

**CERTIFIED PUBLIC ACCOUNTANT  
ADVANCED LEVEL 1 EXAMINATIONS**

**A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES**

**TUESDAY: 01 DECEMBER 2020**

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**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.

# **SECTION A**

## **QUESTION ONE**

Kigali Smart Bank Plc (“The Bank”) is the largest deposit taking financial institution listed on the Rwanda Stock Exchange. The Bank operates in Rwanda under the Banking license No. BL001 issued by the National Bank of Rwanda (NBR).

Due to the 3-year mandatory rotation requirements issued by the NBR, Management of the Bank have approached your firm “Smart Brain Limited” to be their current auditor to replace their outgoing auditor A2Z Limited after having successfully completed their three-year term.

After signing the Non-Disclosure Agreement, the following information have been given to you as it is deemed relevant for your firm to gain a full understanding of the Banking operations, its environment as well as its transactions with different stakeholders prior to accepting the appointment.

1. The Bank is owned by 7 shareholders of which 2 are executive directors. 3 of the directors including the CEO own more than 25% individually.
2. The Bank deals with local and international services including but not limited to the following:
  - Receipt of deposits from individuals, SMEs, Government institutions, international agencies as well as large corporates among others.
  - Issue of loans ranging from personal loans, retail and corporate loans, mortgage loans at 16%, 15%, 13% and 11% respectively. The Bank’s employees have preferential rates of 10% and 5% on personal and mortgage loan respectively. All these rates are published in the tariff guide which is reviewed and approved by the Board of Directors biannually.
  - Facilitating international trade through issue of Letters of Credit (LC), issue of performance guarantees among others. Fee rates earned from these services are also published in the tariff guide
3. The Bank is financed by shareholders ‘equity as well as a long-term loan amounting to Rwf 1,000,000,000 obtained on 1 January 2019 from the Financial Health Trust (“The Lender” or “FHT”) based in the United Kingdom at 8% pa annum. The following covenants are attached to this type of facility
  - Debt to Equity ratio should at any point in time never go above 10%.
  - Loan to related parties should not in aggregate exceed 5% of total Equity.
  - Liquidity ratio (Total cash and cash equivalent as per IAS 7 divided by Total customer deposits) should never go below 20%.
  - All interest shall be computed on a monthly basis using simple interest method.
  - FHT reserves the right to recall its funds if any one of the above covenants is breached.
4. The Bank hired “The Digital Champion”, a consultant to help them develop a model to manage its loan book in a manner that is fully compliant with IFRS 9 and other applicable standards.

In developing the IFRS 9 model, management and their consultant have agreed on a number of assumptions including but not limited to the following:

#### **4.1.Probability of Default (PD)**

- 4.1.1. Probabilities of default (PD) have been determined based on yearly transition matrices i.e. 2017 to 2018. Management have indicated that 2018 to 2019 data are not yet finalized hence excluded from the model developed.

#### **4.2.Exposure at Default (EAD)**

- 4.2.1. The EAD for loans in stage 2 and 3 will be equivalent to the capital loan outstanding at the valuation date less expected present value of future installment repayments over the shorter of 12 months and the outstanding duration of the loan.

#### **4.3.Loss Given Default (LGD)**

- 4.3.1. Due to lack of The Bank's own historical data, haircut of 25% and 40% applied on the value of residential and commercial properties respectively are similar to those applied by the Financial Health Trust "The Lender" and management believes that this is appropriate provided they are in the same industry.  
Collateral values used in the IFRS 9 model are based on Open Market Value assigned by real estate valuers accredited by the Institute of Real Property Valuers (IRPV) in Rwanda

You recently attended a meeting with management a week prior to the commencement of your audit and have learnt the following:

- Three senior officials of the Bank namely the Chief Executive Officer (CEO), Head of Credit department and the Chief Risk Officer have been recently suspended from their duties by the Board of Directors following the internal auditor's report which revealed that the three officials have been involved in a bribe that was given by DMC Limited, a car dealer who secured a loan amounting to Rwf 800,000,000 against a fictitious collateral which was recommended by the Bank's CEO before the Board Credit Committee for approval. A whistleblower from the Credit Analysts team reported this matter through anonymous channels established by the Bank. This loan is performing and is classified under stage 1.
- The Board has appointed, the "Investigate&Report Co", a consultant well known in carrying out investigations involving top management, but their report is likely to be issued after the signing of the financial statements for tax filing with RRA.
- Management led by the suspended CEO had recently submitted a strategic paper to the board on their consideration to buy unquoted shares in "Akeza Ltd" a local manufacturer of traditional arts which are exported and sold to Rwandans who live abroad. There is no proper feasibility study conducted to support the proposal, however, the CEO was very optimistic that the Bank would generate a huge return from the investment since the investee is making good profits. This investment proposal was approved by the Board of Directors prior to the CEO's suspension. Rumors indicate that the CEO has an indirect family relationship with the owner of Akeza Ltd and is a direct cousin to the current president of the Republic of Rwanda.

- The Board at the annual planning meeting promised management team composed of 5 people to get a performance bonus of 1% of total revenue if the profit after tax is grown by 10% or above compared to last year.
- There have been no significant changes from prior year in terms of business processes or products and services offered by the Bank
- The Directors and shareholders consider any movement equal or above 5% to be unusual except where change in business has happened as explained by management.

The following financial information has been extracted from the full financial statements for purposes of your audit plan and audit testing.

**Statement of Financial Position (Extract)**

Financial Statement Line Item	31 December 2020	31 December 2019	%age growth
<b>Assets (Extract)</b>	Rwf'000	Rwf'000	
Net loans and advances (note b)	30,000,000	27,000,000	11%
Investment in Akeza Ltd	300,000	-	100%
Investments with financial institutions	5,000,000	5,000,000	0%
Cash and cash equivalents (note a)	15,000,000	17,000,000	-12%
<b>Long term Liabilities (Extract)</b>			
FHT loan-Non-current	1,060,000	-	100%
<b>Short term liabilities (Extract)</b>			
Deposits from customers and other financial institutions	50,592,000	63,500,000	-20%

**Additional information:**

- a) Included in cash and cash equivalents balance is a 5-year treasury bond amounting to Rwf 5,000,000 which has 5 days remaining to maturity
- b) Net loans and advances balance has been arrived at after deducting the Expected Credit Loss amounting to Rwf 4 billion and Rwf 2.8 billion for 2020 and 2019 respectively

**Required:**

You are the engagement manager and the engagement partner has requested you the following prior to your meeting with him:

- (a) **Identify and explain all activities that need to be performed prior to the acceptance of the appointment to avoid any breach of your firm's quality control objectives.**

(5 Marks)

- (b) **After accepting the appointment as the auditor of the Bank, identify all planning activities that you will perform and explain why they are relevant and also highlight the information you expect to gather as part of engagement planning process.** (10 Marks)
- (c) **Prepare a note stating all significant risks identified and the procedures you intend to perform to respond to those identified risks.** (15 Marks)
- (d) **Recommend the testing approach in regard to the Bank's IFRS 9 model with a focus on PD, LGD and EAD.** (15 Marks)
- (e) **From your review of the financial statements and other information provided, state which exceptions and other matters you have noted if any and propose adjustments where applicable.** (5 Marks)
- (Total :50 Marks)**

## **SECTION B**

### **QUESTION TWO**

- a) In line with the cost management principles set by the parent company “Bahoneza Plc” which have been cascaded down to all its subsidiaries including “Rwagasabo Ltd” a subsidiary which has the main objective of training and inspiring young girls and women to become leaders and have a greater societal impact in their day today lives, Rwagasabo Limited has submitted a Request for Proposal for you to respond to as the manager on behalf of your audit firm Rwanda Rugari & Associates.
- You are requested to provide a quotation for both external audit services, financial statements preparation as well as tax computation preparation and review services for the year ending 31 December 2020. Management of Rwagasabo Limited have indicated that it is more efficient and effective to get both services from the same company to be able to obtain a 30% discount which could not be obtained if these services were to be provided by separate firms.
  - Your Company has three departments namely Assurance department in charge of providing audit/assurance services, Tax department in charge of offering tax services and a department called “Other services” which provides financial statements preparation services. These three departments operate independently of each other irrespective of being under one firm whose revenue is reported on a consolidation basis. Each department has a director who is authorized to sign on the deliverables issued by each department on behalf of the Company.

Your proposed engagement partner who is also the overall head of these three departments is very sensitive when it comes to risk management and firm's reputational damage but is also under pressure to report 10% increase in profitability since last year, he reported the smallest profit among all member firms operating on the African continent. He has requested you to advise him on the following:

- i. **Ethical threats (if any) that this engagement is presenting to your audit firm with specific examples from the request for proposal issued to you.** (5 Marks)

- ii. **Your opinion/decision on whether to issue requested quotation or not. You are required to support your Yes or No decision based on the information provided to you above and the guidance provided by the Code of Ethics for professional accountants.** (5 Marks)

b) You are the audit manager of the largest listed telecommunication company in East Africa and in the course of your system audit you identified that voice call rates set in the system are different from rates published on the tariff guide which was approved by the board of Directors. Loss sustained by each customer in the whole financial year ended 31 September 2020 is below materiality hence management requested that this should not be communicated to the public to avoid any damage to the Company's reputation which could cause loss of customers to the competitors as well as loss of significant amount of money and several years to recover the public trust. Additionally, management of your client have advised you to present your findings internally since it is not material for management and the board to take immediate remedial action so that this does not recur in future. You performed additional inquiries with other staff members that are not considered as key management personnel outside finance and IT department and came to a conclusion that the system manipulation of tariff guide rates was a deliberate act done by the IT manager who had super-user system rights to perform certain functions without requiring other people's approval. You presented your findings to the engagement partner and told him about the management's proposal to present the report internally and your partner seem to be in agreement with their proposed approach since there was no material financial loss suffered by the public and as a result he has asked you to revise your report and remove that specific finding before your report is shared by the Board of Directors for the annual general meeting which will be held next month. Your engagement partner also added that in your next year audit, you should pay much attention to system settings especially by checking if rates as per tariff guide match what has been mapped in the system.

**Required:**

- i. **Do you agree with the management proposal not to disclose the matter identified based on materiality? Explain your position.** (3 Marks)
- ii. **What are the likely consequences to you, your engagement partner and your audit firm as well as the audit client if this matter is/is not disclosed to the Company's shareholders in the upcoming annual general meeting?** (5 Marks)
- c) You are a manager at "GoBig Consult Rwanda Ltd" a multinational professional firm providing a range of audit and non-audit services including advisory services. Go Rich Plc, a regional Bank has approached you to offer financial statements audit services to be finalized in one month from the engagement signing date since they are required to file this with their potential lender, "Financial Power Plc", which will use the financial statements in their credit analysis prior to approval of the credit facility.

In your letter of engagement, you have agreed with the client that you will give assurance on key ratios (such as Capital Adequacy Ratio, Liquidity Ratio, Asset to Equity Ratio, Acid Test Ratio, Debt to Equity Ratio) that the lender assesses while making the lending decisions.

From your review you noted that Liquidity and Debt to Equity Ratios are below the threshold required by the lender. You highlighted the breach of these two ratios together with other suggested changes in the client's draft report as part of your review and sent it back to the client to update before it is sent back to you for final review and printing for directors' signatures.

It was already late in the day and the report was expected the same day hence you had a cursory review of the changes made in comparison to what you had suggested in your reviewed report and covered 90% (since in audit, sampling methodology i.e. not testing 100% is permitted under ISA) of all changes you had suggested and all had been captured correctly. It was approaching midnight and you asked your engagement partner if you can send the report on assumption that all suggested changes that you have checked have been well captured consistently with your prior period experience since this is the 3rd year of your audit with this client.

Two months after approval and disbursement of the requested loan to the "Go Rich Plc", The Lender "Financial Power Plc" went through the excel workings shared by the Borrower "Go Rich Plc" and discovered that the two ratios were below the threshold they had set which is inconsistent with your report as well as the financial statements. Immediately one of the Financial Power Plc's credit analysts sent you an email asking what went wrong and when you checked the signed financial statements, you noted that the client didn't adjust the financial statements with the real ratios which were below the threshold regardless of the fact that you had raised it in your review comments for management to make the changes.

The Borrower "Go Rich Plc" was expecting the acquired loan to boost their performance but as time went on, the profitability continued to shrink until when it was declared insolvent and was not able to pay back Rwf 500,000,000 out of Rwf 700,000,000 which they had borrowed from Financial Power Plc and as a result your Company is taken to court to pay the remaining Rwf 500,000,000 together with any related damages that will be determined by the court.

**You are required to demonstrate the following:**

**(i) Explain the likelihood of your Company losing the case if found to have acted with negligence in the conduct of your work with reference to specific examples in the case study above (if any).** (2 Marks)

**(ii) Which steps would you take to avoid these issues to recur in future including those that are intended to limit your Company's professional liabilities in case they arise.**

(5 marks)

**Total:25 Marks)**

### QUESTION THREE

- A. All Stars Limited, “The Company” or User entity”, is a betting company operating in Rwanda under the law no. 17/2018/ of 13/04/2018 Governing Companies; which has a success track record in bringing a financial transformation into the lives of many Rwandans through winning betting lotteries. In the year 2019, the Company hired a service organization, called “Kigali Professionals Empire”, a company which is specialized in offering services to large and medium enterprises ranging from IT and related IT support services, accounting including record keeping, financial statements preparation and historical financial statements reviews in line with ISRE 2400.

The scope of their service to the Company is limited to the financial information recording, processing and keeping supporting documentation to back up all entries passed into the system. The Company also hired a second service organization called “The Future Begins Now” whose scope is also limited to staff recruitment (excluding members of the Executive Committee known as “Exco” and financial statements preparation which is based on the trial balance extracted from Digital Casting technologies, an accounting software that was developed in-house by one of the Kigali Professionals Empire’s IT staff members.

Both service organizations claim to have put in place adequate controls over data processing and authorization and they maintain accountability of all transactions processed and submit summary reports to the Company for a high-level review which is performed by the Exco on a monthly basis. Both service organizations are audited by, “The Genius Professionals”, a company with 10 years of experience in auditing service organizations.

The Company has been issued with a Type 2 report covering the period from 01 July to 31 December 2019, a period over which controls over systems were enhanced following one event of system breakdown that occurred on 15 February 2019 but no major loss of data were reported by the Kigali Professionals Empire and there were no history of such cases reported in the past.

#### **Required:**

You firm “Aluta Continua” has been appointed the auditors of the Company to issue an opinion over the financial statements for the year ended 31 December 2019 and as the engagement manager, your engagement partner has requested you to draft a memo highlighting the following items for your engagement team planning meeting:

- (a) **Planning activities you plan to perform and the information you expect to get to gain an understanding of the nature and significance of the services provided by the service organizations.** (5 Marks)
- (b) **A range of audit evidences from which you expect to get over the quality of both service organizations and activities you expect to perform to ensure evidence obtained is reliable for your financial statements audit.** (5 Marks)
- (c) **i. Risks associated with the use of service organizations.** (2 marks)



**ii. What risks have you noted from the use of Kigali Professionals Empire' services and what procedures do you intend to perform to gain comfort over controls they have established?** (3 marks)

- B. Financial Inclusion Plc (The "Bank") is a local medium sized Bank licensed by the National Bank of Rwanda to issue loans and collect deposits in form of current accounts, savings accounts and term deposits and the latter two products are interest bearing. Its loan book concentration is as follows: 70% SME, 20% Agriculture, 5% residential mortgage and the remaining 5% covers various products including personal and staff loans.

Your firm "Analyse & Invest Co." has been engaged by a potential investor "King of Kings Bank Plc" also referred to as the "Acquirer" to carry out due diligence on the Bank's financial performance, financial position and their projected prospective financial information for the year ending 31 December 2020.

You are given the following additional information to carry out your work and report on factual findings to the acquirer.

Financial Statement Line Item	31-Dec-19 (Audited)	31 December 2020- Projected	%age growth- Projected
	Rwf'000	Rwf'000	
Interest income	12,000,000	12,600,000	5.00%
Interest expense	8,000,000	8,160,000	2.00%
<b>Net income</b>	<b>4,000,000</b>	<b>4,440,000</b>	11%
Net fees and commission income	1,000,000	1,030,000	3.00%
Net forex income	300,000	293,000	(2.33%)
Impairment charge on financial instruments	(500,000)	300,000	(160)%
<b>Total operating income</b>	<b>4,800,000</b>	<b>6,063,000</b>	26%
General administrative expenses	2,000,000	2,120,000	6.00%
Profit before tax	2,800,000	3,943,000	41%
Income tax expense	840,000	1,182,900	41%
<b>Net profit for the period</b>	<b>1,960,000</b>	<b>2,760,100</b>	41%

Financial Statement Line Item	31-Dec-19	31 December 2020- Projected	%age growth- Projected
	Rwf'000	Rwf'000	
Property and Equipment	7,000,000	8,000,000	14%
Net loans and advances	30,000,000	38,700,000	29%

<b>Financial Statement Line Item</b>	<b>31-Dec-19</b>	<b>31 December 2020-Projected</b>	<b>%age growth-Projected</b>
Transit accounts and other assets	1,000,000	1,900,000	90%
Investments with financial institutions	5,000,000	10,000,000	100%
Cash and cash equivalents	15,000,000	26,069,100	74%
<b>TOTAL ASSETS</b>	<b>58,000,000</b>	<b>84,669,100</b>	<b>46%</b>
Share capital	1,000,000	1,000,000	0%
Statutory reserve	300,000	320,000	7%
Retained earnings	2,348,000	15,721,580	570%
<b>Total Equity</b>	<b>3,648,000</b>	<b>17,041,580</b>	<b>367%</b>
Borrowing-Noncurrent	1,060,000	11,000,000	938%
Deposits from customers and other financial institutions	50,592,000	53,627,520	6%
Other liabilities	2,700,000	3,000,000	11%
<b>Total liabilities</b>	<b>54,352,000</b>	<b>67,627,520</b>	<b>24%</b>
<b>Total Equity and Liabilities</b>	<b>58,000,000</b>	<b>84,669,100</b>	<b>46%</b>

**Additional information:**

The Bank has a board of directors, board committees and management committees that actively monitor the performance of the Bank through various reports shared with them by management.

The potential acquirer will need solid support on assumptions applied on each area where an increase of more than 10% has been projected.

**Required:**

Through inquiries or a combination of inquiries and analytical procedures, write down the examination procedures around the following areas for you to report to the Acquirer:

- Property and equipment, loans and advances, investment with financial institutions, cash and cash equivalent focusing on Existence, Right Obligation and valuation assertions.** (6 Marks)
- Borrowings balance. With a focus on Right Obligation assertion.** (2 Marks)
- Apart from the above areas to cover, which other areas should be covered when conducting a client due diligence with reference to the information provided above?**

(2Marks)

**(Total:25 Marks)**

## QUESTION FOUR

Insure2BeSure Limited (The “Company”) is an insurance company operating in Rwanda under license No. 002784 issued by the National Bank of Rwanda to carry out short term businesses.

In preparation for the 3-year mandatory auditor rotation required by the National Bank of Rwanda, the Company has submitted a request for proposal (RFP) through Jobs in Rwanda platform and published the same in The New Times magazine to hire a qualified independent auditor to offer audit services over the coming 3 years and you are given a task to respond to this RFP within a week from the date of its publication.

Your Company called Watch & Report Ltd has put in place risk management procedures including those intended to deal with anti-money laundering and fighting against bribe and corruption.

### Required

a) **Your Assurance department head has requested you to come up with a checklist showing information you need to obtain from the prospective client/the Company to enable you perform all the necessary anti-money laundering checks prior to the submission of your response to the RFP. You also need to explain to them how each of the requested information is relevant to the exercise you are going to do.** (7 Marks)

b) In addition to the information you requested from the Company, you also performed an internet-based research and the following information came to your attention:

- Negative media was found on one of the shareholders who owns 30% of the shares because a company she owned was declared bankrupt in 2008 during the global financial crisis and according to the media results, this was due to mismanagement even though their auditors, management and board of directors attribute the bankruptcy to the global economy which went bad.
- 51% of the Company shares is owned by another company registered in Mauritius providing short and long-term insurance businesses with 10 years of experience in the insurance sector
- Two of the Company’s independent directors were negatively criticised by the opposition internet-based newspaper and they were called cowards due to their political opinion following the recent presidential and parliamentary elections where one ran for presidency and another one for membership in parliament but none of them succeeded. The political party in which they come from works well with the ruling party from the past and the two directors requested their followers to vote for the ruling party and dropped off election two days away from the election date. The election happened before they were appointed as Company directors

You discussed these internet-based results with your Assurance department head and has told you that he is of the view that this engagement poses a high risk and should be dropped unless you provide and document adequate resolutions of the issues identified in your company’s anti-money laundering database.

**Required:**

**Do you agree with your Assurance department head to drop this engagement? If Yes, explain the basis for your decision to rate this engagement as a high risk, if no, explain how best you can dismiss the findings noted above to be able to proceed with the response to the request for proposal (RFP) once all other internal risk management procedures are completed. (8 Marks)**

- c) Alfa&Omega Company Limited is an insurance company operating in Rwanda which has 7 board of directors and 4 members of the audit committee where 3 of the latter are independent in line with Regulation No.11/2017 of 23/11/2017 on corporate governance, risk management and internal controls requirements for insurance business in Rwanda.

The Company had been put under administration by the regulator due to underperformance which was a result of mismanagement noted between the year 2006 and 2010 and the shareholders made a decision to fire all key management personnel and forced the board of directors as well as audit committee members to resign to be able to form another team of professionals and experts who did not have previous experience with the Company. Administration was lifted in 2011 and a new management, board of directors and all board committees were reconstituted with a key mandate to revive the business and turn it into a profitable venture in 2 years only to be able to remain relevant in the market and withstand the current stiff competition.

The Company has approached your firm through the advisory department to offer non audit services including recruitment and training of the board members and members of board committees on corporate governance to help them have a smart start to accomplish their mission.

**Required:**

**You are a member of the recruitment team and you are requested to describe the qualities that a member of the board of directors and the board audit committee must possess in line with regulation No.11/2017 of 23/11/2017 on corporate governance, risk management and internal controls requirements for insurance business in Rwanda bearing in mind that the previous committee was dissolved and that the new committee will be required to work harder to revive the performance of the company. (10 Marks)**

**(Total:25 Marks)**