for a representative from OAG to accompany them to meet the Ministry of Finance officials as OAG is in a better position to support their request for increase in funding in the next financial year. The Head of Finance informed the team from the OAG that RPU's financial statements had never been qualified and that he hoped that would remain the same for this financial year.

The walk through tests on the internal controls in relation to tuition fees from private students indicated that the Finance & Administration department obtains bank statements from the bank and reconciles these with both the bank slips received from students and the students register on a daily basis. The tuition fees ledger and bank ledger in the computerized accounting system are then updated. No other controls are necessary on tuition fees.

REQUIRED

- (a) Comment on the ethical and other professional issues in relation to the audit of RPU and recommend any action that should be undertaken to mitigate those issues. **(6 Marks)**
- (b) Explain the deficiencies in RPU's internal control system over revenue from tuition fees and recommend appropriate control procedures. **(13 Marks)**
- (c) Advise the internal audit department of RPU on how they can improve the effectiveness of their audits of the respective departments/ faculties of the University. **(6 Marks)**

(Total 25 Marks)

QUESTION THREE

Kigali Bank Limited (KBL), a medium-sized bank, is an audit client of your firm, Kafulu & Co. (Kafulu) for the second year running. You are the audit manager responsible for the audit of KBL for the year ended 30 June, 2018. KBL's financial statements are prepared in accordance with International Financial Reporting Standards. (IFRS).

You have just been reminded by the audit senior that Kafulu & Co. is required to send a new engagement letter every year to KBL as per the requirements of the bank. The previous engagement letter for the year ended 30 June 2017, however, stated that the letter would remain in force for the foreseeable future.

The audit is almost complete and you are at the stage of reviewing the audit working papers. The financial statements indicate revenue of RWF 5.5 billion; profit before tax RWF 2 billion and total assets RWF 4 billion.

There were some uncorrected errors identified during the audit as described below.

1. Intangible assets

The bank has amortized its software using a rate of 10% contrary to the accounting policy rate of 33.3%. The value of the software asset has consequently been overstated and the amortization in profit or loss understated by RWF 5.8 million. The total value of the intangible asset at the end of the year is RWF 90 million.

2. Loan from PTA bank

On 1 January, 2018 KBL secured a loan of US\$ 1 million from PTA Bank to boost its loan portfolio. The loan is payable on a quarterly basis with a grace period of 6 months and therefore payment commenced in July 2018. The loan was converted to Rwanda francs at a rate of RWF 700 and is therefore recorded in the accounts at RWF.700 million. The exchange rate at the closing date of 30 June, 2018, however, was RWF 900 implying that the loan should have been adjusted to RWF 900 million. This, therefore, means that the loan balance is under stated and profits over stated by RWF 200 million. No further procedures were carried out in relation to loans from PTA Bank as there was no movement in the amount received. The loan is secured against the loan portfolio book and a debenture was registered with the registrar of Companies to that effect.

3. Loan advanced to Lucy.

During a review of loans and advances to customers, the audit team discovered that one of the KBL directors received a loan of RWF. 10 million in March 2018 payable in 12 months. There is no disclosure in the financial statements relating to this amount as management indicated that the soft loan was payable within a short time.

A meeting has been scheduled with KBL management to discuss the uncorrected errors and related issues so that the audit may be finalized.

REQUIRED:

- (a) Discuss with KBL's management the factors that may necessitate the revision of the terms of the audit engagement agreed upon earlier. **(5 Marks)**
 - (b) For each of the uncorrected misstatements:
 - (i) Explain the matters that need to be discussed with KBL's management.
 - (ii) If management of KBL does not adjust the misstatements identified, evaluate the effect of each on the audit opinion. **(15 Marks)**
 - (c) Recommend further audit procedures for the loan obtained from PTA Bank. **(5 Marks)**
- (Total 25 Marks)**

QUESTION FOUR

World Care International (WC) is a Non-Government Organization (NGO) offering humanitarian aid to communities of Rwanda. WC has its headquarters in the United States of America (USA) and the organization operates in over 50 countries.

WC is audited by Kabera & Co. The donors have received allegations/ complaints from one of top management staff that the audit manager of Kabera & Co and his team discovered fraud committed by top management but they were compromised not to disclose it. The donors sent their auditors to confirm these allegations but management did not cooperate fully hence frustrating their work.

The donors have since written to iCPAR demanding that disciplinary action be taken against Kabera & Co and the audit manager in charge of the audit of WC be punished for unethical behavior.

iCPAR has written to Kabera & Co. stating that the firm is required to establish policies and procedures designed to provide it with reasonable assurance that audit engagements are performed in accordance with professional standards and applicable legal and regulatory requirements. Engagement partners are expected to issue reports that are appropriate in the circumstances. Occurrence of management fraud, therefore, implies that the audit partners did not carry out their review responsibilities hence giving the audit manager and his team an opportunity to collude with WC's management.

You are an audit manager with Kamanzi & Co. and your firm has been appointed by the donors to carry out a thorough investigation and report directly to them. The donors are interested in knowing the loss incurred so that they can take legal action against Kabera & Co and the individuals involved in the fraud. Some of top management staff have been consequently sent on forced leave to allow for the investigation to take place.

REQUIRED:

- (a) Discuss with the audit partners at Kamanzi & Co.:
 - (i) The factors that may contribute to fraud in an organization like WC **(3 Marks)**
 - (ii) The possible red flags of management fraud **(8 Marks)**
 - (b) Design the steps/ approach Kamanzi & Co. will follow as they carry out the fraud investigations. **(9 Marks)**
 - (c) Advise the partners of Kabera & Co. on the considerations to make as they carry out their review responsibilities in regard to the audit of WC. **(5 Marks)**
- (Total 25 Marks)**