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**CERTIFIED ACCOUNTING TECHNICIAN  
STAGE 3 EXAMINATION**

**S3.4 AUDIT AND ASSURANCE**

**DATE: TUESDAY, 26 JULY 2022**

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**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**

Clara has been part of the audit team auditing MNK Ltd, a retail supermarket operating in Kigali. while reviewing the operating standards she found them to be vague and not understandable.

**In respect to the control environment, which of the following approach should Clara take:**

- A Determine best practices in this area and use them as the standard.
- B Interpret the standards in her strictest sense as an auditor because standards are otherwise only minimum measures of acceptance.
- C Seek agreement with the auditee as to the standards to be used to measure operating performance.
- D Omit any comments on standards and the auditee's performance in relation to those standards, because such an analysis would be meaningless.

**(2 Marks)**

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### **QUESTION TWO**

MGZ Ltd company recently hired a highly qualified accounts payable Manager who had been terminated from another company for alleged wrongdoing. After 9 months later, the Manager diverted FRW 100 million by sending duplicate payments of invoices to a relative.

**You have been required to advise the management of MGZ Ltd company which Control might have prevented this situation among the following:**

- A Adequately check prior employment backgrounds for all new employees.
- B Not hire individuals who appear overqualified for a job.
- C Verify educational background for all new employees.
- D Check to see if close relatives work for vendors.

**(2 Marks)**

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### **QUESTION THREE**

Anita is a Chief Accountant at Nshuti Auto Limited an auto dealer's 5,000 line-item inventory. She has been doing some month end reports and wanted to select a sample for her self-review to ensure accuracy of her inventory report. She has been advised by her friend that statistical sampling would be appropriate to estimate the value of an auto dealer's 5000 line- item inventory.

Anita is unsure as to why she should use statistical sampling rather than non-statistical methods, as advised by her friend.

**Which of the following is the reason why you will recommend Anita to use statistical sampling?**

- A Because Statistical sampling is Thorough and accurate.
- B Because Statistical sampling is Complete and precise.
- C Because Statistical sampling is Thorough and Complete.
- D Because Statistical sampling is Reliable and objective.

**(2 Marks)**

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#### **QUESTION FOUR**

Valentine was a Senior Auditor at HGV Accountants, and was in charge of KM Oil Ltd. During the planning process of the audit of KM Oil Limited, Valentine concluded that KM Oil Ltd.'s internal controls were likely to be effective and that the audit should therefore focus on conducting substantive procedures. After the engagement planning, Valentine has unfortunately resigned from her position with HGV Accountants and the Audit Manager directed Divine to immediately take over the assignment.

After reviewing the work done by Valentine, Divine believes that Valentine was mistaken and that KM Oil Ltd.'s internal controls are likely to contain significant deficiencies.

**Assuming that Divine is right, which of the following correctly describe the likely consequences of Valentine's decision to focus on Substantive procedure?**

- i. Audit effectiveness would be at risk.
- ii. Audit efficiency would be at risk.
- iii. Too much detection risk would be accepted by the auditor.
- iv. Control risk would be assessed as higher than it would have been.

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

**(2 Marks)**

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#### **QUESTION FIVE**

You are part of the audit team auditing Select Insurance Company Ltd, and you have been assigned to test the assertion that all claims paid by the medical insurance department contain proper authorization and documentation, including but not limited to the validity of the claim from an approved physician and an indication that the claim complies with the claimant's policy. The **most** appropriate audit procedure would be to:

- A Select a random statistical sample of all policyholders and examine all claims for the sampled items during the year to determine if they were handled properly.

- B Select a sample of paid claims from the claims (cash) disbursement file and trace to documentary evidence of authorization and other supporting documentation.
- C Select a sample of claims filed and trace to documentary evidence of authorization and other supporting documentation.
- D Select a sample of claims denied and determine that all claims denied were appropriate. The claims' denied file is much smaller, and the auditor can obtain greater coverage with the sample size.

**(2 Marks)**

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### **QUESTION SIX**

**Which of the following audit procedures provides the best evidence about the collectability of notes receivable?**

- A Confirmation of note receivable balances with the debtors.
- B Examination of notes for appropriate debtors' signatures.
- C Reconciliation of the detail of notes receivable and the provision for uncollectible amounts to the general ledger control.
- D Examination of cash receipts records to determine promptness of interest and principal payments.

**(2 Marks)**

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### **QUESTION SEVEN**

Pamoja Consultants has been engaged by Twende Transport Ltd to perform its annual audit for the year ended 31 December 2020. The firm performed the audit in a competent, non-negligent manner and billed Twende Transport Limited for FRW 20 million, as the agreed fee. Shortly, after delivery of the audited financial report, Zawadi the Assistant Controller, disappeared, taking with him FRW 50 million of Twende's funds. It was then discovered that he had also previously embezzled FRW 30 million of Twende's funds in the year 2019 prior to the appointment of Pamoja Consultants. On that background the management of Twende Transport Ltd accuse Pamoja Consultants to be negligent and has refused to pay the auditor's fee and is seeking to recover the FRW 80 million that was stolen by Zawadi.

**Which of the following is correct?**

- A The auditor cannot recover the audit fee and is liable for FRW 80 million.
- B The auditor is entitled to collect the audit fee and is not liable for FRW 80 million.
- C Twende Transport Ltd is entitled to recover the FRW 50 million and is not liable for the FRW 20 million fee.
- D Twende Transport Ltd is entitled to revoke the audit contract and thus is not liable for the FRW 20 million fees, but it cannot recover damages.

**(2 Marks)**

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### QUESTION EIGHT

The risk that an auditor's procedures will lead to the conclusion that a material misstatement does not exist in an account balance when, in fact, such a misstatement does exist is:

- A Audit risk
- B Control risk
- C Detection risk
- D Inherent risk

(2 Marks)

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### QUESTION NINE

Which of the following is not a typical analytical procedure?

- A Study of relationships between financial and relevant nonfinancial information.
- B Comparison of recorded amounts of major disbursements with appropriate invoices.
- C Comparison of financial information with similar information regarding the industry in which the entity operates.
- D Comparison of recorded amounts of major disbursements with budgeted amounts.

(2 Marks)

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### QUESTION 10

An auditor concludes that there is a material inconsistency in other information in an annual report to shareholders containing audited financial statements. If the auditor concludes that the financial statements do require revision, but the client refuses to revise or eliminate the material inconsistency, the auditor may:

- A Issue a qualified opinion after discussing the matter with the client's board of directors.
- B Consider the matter closed since the other information is not in the audited financial statements.
- C Issue an adverse opinion since the inconsistency is not just material but pervasive.
- D Revise the auditor's report to include other matter paragraph describing the material inconsistency.

(2 Marks)

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## SECTION B

### QUESTION 11

Wishavura recently completed the CAT qualification and immediately got an offer with Chesimo Auditors Ltd as a Junior Auditor. During her first assignment she was cross checking the Trial Balance of HIRWA Inc. and noted a provision of FRW 70 million and she has been informed that this provision relates to a damage which is likely to result from a pending litigation against HIRWA Inc. by a customer for the breach of a contract.

#### **Required:**

- a) **What do you understand by the term “Accounting Estimate”?** (1 Mark)
- b) **Outline the examples of accounting estimates.** (3 Marks)
- c) **Wishavura has been requested by her supervisor to determine whether the above accounting estimates is reasonable in the context of the applicable financial reporting framework or are misstated in accordance with ISA 540. Advise Wishavura on the audit procedures that she would need to consider in relation to the above estimate.** (6 Marks)

**(Total: 10 Marks)**

### QUESTION 12

Trust Wood Ltd, is a new audit client and you are at the planning meeting for the forthcoming audit. The company has grown rapidly and has a 30 June year-end. The financial statements have not been audited in previous years since the organization has only just converted from a partnership to a company. The company's bankers have requested that an audit is undertaken on the financial statements for the year ending 30 June 2021. Higher levels of inventory required to meet the increasing demand for its products have necessitated a request for an increase in the bank's overdraft facility. The company makes wardrobes. It buys the materials directly from the supplier and thereafter manufactures the wardrobes. At the year-end, inventory comprises raw materials, work-in-progress and finished goods. The company does not undertake continuous inventory counting but does intend to perform a full inventory count on 30th June 2021. The company uses a standard costing system to value finished products and work-in-progress.

#### **Required:**

**What are the objectives of the planning stage, with particular attention being paid to those areas that will assist the auditor in obtaining a sound knowledge of the business?**

(10 Marks)

**(Total: 10 Marks)**

## SECTION C

### **QUESTION 13**

Iteka Manufacturing Limited (Iteka Ltd) sought a FRW 200 million loan from TDK Bank. The bank insisted that the audited financial statements be submitted before it would extend the loan amount. Iteka Ltd agreed to do this and also agreed to pay the audit fee. An audit was performed by Creative Auditors Ltd which submitted the audit report to TDK Bank to be used solely for the purpose of the loan negotiation with TDK Bank. The TDK Bank after reviewing the audited financial statements, decided not to extend the loan to Iteka Ltd. The TDK Bank had been using some ratios from the financial statements and decided they were too low. Iteka Ltd then presented the audited financial statements to another financial institution, Secure Bank, and obtained FRW 200 million loan from Secure Bank. Six months later Iteka Ltd went into receivership and defaulted on its loan. Secure Bank discovered that Iteka's inventory accounts have been significantly overstated and sued Creative Ltd for negligence. Creative Auditors Ltd strongly denied the claim and argued that they had relied on management representation letter for valuation of inventory.

#### **Required:**

- a) **Explain the differences and similarities between Contract law and Third-parties negligence.** (3 Marks)
- b) **Briefly explain the criteria that Secure Bank must prove in order to establish a course of action for negligence against Creative Auditors Ltd.** (6 Marks)
- c) **Will Creative Auditors Ltd be liable to Secure Bank for negligence? Explain**(2 Marks)
- d) **Discuss the likelihood of Secure Bank winning a negligence claim against Creative Auditors Ltd.** (9 Marks)

**(Total: 20 Marks)**

## QUESTION 14

You are carrying out an audit of the revenue system of Mugisha Ltd, a company that manufactures office furniture. The company has annual revenue of FRW 500 million. All the shares are owned by Shadia and her husband Amani. Neither is involved in the running of the business. The chairperson is responsible for running the business but does not own any of the company's shares. The bookkeeper maintains all the accounting records and prepares the annual financial statements.

A stand-alone computer is used to maintain the accounting records including those of the revenue system. Standard accounting software is used, which was purchased from an independent supplier. For the revenue system, a sales ledger is maintained to which sales invoices, credit notes, cash and discounts are posted. When sales invoices are posted and credit notes are input to the computer, the value of the invoice or credit note is posted to both the sales ledger and the nominal ledger.

You have determined that the documents and personnel involved in the sales ledger are as follows:

- i. When an order is received by telephone it is recorded by the salesclerk in the sales department. This is usually done on a note pad.
- ii. The salesclerk will then pass the sales order to the stores, to the goods outwards department where the office furniture is kept.
- iii. If the goods ordered are in inventory, then the goods will be loaded into one of the vehicle delivery trucks. A two-part dispatch note will be prepared to accompany the sales order. This is usually done before the stores have received the sales order from the sales department.
- iv. The goods are delivered to the customer together with the copy of the goods dispatch note.
- v. The driver on his return will inform the sales department that the delivery has been a success and will retain the bottom copy of the goods dispatch note in the stores.
- vi. At the end of the week, the sales department prepare a sales invoice for the customer.
- vii. When the post is received, it is opened by one of the sales departments. The person opening the post will both make a list of all the cheques received and that same person will then go to the bank and bank the cheques. Upon return, the remittances and cheque paying-in book are passed to the bookkeeper for updating the receivables ledger.
- viii. The receivables ledger is reviewed by the bookkeeper on a monthly basis to see which customers are over their credit terms and will inform the sales staff on who to telephone and chase up about their debt.

### Required:

- a) With the use of a table, **identify the weaknesses in the internal control of Mugisha Ltd's revenue system and propose one control to address each weakness you identified.** (10 Marks)
- b) It has been suspected that Shadia and Amani are considering manipulating the financial statements. In such a situation, **which assertion would you pay more attention to; in the audit of receivables – completeness or existence?** (2 Marks)

c) **Explain your answer to part (b) and give a substantive test that would test your suspicion.** (3 Marks)

d) A receivables' circularization frequently does not produce the same quality of audit evidence as a supplier statement reconciliation. **Discuss your understanding in this matter.** (5 Marks)

**(Total: 20 Marks)**

### **QUESTION 15**

Ontime Engineers Ltd is a computer maintenance company with a current annual turnover of FRW 700 million. Generally, customers are invoiced for maintenance work at the time that service is provided although the company offers their customers a four-year service contract on payment of a non-refundable fixed sum at the beginning of the contract.

As a Certified Accounting Technician, you have been appointed auditor; from your review of prior period financial statements, you noted that their report was unqualified.

You have commenced planning the audit of the financial statements for the year ending 30 September 2021 and have found that on the basis that payments for four-year service contracts are non-refundable, the directors have in previous years taken credit for all such income at the time that the contract is entered into.

The management accounts for the year-to-date show that direct costs represent approximately 80% of the service contract income. The net profit for the year ended 30 September 2021 was FRW 280 million and income from service contracts entered into during that year amounted to RWF 600 million.

#### **Required:**

You are required to write a formal letter to the directors setting out:

a) **On your observation, if any, on the accounting policy adopted for three-year service contracts.** (10 Marks)

b) **Your recommended treatment of such income, together with the disclosures you consider necessary in order for the financial statements to show a true and fair view** (5 Marks)

c) **A client's affairs should not be disclosed to third parties. However, where a client has been guilty of an unlawful act, to whom should the auditor disclose this information, and in what order.** (5 Marks)

**(Total: 20 Marks)**

**End of Question Paper**

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