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**CERTIFIED PUBLIC ACCOUNTANT  
ADVANCED LEVEL 1 EXAMINATIONS**

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

**DATE: FRIDAY, 29 JULY 2022**

**MARKING GUIDE AND MODEL ANSWERS**

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## **SECTION A**

### **QUESTION ONE**

<b>Marking guide</b>	<b>Marks</b>
<b>Q1 (a): Evaluation of audit risks</b>	
Up to 3 marks for each audit risk evaluated unless otherwise indicated. Marks may be awarded for other, relevant risks not included in the marking guide. In addition, ½ mark for each relevant trend or calculation which forms part of the audit risk evaluation	
<b>Materiality calculations should be awarded 1 mark each</b>	
<ul style="list-style-type: none"> <li>❖ Disclosure of events after the reporting period in respect of group restructuring – risk of inadequate disclosure</li> <li>❖ Assets held for sale in respect of planned disposal of Ceramic Ltd – risk assets not measured or recognised appropriately as assets held for sale.</li> <li>❖ Discontinued operation – risk that group statement of profit or loss does not reflect results of Ceramic Ltd as a discontinued operation</li> <li>❖ Disposal of Ceramic Ltd – incentive for manipulation</li> <li>❖ Joint arrangement in Swemele Ltd – risk that the investment is not equity accounted.</li> <li>❖ Misclassification of operating license in respect of Bourbon Ltd buy-express as PPE, impact on measurement of PPE and intangible assets and associated expenses</li> <li>❖ Bourbon Ltd drive-throughs likely to be a reportable segment – risk of incomplete disclosure of operating segments</li> <li>❖ Government grant – risk that conditions will not be met and a liability should be recognised for repayment of the grant</li> <li>❖ Audit committee – lack of financial reporting expert creates control risk</li> </ul>	
<b>Maximum Marks for Q1 (a) - using the guide provided above</b>	<b>24</b>
<b>Q1 (b): Additional information required to plan the audit of the planned disposal of Ceramic Ltd</b>	
<b>Award up to 1 mark for each piece of additional information</b>	
<ul style="list-style-type: none"> <li>❖ The financial statements of Ceramic Ltd, to ascertain the detail of the amounts recognized</li> <li>❖ A copy of the vendor's due diligence report to ascertain key findings, e.g., valuations of assets and liabilities</li> <li>❖ Information surrounding the reasons for disposal, from the Venture Ltd board minutes at which approval was given for the disposal</li> <li>❖ Information regarding the potential acquirers of Ceramic Ltd and the stage of negotiations</li> <li>❖ Any preliminary determination by management of the anticipated profit or loss on disposal and expectation of any impairment to the value of assets held in the disposal group</li> </ul>	



❖ Obtain a copy of management's assessment/workings of the impact on the group's financial position on the sale of Ceramic Ltd and the overall impact of the restructure of the group.	
<b>Maximum Marks for Q1 (b) - using the guide provided above</b>	<b>4</b>
<b>Q1 (c): (i) Principal audit procedures the 50% investment in Real estate Ltd</b>	
<b>Award up to 1 mark for each well-designed audit procedure.</b>	
<p>❖ Obtain the legal documentation supporting the investment and agree the details of the investment including:</p> <ul style="list-style-type: none"> <li>✓ Date of investment</li> <li>✓ Amount paid</li> <li>✓ Number of shares purchased</li> <li>✓ The voting rights attached to the shares</li> <li>✓ The nature of the profit-sharing arrangement between the group and Swemele Ltd.</li> <li>✓ The nature of access to Realestate Ltd assets under the terms of the agreement.</li> </ul> <p>❖ Confirmation that there is no restriction of venture Ltd share control of Realstate Ltd</p> <p>❖ Review board minutes to confirm the approval of the investment and to understand the business rationale for the investment</p> <p>❖ Review minutes of relevant meetings between the group and Swemele Ltd to confirm that control is shared between the two investors and to understand the nature of the relationship and the decision-making process</p> <p>❖ Obtain documentation such as Realestate Ltd organizational structure to confirm that the group has successfully appointed members to the board of the company and that those members have equal power to the members appointed by Swemele Ltd</p>	
<b>Maximum Marks for Q1 (c) (i) - using the guide provided above</b>	<b>6</b>
<b>Q1 (c): (ii) Principal audit procedures the government grant</b>	
<b>Award up to 1 mark for each point explained</b>	
<p>❖ Obtain the documentation relating to the grant and review to obtain understanding of:</p> <ul style="list-style-type: none"> <li>✓ The terms of the grant, in particular requirements relating to the specific use of the funds</li> <li>✓ The date by which the funds must be used</li> <li>✓ Any clauses relating to repayment of some or all of the grant should certain conditions arise</li> </ul> <p>❖ Agree the amount received to bank statement and cash book of Ventures Ltd</p> <p>❖ Obtain and review the group's capital expenditure forecast to confirm the amount planned to be spent on capital expenditure relating to environmental matters</p>	



<ul style="list-style-type: none"> <li>❖ Discuss the use of the grant to fund an advertising campaign with an appropriate person, e.g., group marketing director, and review any plans to use the funds for promotional purposes to confirm that recycling features in the campaign, as intended by the government</li> <li>❖ Confirm, through agreement to marketing plans, whether any funds will be spent during this financial year</li> <li>❖ Obtain a written representation from management that the grant received will be used for the specific purposes required by the government.</li> </ul>	
<b>Maximum Marks for Q1 (c) (ii) - using the guide provided above</b>	<b>6</b>
<b>Q1 (d): Ethical issues</b>	
<b>Award up to 1 mark for each point explained</b>	
<ul style="list-style-type: none"> <li>❖ Audit firm partner serving on group audit committee – self-review threat explained</li> <li>❖ Audit firm partner serving on group audit committee – self-interest threat explained</li> <li>❖ Safeguards cannot reduce to an acceptable level so cannot provide partner to serve on audit committee</li> <li>❖ Referral fee – self-interest threat to objectivity and professional competence explained</li> <li>❖ Can earn referral fee as long as safeguards used – disclose to client and obtain agreement</li> <li>❖ Internal audit assistance – self-review threat explained</li> <li>❖ Internal audit assistance – management responsibility threat explained</li> <li>❖ No safeguards can reduce threat relating to management responsibility</li> <li>❖ For PIE client cannot provide internal audit assistance in relation to material/significant matter.</li> <li>❖ Audit firm therefore cannot provide internal audit assistance.</li> </ul>	
<b>Maximum Marks for Q1 (d) - using the guide provided above</b>	<b>10</b>
<b>Total marks for Question One</b>	<b>50</b>



## **Model answers:**

### **(a) Evaluation of significant audit risks**

#### **Planned disposal of Ceramic Ltd and acquisition of Real-estate Ltd – events after the reporting date**

Ventures Ltd is planning a significant restructuring. The disposal of Ceramic Ltd is planned to take place shortly after the year end, and the disposal will have a material impact on the group financial statements given that Ceramic Ltd accounts for 23.2% of projected group total assets and 30.9% of projected group revenue.

The acquisition of Real-estate Ltd, which is planned to take place in the first quarter of the next financial year, will be material to the group, with the anticipated cost of investment and the fair value of identifiable net assets of Real-estate Ltd representing 21.1% and 17.9% of projected Group assets respectively.

Both events will fall under the scope of IAS 10 *Events after the Reporting Period*, meeting the definition of a non-adjusting event. IAS 10 requires that non-adjusting events should be disclosed if they are of such importance that non-disclosure would affect the ability of users to make proper evaluations and decisions. The required disclosure is the nature of the event and an estimate of its financial effect or a statement that a reasonable estimate of the effect cannot be made. The audit risk is that incomplete or inaccurate disclosure relating to the acquisition and disposal is provided in the notes to the financial statements.

#### **Disposal of Ceramic Ltd – assets held for sale and discontinued operations.**

The planned disposal should be accounted for under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, which requires that once certain conditions are met, a disposal group of assets should be classified as held for sale. The conditions include:

- Management is committed to a plan to sell
- The asset is available for immediate sale
- An active programme to locate a buyer is initiated
- The sale is highly probable, within 12 months of classification as held for sale
- The asset is being actively marketed for sale at a sales price reasonable in relation to its fair value
- Actions required to complete the plan indicate that it is unlikely that plan will be significantly changed or withdrawn.

Assuming that the conditions are met, which seems likely given that the board approved the sale in March 2022 and that potential purchasers have already expressed an interest, the assets held in the disposal group should be reclassified as assets held for sale and measured at the lower of carrying amount and fair value less costs to sell. The assets should not be depreciated after reclassification. IFRS 5 also requires that immediately prior to classifying an asset or disposal group as held for sale, impairment is measured and recognised in accordance with the



applicable IFRS Standards, which in this case would be IAS 16 *Property, Plant and Equipment* and IAS 36 *Impairment of Assets*.

Several audit risks arise as a result of the disposal. First there is a risk that the assets are not treated as a disposal group for the purpose of IFRS 5 and have continued to be depreciated. Assets are possibly overvalued if an impairment review has not been performed or assets not measured at the lower of carrying amount and fair value less costs to sell. The fact that Ceramic Ltd's revenue is projected to fall by 3.9% indicates that impairment of assets could be an issue, increasing the risk of misstatement.

There is also a risk relating to disclosure, as assets and liabilities held for sale should be recognised separately from other assets and liabilities in the statement of financial position, and if they have not been appropriately reclassified, then non-current assets and liabilities will be overstated.

**There is also an audit risk that Ceramic Ltd is not treated as a discontinued operation in accordance with IFRS 5.**

A discontinued operation is defined as a component of an entity which either has been disposed of or is classified as held for sale, and represents a separate major line of business or a geographical area of operations and is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations. Given the materiality of Ceramic Ltd and its products being a separate line of business for the group, it meets the definition of a discontinued operation. In accordance with IFRS 5, the post-tax profit or loss of the discontinued operation and the post-tax gain or loss recognised on the measurement to fair value less cost to sell or on the disposal of the disposal group should be presented as a single amount on the face of the statement of comprehensive income. In addition, detailed disclosure of revenue, expenses, pre-tax profit or loss and related income taxes is required either in the notes or in the statement of comprehensive income in a section distinct from continuing operations. The risk is that the necessary disclosures are not made, leading to incorrect presentation of group profit or loss and incomplete information in the notes to the group financial statements.

### **Disposal of Ceramic Ltd – potential for manipulation**

A further audit risk relating to the disposal of Ceramic Ltd is that the results of the subsidiary could be manipulated to make it look more favourable to any potential purchaser. The financial information indicates that this subsidiary's revenue has declined and therefore it could be that management attempts to manipulate the financial statements to present a healthier financial performance to potential buyers. For example, costs could be suppressed or shifted to other Group companies to maintain the profit of Ceramic Ltd and make it more attractive to purchasers.



## **Investment in Real-estate Ltd**

Venture Ltd will be investing FRW 48 million in Realestate Ltd; this represents 10.1% of projected group assets and therefore is material to the group financial statements. From the information provided, it seems that the investment is a joint venture, with control of Realestate Ltd shared between the group and Swemele Ltd. IFRS 11 *Joint Arrangements* defines a joint venture as a joint arrangement whereby the parties who have joint control of the arrangement have rights to the net assets of the arrangement. IFRS 11 requires that a joint venture recognises its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with IAS 28 *Investments in Associates and Joint Ventures*. Audit risk arises if the group fails to apply equity accounting to the investment, which may lead to an under or overstated value of investment and incorrect presentation of income and expenses relating to the joint venture in the group statement of profit or loss.

## **Bourbon buy-express – capital expenditure**

During the year, there has been significant capital expenditure relating to 50 new buy-express Nescafe outlets. The total amount capitalised is FRW 43 million, of which FRW 15 million relates to acquiring operating licences. The audit risk relates to the classification of the licences within property, plant and equipment, they should instead be recognised as intangible assets. This error is material, with the FRW 15 million cost of the licences representing 3.2% of projected group assets. If the error is uncorrected, property, plant and equipment is overstated and intangible assets are understated.

A consequence of the misclassification is that the FRW 15 million should be amortized over its specific useful life of three years, so assuming that a full year's worth of amortization should have been expensed, this amounts to FRW 5 million. Currently, the amount has been treated as property, plant and equipment and depreciated over a 20-year life, so FRW 0.75 million has been expensed. Therefore, expenses are understated by FRW 4.25 million. This is material, representing 21.3% of group profit before tax. There is therefore an audit risk that group profit is significantly overstated.

## **Bourbon Ltd buy-express – reportable operating segment**

According to the Group finance director, revenue from the new buy-express Nescafe outlets accounts for almost all of the increase in revenue from Bourbon Ltd. The financial information shows that Bourbon Ltd revenue is projected to increase by FRW 45 million this year. Total group revenue is projected to be FRW 320 million; FRW 45 million is 14.1% of this total.



The revenue from the buy-express coffee shops could be a reportable operating segment under IFRS 8 *Operating Segments*.

An operating segment is a component of an entity:

- which engages in business activities from which it may earn revenues and incur expenses,
- whose operating results are reviewed regularly by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

IFRS 8 requires an entity to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments which meet specified criteria, including that its reported revenue is 10% or more of the combined revenue of all operating segments.

It seems that the buy-express Nescafe outlets should be treated as a reportable segment given that discrete information is available through the group's management information system, the results are reviewed, and it generates more than 10% of group revenue. The audit risk is that disclosure is not provided at all in relation to this reportable segment, or that disclosure is incomplete in the final version of the financial statements.

### **Government grant**

The group received a government grant of FRW 20 million, representing 4.2% of projected group assets and therefore material to the group statement of financial position. In addition, if the FRW 20 million grant receipt had not been recognized in full as income this financial year, the projected group profit before tax would be zero. The recognition as income is therefore extremely significant to the group financial statements.

The grant should be accounted for in accordance with IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* which requires government grants to be recognized in profit or loss on a systematic basis over the periods in which the entity recognizes as expenses the related costs for which the grants are intended to compensate.

The two parts of the grant should be accounted for separately. The amount relating to capital expenditure should be deferred on the statement of financial position and assuming that the grant will be used to upgrade items of property, plant and equipment, the grant should then be recognized in profit or loss over the periods in which depreciation expense on the assets to which it relates is recognized. The part of the grant relating to promotional activity should be recognized in profit or loss in the same period as the relevant expenses – which may be this year, or could be the next financial year, depending on when the expenses relating to the advertising campaign are incurred.

It is likely that if funds are not used in the manner intended by the government, i.e., that half of it is used to make the assets more environmentally friendly, then some or all of the grant would be repayable. This would mean that a provision or contingent liability should be recognized, and there is an audit risk that liabilities are understated if any amount probable to



be repaid is not accounted for as a provision, or that insufficient disclosure is made in the note to the financial statements if a contingent liability arises.

Therefore, the audit risk is that group profit is overstated by a maximum amount of FRW 20 million, and liabilities understated by the same amount. The accounting treatment could be a deliberate attempt to enhance the appearance of the group profit for the year, and this issue should be approached with a high degree of professional skepticism during the audit.

### **Audit committee lack of financial reporting expert**

Since January 2022, the group audit committee does not have a financial reporting expert. It is a requirement of best practice corporate governance principles that the board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience and that the committee as a whole shall have competence relevant to the sector in which the group operates. The group is in breach of this principle, as there has not been a financial reporting expert member of the audit committee for a significant period during the financial year, and this represents a control risk. One of the roles of the audit committee is to monitor the integrity of the financial statements of the group and, in particular, to review significant financial reporting judgements contained in them. Without a financial reporting expert on the audit committee to provide this oversight, there is a risk that inappropriate judgements are made and a higher risk that errors or deliberate manipulation of the financial statements are not addressed.

### **(b) Additional information required to plan the audit of the disposal of Ceramic Ltd**

- The individual financial statements of Ceramic Ltd, to ascertain the detail of the amounts recognised – this will assist the audit team in planning to audit the compliance with measurement and disclosure requirements of IFRS 5 and to confirm materiality of the balances involved.
- A copy of the vendor's due diligence report produced by Mugisha CPA, to ascertain key findings, e.g., valuations of assets and liabilities; this will help in planning to audit the measurement of the disposal group and whether any impairment should be recognized.
- Further information surrounding the reasons for disposal, from the group board minutes at which approval was given for the disposal, to enable the auditor to develop an understanding of management's rationale and how the disposal fits in with the group restructuring as a whole.
- Information regarding the potential acquirers of Ceramic Ltd and the stage of negotiations, this will help the audit team develop an expectation as to whether the disposal is likely to take place after the year end and the potential sales price.
- Any preliminary determination by management of the anticipated profit or loss on disposal and expectation of any impairment to the value of assets held in the disposal group.



- Obtain a copy of management's assessment/workings of the impact on the group's financial position on the sale of Ceramic Ltd and the overall impact of the restructure of the group.

**(c)(i) Principal audit procedures in respect of the classification of the investment in Real-estate Ltd**

- Obtain the legal documentation supporting the investment and agree the details of the investment including:
  - i) Date of investment
  - ii) Amount paid
  - iii) Number of shares purchased
  - iv) The voting rights attached to the shares
  - v) The nature of the profit-sharing arrangement between the group and Swemele Ltd.
  - vi) The nature of access to Real-estate Ltd assets under the terms of the agreement.
  - vii) Confirmation that there is no restriction of venture Ltd share control of Real-state Ltd
- Review board minutes to confirm the approval of the investment and to understand the business rationale for the investment.
- Review minutes of relevant meetings between the group and Swemele Ltd to confirm that control is shared between the two investors and to understand the nature of the relationship and the decision-making process.
- Obtain documentation such as Real-estate Ltd 's organizational structure to confirm that the group has successfully appointed members to the board of the company and that those members have equal power to the members appointed by Swemele Ltd.

**(ii) Principal audit procedures in respect of the government grant received**

- Obtain the documentation relating to the grant and review to obtain an understanding of:
  - ❖ The terms of the grant including the amount received, and in particular requirements relating to the specific use of the funds
  - ❖ The date by which the funds must be used
  - ❖ Any clauses relating to repayment of some or all of the grant should certain conditions arise.
  - ❖ Agree the amount received to bank statements and Ventures Ltd cash book.
  - ❖ Obtain and review the group's capital expenditure forecast to confirm the amount planned to be spent on capital expenditure relating to environmental matters.
  - ❖ Discuss the use of the grant to fund an advertising campaign with an appropriate person, e.g., Venture Ltd marketing director, and review any plans to use the funds for promotional purposes to confirm that recycling features in the campaign, as intended by the government.
  - ❖ Confirm, through agreement to marketing plans, whether any funds will be spent during this financial year.
  - ❖ Obtain a written representation from management that the grant received will be used for the specific purposes required by the government.



## **(d) Ethical issues**

### **Partner to serve on audit committee**

Ventures Ltd audit committee has requested that a senior partner from Mugeraneza CPA could assume a role on the group audit committee while a replacement for the financial reporting expert committee member is being sought. Should a partner from Mugeraneza CPA take this appointment, a self-review threat to objectivity arises because an audit committee member is in a position to exert influence over the financial statements, and the audit team would be less likely to challenge issues during the audit, thereby losing their professional skepticism. A self-interest threat also arises because the audit firm's interests become closely aligned to the interests of the group, impacting on auditor objectivity.

For these reasons, the IESBA *International Code of Ethics for Professional Accountants* (the *Code*) states that a partner or an employee of the audit firm shall not serve as a director or officer of an audit client. Therefore, Mugeraneza CPA cannot provide a senior partner, or any other member of staff, to serve on the Group's audit committee.

### **Referral fee**

The Group audit committee understands that Mugeraneza CPA cannot provide a corporate finance service, but could recommend another firm, Kabanga Associates, for this work, for which the firm would earn a referral fee. The *Code* states that this creates a self-interest threat to objectivity and to professional competence and due care. The self-interest threat arises from the income generated from the referral, and this may result in the audit firm recommending another firm for the work without proper consideration of their competence to perform the engagement.

The *Code* does not prohibit referral fees but the significance of the threats should be evaluated and safeguards applied to reduce the threats to an acceptable level. Safeguards may include:

- Disclosing to the group in writing the arrangement for a referral fee to be received from Kabanga Associates, and
- Obtaining advance agreement from the group that the arrangement is acceptable.

Therefore, the matter should be discussed again with the group audit committee, and if the committee confirms agreement with the proposed referral fee, Mugeraneza CPA can recommend Kabanga Associates to perform the corporate finance work for the Group. Internal audit

A further threat arises from the audit committee's request for Mugeraneza CPA to work with the Group internal audit team to design and evaluate internal controls relating to revenue. The *Code* suggests that providing an audit client with an internal audit service might create a self-review threat to objectivity. This is because in subsequent audits the audit team may use the internal audit work performed in their audit of revenue. They may over-rely on the internal controls designed and evaluated by the audit firm or will not apply an appropriate level of skepticism when assessing the work.

In addition, a threat of management responsibility arises, whereby the audit firm is making decisions and using judgement which is properly the responsibility of management. The *Code* states that taking responsibility for designing, implementing, monitoring and maintaining



internal control is assuming management responsibility. According to the *Code*, an audit firm must not assume management responsibility for an audit client because the threat to independence created is so significant that no safeguards could reduce it to an acceptable level.

Specifically in relation to public interest entities, the *Code* further states that an audit firm shall not provide internal audit services which relate to a significant part of controls over financial reporting, financial accounting systems which are significant to the financial statements or amounts or disclosures which are material to the financial statements.

Therefore, Mugeraneza CPA should politely decline the request made by the audit committee and ensure that the committee is fully aware of the ethical issues raised by their requests.

### **Conclusion**

There is a range of audit risks to be considered in planning the forthcoming group audit, many of the more significant risks relate to the Venture Ltd restructure. Recommended audit procedures have been designed in relation to two material audit issues, and finally three ethical issues have been identified and evaluated. Mugeraneza CPA should not provide internal audit assistance to Venture Ltd, nor allow a partner to serve on Venture Ltd audit committee. However, a referral fee from Kabanga Associates is acceptable, provided Venture Ltd agrees to the arrangement.



## **SECTION B**

### **QUESTION TWO: Kayonza Ltd**

<b>Marking guide</b>	<b>Marks</b>
<b>Q2: Critical appraisal of extract from draft auditor's report</b>	
<b>Award 1 Mark for title</b>	<b>1</b>
<b>Award up to 3 Marks for each well explained point up, to maximum of 24 Marks</b>	<b>24</b>
<ul style="list-style-type: none"> <li>❖ Addressee should be shareholders only (not directors)</li> <li>❖ Incorrect order – opinion paragraph should be before basis for opinion</li> <li>❖ Lack of specific reference to ethical code</li> </ul> <p><b>Material uncertainty going concern:</b></p> <ul style="list-style-type: none"> <li>❖ Opinion paragraph should be headed ‘qualified/adverse opinion’ followed by ‘basis for qualified/adverse opinion’</li> <li>❖ Modification due to material misstatement absence of disclosure – ‘except for’ or adverse depending on auditor’s professional judgement re level of impact on financial statements.</li> <li>❖ Incorrect use of ‘material uncertainty regarding going concern’ paragraph – this paragraph should be used when adequate disclosure has been made by directors in financial statements.</li> <li>❖ Details of uncertainty ongoing concerns should be given in basis for qualified/adverse opinion paragraph Long-term contracts:</li> <li>❖ Incorrect use of ‘other information’ paragraph – should be used to describe auditor’s responsibilities for ‘other information’ (e.g. rest of the annual report, including management report) and outcome of fulfilling those responsibilities</li> <li>❖ Issue is area of significant auditor judgement which should be considered for inclusion as KAM which as a listed company, Kayonza Ltd should disclose in separate KAM section of audit report</li> <li>✓ KAM section should include explanation of what is a KAM</li> <li>✓ KAM section should explain why matter is considered to be KAM</li> <li>✓ KAM section should also explain how KAM was addressed by audit process</li> </ul>	
<b>Total marks for Question two</b>	<b>25</b>



## **Model Answer**

### **Kayonza Ltd**

Critical appraisal of extract from draft auditor's report Presentation and structure of auditor's report extract.

- The structure and format of the auditor's report is prescribed by ISA 700 *Forming an Opinion and Reporting on Financial Statements*.
- The auditor's report should be addressed solely to the shareholders of the reporting entity and the title should not include any reference to the directors of Kayonza Ltd.
- In addition, the first two paragraphs are presented in the incorrect order, the Opinion paragraph should precede the Basis for Opinion paragraph.

### **Reference to ethical code**

- ISA 700 requires that in the Basis for Opinion paragraph, the auditor should identify the relevant ethical code, naming the IESBA *International Code of Ethics for Professional Accountants*.
- The draft auditor's report does not specifically refer to the ethical code which has been applied during the audit and is therefore not in compliance with the requirements of ISA 700.

### **Material uncertainty regarding going concern**

- ISA 570 *Going Concern* provides guidance on how an auditor should report uncertainties regarding going concern in the auditor's report.
- According to ISA 570, if adequate disclosure about the material uncertainty is not made in the financial statements, the auditor should express a qualified opinion or adverse opinion as appropriate.
- The use of a 'material uncertainty regarding going concern' paragraph in the draft auditor's report extract is therefore incorrect.
- This paragraph should only be used when adequate disclosure has been made by the directors in the financial statements and would include a cross reference to this disclosure.
- Given that this disclosure has not been made, this is therefore not appropriate in this case.
- In this case, therefore, the absence of any disclosure in the financial statements in relation to the uncertainties regarding going concern is grounds for a modification of the auditor's opinion.
- The modification is due to a material misstatement in relation to the absence of this key disclosure. If, in the auditor's professional judgement, the impact of this non-disclosure on the



financial statements is material but not pervasive, a qualified ‘except for’ opinion should be issued.

- In this case, the opinion paragraph should be headed ‘qualified opinion’ and this should be followed immediately by a ‘basis for qualified opinion’ paragraph.
- If, on the other hand, the auditor believes that the impact on the financial statements of the non-disclosure is both material and pervasive, an adverse opinion should be given.
- The opinion paragraph should then be headed ‘adverse opinion’ and should be followed immediately by a ‘basis for adverse opinion’ paragraph.
- In addition, details of the uncertainty regarding going concern should be given in the basis for qualified or adverse opinion paragraph.

### **Long-term contracts**

- The use of the ‘other information’ section in this context is inappropriate. This section should be used to describe the auditor’s responsibilities for ‘other information’ (e.g. the rest of the annual report, including the management report) and the outcome of fulfilling those responsibilities.
- The disclosure regarding long-term contracts is more in line with the requirements of ISA 701 *Communicating Key Audit Matters in the Independent Auditor’s Report*, where key audit matters are those which in the auditor’s professional judgement were of most significance to the audit. In determining which matters to report, the auditor should take into account areas of significant auditor attention in performing the audit, including:
  - Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.
  - Significant auditor judgements relating to areas in the financial statements which involved significant management judgement, including accounting estimates which have been identified as having high estimation uncertainty.
  - The effect on the audit of significant events or transactions which occurred during the period.
- The extract from the draft auditor’s report states that significant judgement is applied in assessing the percentage of completeness of material long-term contracts and that this percentage is then applied in calculating the revenue for the year.
- This is a matter of high risk requiring significant auditor attention and given that Kayonza Ltd is a listed entity, it would be appropriate for this to be disclosed in the Key Audit Matters section of the auditor’s report.
- The Key Audit Matters section of the auditor’s report should begin with an introductory paragraph explaining what a Key Audit Matters is. The Key Audit Matters section should then explain why this matter is considered to be a Key Audit Matters due to the significant judgement involved in assessing the percentage completeness of the long-term contracts and the high risk of material misstatement associated with this judgement process.
- The Key Audit Matters section should also include an explanation of how the Key Audit Matters was addressed by the audit process. In this case, this might include, for example, an evaluation of the controls designed and implemented by Kayonza Ltd to monitor the progress of and the amounts owing on service and construction contracts; a review of the financial



performance of key contracts against budgets and historical trends; and challenging management's estimates and judgements in respect of the progress to date on the contracts.

### QUESTION THREE

Marking guide	Marks
<b>Q3 (a) Liboye Hardware Ltd</b>	
<b>(i) Matters to consider before accepting the review engagement</b>	
<b>Award up to 1 mark for each matter explained:</b> <ul style="list-style-type: none"> <li>• Intended use of the cash flow forecast</li> <li>• Distribution of the information</li> <li>• Period covered by the cash flow forecast and key assumptions used</li> <li>• Scope of the work</li> <li>• Resources and skills</li> <li>• Ethical matters</li> </ul>	<b>6</b>
<b>ii) Examination procedures on cash flow forecast</b>	
<b>Award 1 mark for each specific procedure</b> <ul style="list-style-type: none"> <li>• Cast the forecast to confirm accuracy</li> <li>• Confirm consistency of accounting policies with those used in last audited financial statements</li> <li>• Agree opening cash position to cash book and bank statement</li> <li>• Discuss key assumptions underlying forecast with management</li> <li>• Analytically review cash flow trends comparing with historical data</li> <li>• Agree discount and penalty terms with customers and suppliers to agreed contractual documentation; agree to purchase ledger payments to confirm that discounts taken and penalties paid</li> <li>• Agree average collection and payment periods to recent sales and purchase ledgers</li> <li>• Recalculate patterns of cash flows based on management's assumptions</li> <li>• Perform sensitivity analyses varying key assumptions</li> <li>• Agree salaries to latest payroll records</li> <li>• Obtain and review breakdown of overhead costs</li> <li>• For sample of overhead costs, review supporting documentation</li> <li>• Obtain and review budgets and analyses of costs to date for new shops and marketing campaign</li> <li>• Review board minutes for discussion of new shops and marketing campaign</li> <li>• Review outcomes of previous management forecasts</li> <li>• Assess competence and experience of preparer of forecast</li> <li>• Discuss possible cost omissions with preparer, e.g. finance costs, capital expenditure, tax payments</li> <li>• Obtain written representations from management (with justification)</li> </ul>	



<ul style="list-style-type: none"> <li>Request confirmation from the bank of potential terms of additional finance to confirm the interest rate</li> <li>Consider whether finance charge in forecast cash flow appears reasonable</li> </ul>	
<b>Maximum Marks for Q3 (ii) - using the guide provided above</b>	<b>9</b>
<b>Q3. (b) Kimironko Ltd ethical issues arising of planned listing</b>	
<b>Award 1 Mark for each well explained point up to maximum of 10 Marks)</b>	
<p><b>Long association of senior audit personnel</b></p> <ul style="list-style-type: none"> <li>Familiarity threat – explained</li> <li>Rotation with appropriate cooling-off period</li> </ul> <p><b>Fee dependence</b></p> <ul style="list-style-type: none"> <li>Self-interest and intimidation threats to auditor – explained</li> <li>Independent quality control pre-issuance review should be performed and full disclosure made to Those Charged with Governance (TCWG)</li> </ul> <p><b>Provision of bookkeeping and accounting services</b></p> <p>Self-review threat – explained Which cannot be reduced to acceptable level following Kimironko Ltd's Ltd listing on stock market</p> <p><b>Share prospectus</b></p> <ul style="list-style-type: none"> <li>Advocacy threat – explained</li> <li>Mwisigye&amp; Nalongo consultants should decline to assist in preparation of document and to endorse recommendation to investors to purchase shares</li> <li>Opinion on the financial information should be limited to confirming that it is properly compiled on basis stated in document and is consistent with company's accounting policies</li> </ul> <p><b>Review of audit appointment</b></p> <ul style="list-style-type: none"> <li>Intimidation threat to auditor's objectivity – explained</li> </ul> <p>Mwisigye&amp; Nalongo consultants should explain ethical duties to client and clearly identify services it will not be able to provide following stock market listing.</p>	
<b>Total marks for Question three</b>	<b>25</b>



## **Model Answer**

**(a) Liboye Hardware Ltd**

### **(i) Matters to consider before accepting the review engagement**

❖ Before accepting the review engagement to review and provide an assurance report on Liboye Hardware Ltd's cash flow forecast, ISAE 3400 *The Examination of Prospective Financial Information* identifies a number of matters which need to be considered:

#### **The intended use of the information**

❖ Mwisigye& Nalongo consultants must consider, for example, whether the cash flow forecast and assurance report will be used solely for the purpose of the increase in Liboye Hardware Ltd's overdraft facility.

❖ If Liboye Hardware Ltd is planning to use the assurance report for purposes other than an extension to its current overdraft, for example, to arrange new loan finance from the company's bank, this must be made clear to Mwisigye& Nalongo consultants.

#### **Whether the information will be for general or limited distribution**

❖ Mwisigye& Nalongo consultants needs to consider who will receive the report and potentially rely upon it as this will impact on the firm's assessment of the risk associated with the engagement. If the cash flow forecast is intended for general distribution, this will increase the level of risk for Mwisigye& Nalongo consultants as a larger audience will rely on it.

❖ In this case, if the information will be used solely in support of the application to the bank and will not be made available to other parties, this should be confirmed before accepting the engagement and will reduce the risk of the assignment.

#### **The period covered by the cash flow forecast and the key assumptions used**

❖ Mwisigye& Nalongo consultants must also consider the period covered by the cash flow forecast and the key assumptions which have been used in its preparation. Short-term forecasts are likely to be easier to verify and provide assurance on than longer term projections. ISAE 3400 states that a prospective financial information (PFI) engagement should not be accepted when the assumptions used in its preparation are clearly unrealistic or when the practitioner believes that the PFI will be inappropriate for its intended use. In the case of Liboye Hardware Ltd, although the forecast is only for 12 months, the growth rates assumed in relation to its operating cash receipts may, for example, be judged to be unrealistic given recent trends in its business and the requested overdraft facility of FRW17 million for the next six months may prove to be insufficient.



## **The scope of the work**

❖ Mwisigye & Nalongo consultants will need to consider the specific terms of the engagement, the level of assurance being sought by Liboye Hardware Ltd and the form of the report required by the bank. Mwisigye & Nalongo consultants will need to identify clearly the elements which it is being asked to report on – for example, is it being asked to report on the cash flow forecast only or is the firm also being asked to report on accompanying narrative or other PFI.

❖ Due to the uncertainty of forecasts and the inevitable subjectivity involved in their preparation, Mwisigye & Nalongo consultants will need to confirm that it is only being asked to provide negative assurance as to whether management’s assumptions provide a reasonable basis for the cash flow forecast and to give an opinion as to whether it is properly prepared on the basis of these assumptions.

## **Resources and skills**

The firm needs to consider whether it has sufficient staff available with the appropriate skills and experience needed to perform the PFI engagement for Liboye Hardware Ltd. Mwisigye & Nalongo consultants should also consider whether it can meet the deadline for completing the work and whether it will have access to all relevant information and client staff. Given the company’s predicted need for cash in the next six months, presumably the extended overdraft facility will need to be provided very soon and this may lead to Mwisigye & Nalongo consultants being under pressure to meet a tight reporting deadline.

## **Client integrity**

❖ ISQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Information, and Other Assurance and Related Services Engagements* requires Mwisigye & Nalongo consultants to consider the integrity of Liboye Hardware Ltd’s management in relation to the acceptance decision. In particular, the firm should consider management’s reasons for appointing a different firm from its auditors and the potential for management bias in the preparation of a cash flow forecast in support of its required overdraft facility.

❖ In addition to the matters identified by ISAE 3400 and ISQC 1, Mwisigye & Nalongo consultants should also consider the following ethical matters before accepting the review engagement:

## **Ethical matters**

❖ Given that Mwisigye & Nalongo consultants are not the auditors, the firm’s independence from Liboye Hardware Ltd will not have been previously considered. In this regard, it is important to ensure that there are no threats to the firm’s objectivity which might prevent it from accepting the appointment. If the firm is not independent and its objectivity is compromised, the reliability of the assurance report will be undermined.



❖ Mwisigye & Nalongo consultants should also consider why the auditors have not been asked to provide the assurance report on Liboye Hardware Ltd's cash flow forecast. In order to provide an assurance report on PFI, a good understanding of the client and its business is required and the incumbent audit firm will usually have the requisite knowledge and understanding.

❖ Mwisigye & Nalongo consultants should therefore consider whether the use of a different firm creates a risk that the client may be hoping that the firm may not be in a position to effectively challenge the key assumptions underlying the preparation of the forecast. When a professional accountant is asked to perform work for a non-audit client, they should be given permission by the client to contact its auditors in order to obtain relevant information. If this permission is not given, the appointment should be declined.

❖ Overall, Mwisigye & Nalongo consultants must assess the risks associated with the review engagement and should not accept an engagement when the assumptions are clearly unrealistic or when the firm believes that the prospective financial information will be inappropriate for its intended use.

## **(ii) Examination procedures on cash flow forecast**

❖ Cast the cash flow forecast to confirm its mathematical accuracy.

❖ Confirm the consistency of the accounting policies used in the preparation of the forecast financial statements with those used in the last audited financial statements.

❖ Agree the opening cash position of FRW 9,193,000 to the cash book and the bank statement.

❖ Discuss the key assumptions underlying the preparation of the forecast with management, including:

✓ the predicted growth rates in operating cash receipts of 13.4% over the year compared to an equivalent growth rate of only 7.3% in operating cash payments.

✓ the stated collection and payment periods in relation to receivables and payables.

✓ confirm that the assumptions appear reasonable and are consistent with the firm's knowledge and understanding of the client.

❖ Analytically review the forecast trends in cash flows comparing with them with historical cash flow statements and other forecast data which is available for the sector and local economy and investigate any significant differences.

❖ Agree the settlement discount of 8% and the late payment penalty of 5% penalty terms with suppliers to supporting contractual documentation; agree to purchase ledger payments in order to confirm that discounts are taken and penalties are paid.

❖ Agree the predicted collection and payment periods to the most recent sales ledgers and purchase ledgers.



- ❖ Recalculate the patterns of cash flows based on management's historical analysis of credit sales to confirm that the forecast has been properly prepared on the basis of these assumptions.
- ❖ Perform sensitivity analyses on the cash flow forecast by varying the key assumptions (in particular, in relation to growth rates and payment periods) and assessing the impact of these variations on the company's forecast cash position.
- ❖ Agree the salary payments to the latest payroll records and cash book payments analyses to confirm accuracy and completeness.
- ❖ Obtain and review a breakdown of the forecast overhead payments and compare it to historical management accounts and current budgets. Review the schedule to ensure that non-cash items such as depreciation, amortization and bad debts have not been included.
- ❖ For a sample of overhead costs, review the supporting documentation such as invoices and utility bills and agree the amount paid each month to the cash book.
- ❖ Obtain and review budgets and analyses of costs to date for the new shops and the online marketing campaign ensuring that the forecast includes all of the budgeted costs and does not include any costs which have already been incurred. Agree a sample of costs to supporting documentation such as invoices, quotations and lease agreements.
- ❖ Review board minutes for discussion of the new shops and the marketing campaign.
- ❖ Review the outcomes of previous management forecasts and assess their accuracy compared to actual data.
- ❖ Assess the competence and experience of the preparer of the forecast.
- ❖ Discuss possible cost omissions with the preparer of the forecast, for example, Liboye Hardware Ltd's cash flow forecast does not include finance costs, tax payments and does not include any capital expenditure other than the new shops.
- ❖ Obtain written representations from management confirming the reasonableness of their assumptions and that all relevant information has been provided to Mwisigye & Nalongo consultants.
- ❖ Request confirmation from the bank of the potential terms of the additional finance being negotiated, to confirm the interest rate.



## **(b) Kimironko Ltd:**

### **Ethical and professional issues arising Long association of senior personnel**

- Frank Kwelime eight-year tenure as audit engagement partner creates a familiarity threat for Mwisigye & Nalongo consultants.
- The threat arises because using the same senior audit personnel on an audit assignment over a long period of time may cause the auditor to become too familiar and too trusting with the client resulting in less professional skepticism being exercised and the possibility of material misstatements going undetected.
- According to the IESBA *International Code of Ethics for Professional Accountants* (the *Code*), with listed audit clients key audit partners must be rotated after seven years unless exceptional circumstances arise.
- In this case, the *Code* permits the partner's tenure to be extended for one further year where this is deemed to be necessary in order to maintain audit quality.
- The *Code* also clarifies that if an existing audit client becomes listed, the length of time which the partner has already served on the client is included in the period to be considered. In the case of Kimironko Ltd, therefore, Frank Kwelime has already served as a key audit partner for the maximum possible period of eight years and following the listing of the client next year, it would be appropriate for her to be replaced by another audit partner.
- The code does allow an exception, which states that with the agreement of those charged with governance, she could serve for a maximum of an additional two years. After this, she may not serve as a key partner on the audit for a minimum of five further years.

### **Fee dependence**

- Over dependence on an audit client for fee income leads to a self-interest and intimidation threat for the auditor. The self-interest threat arises as the firm will have a financial interest in the client due to its dependency on the client and its concern about the impact on its business if it were to lose the client.
- In the case of a listed client, the *Code* states that an audit firm's independence is threatened and should be reviewed if the total fees from a single client exceed 15% of its total fee income for two consecutive years.
- In this case, the 15% limit has been exceeded in both 2021 and 2022 and following the listing of the company's shares in September 2022, Mwisigye & Nalongo consultants is required to review its dependence on the client.
- If retained as a client, the level of fees should be disclosed to those charged with governance and it should be discussed whether prior to the audit opinion being issued, having an independent pre-issuance or post-issuance review performed on the engagement by an external party or by the firm's professional regulatory body is enough to mitigate the threat.



## **Provision of bookkeeping and accounting services**

- The provision of bookkeeping and accounting services for Kimironko Ltd creates a self-review threat for Mwisigye & Nalongo consultants. The self-review threat arises because the auditor is generating figures for inclusion in the financial statements on which they will then give an opinion. As a result, the auditor may be less likely to highlight errors if they are aware that another member of the firm has calculated the figures.
- For a listed client, the *Code* states that a firm is not permitted to provide accounting and bookkeeping services. The *Code* does, however, make an exception for divisions of a company if the services are of a routine and mechanical nature, a separate team is used and the service which the firm provides relates to matters which are immaterial to the division and the company.
- Following Kimironko Ltd's listing in September 2022, therefore, Mwisigye & Nalongo consultants will no longer be able to provide the payroll services for Kimironko Ltd although it may still be able to maintain the financial records for the small division if the conditions stated in the *Code* are satisfied.

## **Share prospectus**

- Mwisigye & Nalongo consultants has been asked to assist in the preparation of the share prospectus document and to provide an accountant's report on financial data, business risks and a business plan which recommends the shares to investors. Performance of these services for Kimironko Ltd would create an advocacy threat for the auditor.
- The advocacy threat arises because the auditor is effectively being asked to promote and represent their client's position to the point where the auditor's objectivity is compromised. The *Code* prohibits an auditor from acting in this way for an audit client and Mwisigye & Nalongo consultants should politely decline to assist in the preparation of the document and to endorse the recommendation to investors to purchase the shares.
- It may be possible, however, for the auditor to provide an accountant's report on some elements of the prospectus. Mwisigye & Nalongo consultants may be able to provide an opinion on the financial information if, for example, it limits the form of opinion to stating that it has been properly compiled on the basis stated within the document and that this basis is consistent with the accounting policies of the company.

## **Review of audit appointment**

- Maggy Shalon comment that Kimironko Ltd is currently reviewing the audit appointment and that it is looking for an audit firm which is capable of taking it through the listing process and providing a full range of services in the future represents an intimidation threat to the auditor's objectivity.
- The intimidation threat arises because Maggy Shalon is applying pressure on Mwisigye & Nalongo consultants to offer a range of services which will result in breaches of the *Code* for the audit firm. She is effectively intimidating the firm by threatening to appoint another audit firm if Mwisigye & Nalongo consultants does not comply.



- Mwisigye & Nalongo consultants should explain its ethical duties to those charged with governance and identify clearly the services which it will not be able to provide if it continues as the company's auditor after the stock market listing in September 2022.

#### QUESTION FOUR

Marking guide	Marks
<b>Q4 Yolati Retailers Ltd</b>	
Report to those charged with governance ( <b>Award 1 Mark for the title of report</b> )	1
<b>Award up to 2 Marks for each matter identified and explained.</b>	
<b>Revaluation of property portfolio</b> <ul style="list-style-type: none"> <li>• Significant findings from audit should be reported to TCWG</li> <li>• These include significant changes in accounting policy and material misstatements</li> <li>• Revaluation of PPE should be consistent across a class of assets (IAS 16), four properties still carried at depreciated historic cost</li> <li>• Four properties are material to SOFP (2.1% assets)</li> <li>• Significant findings from audit also include significant difficulties encountered during audit such as information delays</li> <li>• Delay makes audit less efficient and may result in increase in audit fee</li> <li>• Renovation of car parking facilities</li> <li>• Yolati Retailers Ltd has derived economic benefits from expenditure, should be capitalised</li> <li>• Material to SOFP (2.5% of assets)</li> <li>• Incorrect application of IAS 16 and potential material misstatement should be included in report to TCWG as significant finding from audit</li> <li>• Lack of authorisation indicates lack of management oversight and serious weakness in control which could allow fraud to occur</li> <li>• Lack of integrity shown by management going ahead with renovation works without the necessary permission is an example of management override and could be the tone set throughout organization</li> <li>• Therefore, this is a high-risk matter and they may wish to implement controls and procedures to prevent further breaches</li> <li>• Report to TCWG should include recommendations to management to reduce business risk</li> </ul>	
<b>Long association of audit partner</b>	24



<ul style="list-style-type: none"> <li>• Matters to be communicated to TCWG include ethical issues in relation to auditor independence</li> <li>• Long association creates familiarity and self-interest threats</li> <li>• Audit partner in listed entity should be rotated at least every seven years per IESBA Code</li> <li>• IESBA Code does, however, allow for an additional year if required rotation not possible due to unforeseen circumstances such as illness of intended engagement partner</li> <li>• After current year, may still be possible for Robert Mudakikwa to continue as audit partner if engagement is subject to regular review by independent, external expert</li> <li>• Safeguards should be applied including independent internal or external review of engagement (as per scenario)</li> </ul> <p><b>Award 2 Marks for each well explained point up to maximum of 24 Marks)</b></p>	
<b>Total marks for question four</b>	<b>25</b>

### Model Answer

Yolati Retailers Ltd – Report to those charged with governance

A report to those charged with governance (TCWG) is produced to communicate matters relating to the external audit to those who are ultimately responsible for the financial statements. ISA 260 *Communication With Those Charged With Governance* requires the auditor to communicate many matters including independence and other ethical issues and the significant findings from the audit. In the case of Yolati Retailers Ltd, the matters to be communicated would include the following:

#### Revaluation of property portfolio

- According to ISA 260, the significant findings from the audit include the auditor's views about significant qualitative aspects of the entity's accounting practices including accounting policies and any circumstances which affect the form and content of the auditor's report.
- In the case of Yolati Retailers Ltd, therefore, the significant findings from the audit would relate to the changes in the accounting policy in relation to the revaluation of property and related material misstatements and the following matters should be communicated:
  - IAS 16 *Property, Plant and Equipment* states the revaluation policy should be consistent across a class of assets. However, four properties, which are material to the statement of financial position at 2.1% of total assets, are still carried at depreciated historic cost. This therefore represents a breach of IAS 16 and a material misstatement, which will impact on the form and content of the auditor's report.
  - According to ISA 260, the significant findings from the audit also include significant difficulties encountered during audit such as information delays. The independent external



valuation reports requested at the planning stage were not available when requested by the auditor and it took three weeks before they were received by the audit team.

- The auditor should report this delay to those charged with governance, detailing its impact on the efficiency of the audit process together with any resulting increase in the audit fee.

### **Renovation of car parking facilities**

- The renovation expenditure on the car parking facilities at Yolati Retailers Ltd properties should be recognised as an asset according to IAS 16 if it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably.
- In Yolati Retailers Ltd case, the cost has been quantified as FRW 13.2 million and it has already derived economic benefits in the form of a significant increase in customer numbers and revenue at each of these locations.
- The expenditure should therefore be capitalised and its inclusion in operating expenses is not in compliance with IAS 16. The amount of FRW 13.2 million is also material to the statement of financial position at 2.5% of total assets.
- The incorrect application of IAS 16 and the material misstatement should be included in a report to TCWG as a significant finding from the audit which will impact on the form and content of the auditor's report.
- ISA 265 *Communicating Deficiencies in Internal Control to Those Charged With Governance and Management* requires the auditor to communicate appropriately to those charged with governance deficiencies in internal control which the auditor has identified during the audit and which, in the auditor's professional judgement, are of sufficient importance to merit their respective attentions.
- The audit working papers include minutes of discussions with management which confirm that authorisation had not been gained for this expenditure.
- The lack of authorisation indicates a lack of management oversight and a serious weakness in control which could allow fraud to occur.
- Furthermore, the lack of integrity shown by management in going ahead with the renovation works without the necessary permission is an example of management override and could be indicative of the tone set throughout the organisation.
- This therefore represents a high-risk matter and they may wish to implement controls and procedures to prevent further breaches.
- The report to those charged with governance should include full details on this significant deficiency in internal control and should include recommendations to management in order to reduce the associated business risk.

### **Long association of audit partner**

- As discussed above, ISA 260 requires the auditor to communicate matters in relation to auditor independence. Robert Mudakikwa has acted as audit engagement partner for Yolati Retailers Ltd for eight consecutive years.



- According to the IESBA *Code of Ethics for Professional Accountants* (the *Code*), her long association with the audit client creates both familiarity and self-interest threats to auditor independence.
- The familiarity threat arises due to the long and potentially close relationship which he has with the staff of Yolati Retailers Ltd leading to his being too sympathetic to their interests or too accepting of their work.
- This in turn gives rise to a self-interest threat in that his long association and close relationship with the client create a personal interest which may inappropriately influence her professional judgement or behaviour.
- In order to address these risks, the *Code* requires that an audit partner in a listed entity should be rotated at least every seven years and therefore her eight-year tenure as the audit partner of Yolati Retailers Ltd appears to be in clear breach of this provision.
- However, the *Code* does allow for an engagement partner to serve for an additional year if the required rotation is not possible due to unforeseen circumstances such as the illness of the intended engagement partner.
- In these circumstances, safeguards should be applied such as the independent review of the engagement which is being performed and this should be communicated to those charged with governance.
- Going forward beyond the current year, if it remains impossible to rotate the audit partner due to a lack of alternative expertise within the firm, it may be possible for Robert Mudakikwa to continue as the audit partner if special dispensation is received from the relevant regulator and the necessary safeguards are applied such as the engagement is subject to regular review by an independent, external expert.

**END OF MARKING GUIDE AND MODEL ANSWERS**