# CERTIFIED PUBLIC ACCOUNTANT

# INTERMEDIATE LEVEL EXAMINATIONS

## I1.4 AUDITING

## DATE: FRIDAY, 29 JULY 2022

## MARKING GUIDE AND MODEL ANSWERS

# SECTION A

## QUESTION ONE

**Marking guide**

| | | Maximum Marks |
|---|---|---|
| a. | Advise to Kamali at least 5 the advantages of a non-statutory audit | 5 |
| b. | Explain the concept of corporate governance | 2 |
| | Explain the pillars of corporate governance *(2 marks each with 6 as max*) | 6 |
| | Discuss why KBC should corporate governance and its pillars | 4 |
| c. | Summarize ICPAR's role in the regulation of the accountancy | 3 |
| **Total** | | **20** |

**Model answers**

**a) Advantages of a non-statutory audit to a small or medium business include:**

- The audit can provide a means of settling accounts between the partners.
- Kamali & Brothers Company Ltd would benefit from better access to loan and overdraft facilities may be facilitated if his business is able to produce audited accounts.
- An audit is very useful for other brothers' partners since they are not involved in the management of the business. This can assist in ascertaining the share of profits due to them.
- Audited accounts provide a good indication of a fair valuation for shares particularly unquoted shares.
- An audit provides management with an independent check on the accuracy of their financial statements. Also, some auditors do provide decent management letters.
- Revenue Authority can rely on audited accounts to back up tax returns.

**b) Explaining the concept of corporate governance and its pillars and why KBC should adopt them**

Corporate Governance refers to the way in which companies are governed and to what purpose. It identifies who has power and accountability, and who makes decisions. It is, in essence, a toolkit that enables management and the board to deal more effectively with the challenges of running a company. Corporate governance ensures that businesses have appropriate decision-making processes and controls in place so that the interests of all stakeholders (shareholders, employees, suppliers, customers and the community) are balanced. (CGI UK)

There are mainly four fundamental pillars of corporate governance which include Accountability, Transparency, Responsibility and Fairness. All these are critical for successfully running of an organization such as KBC and forming better relationship with different stakeholders.

Corporate governance pillars are explained here below:

- **Accountability:** is the quality or state of being accountable; that is, being required or expected to justify actions and decisions. It suggests an obligation or willingness to accept responsibility for one's actions.
- **Fairness:** Fairness means "equal treatment of all stakeholders". Establishing effective communication mechanism is important in ensuring just and timely protection of resources.
- **Transparency:** Transparency "means having nothing to hide" that allows its processes and transactions observable to outsiders. It also makes necessary disclosures, informs all stakeholders affected about its decisions and how they are likely to be affected by those decisions. Transparency is a critical component of corporate governance because it ensures that all of entity's actions can be checked at any given time by an outside observer.
- **Responsibility:** Those charged with governance are given authority to act on behalf of the entity. They should therefore accept full responsibility for the powers that is given to them and the authority that it exercises. Those charged with governance are responsible for overseeing the management of the business, affairs of the company, appointing the chief executive and monitoring the performance of the company. In doing so, it is required to act in the best interests of the entity putting aside their own interests.

**Why KBC should adopt corporate them**

Excellent management
Company practicing good governance allows peo-
ple not inked to it to be able to assess its gover-
nance due to transparency.
2. High level of transparency
Companies following a set of best practices are

- **Excellent management**: Company practicing good governance allows people not linked to it to be able to assess its governance due to transparency.
- **High level of transparency:** Companies following a set of best practices are encouraged to be highly transparent about their business.
- **Stakeholder benefits:** Under corporate governance, companies tend to act in the best of itself and its stakeholders.
- **Reputation and recognition**: good governance allows companies to gain the trust of the investors, customers and the community at large.
- **Reduced wastage**: Employees that are trained to follow a good ethical practice will avoid excess wastage of company resources.
- **Reduced risks:** mismanagement and corruption an amount of transparency applied in companies following good governance practices has reduced amount of risks of corruption and mismanagement.

- **Economic benefit**: A company following a good governance practice will be able to achieve the trust of the community and thus gaining success in the long run.

**c) Summary of ICPAR's role in the regulation of the accountancy profession in Rwanda:**

The Institute of Certified Public Accountants of Rwanda (ICPAR) is the Professional Accountancy Organization (PAO) mandated by law number 11/2008 to grow and regulate the accounting profession in the Republic of Rwanda.

Law No 11/2008 also highlights that the Institute has a number of responsibilities, including:

- Regulating the accounting profession in Rwanda (This is the Institute's overall purpose.)
- Preserving the integrity of the accounting profession
- Promoting the competence and capacities of its members
- Providing its members with professional education in accounting and other related disciplines
- Issuing regulations to promote the functioning of the Institute
- Taking disciplinary measures against members unable to perform their duties and guilty of misconduct
- Promoting and preserving the professional independence of its members while exercising their profession

## QUESTION TWO

| **Marking guide** | **Maximum Marks** |
|---|---|
| a) Clearly explain the procedures to appoint auditors in Rwanda | 4 |
| b) Describe the required acceptance procedures to take before accepting a new audit client *(2 marks each)* | 10 |
| c) Identify the required procedures for removal of BCD Partners CPA ltd | 2 |
| Identify the required procedures replacement of BCD Partners CPA ltd | 2 |
| Identify the required procedures resignation of BCD Partners CPA ltd | 2 |
| **Total** | **20** |

**Model answers**

**a) The procedures to appoint auditors in line with Rwanda's Company Act are:**

- The appointment of a particular auditor shall be authorised by the shareholders by ordinary resolution.
- The first auditor of the company may be appointed by the Board of Directors without the shareholders' approval required, and auditors so appointed, unless removed, hold office until the conclusion of the company's first General Assembly or until twenty-eight (28) days after the date that the company's annual accounts are sent to shareholders, whichever is the sooner.
- In case no auditor is appointed in accordance with the above, the Registrar General has the powers to direct the company to appoint its auditor within thirty (30) days.
- The salary and other expenses for the auditor are determined by the General Assembly of shareholders or the Board of Directors.

**b) Required acceptance procedures to take before accepting a new audit client**

- Should ensure that BCD Partners CPA ltd is professionally qualified to be the Company's auditor by considering whether they could be disqualified on ethical or legal grounds.
- Ensure availability of resources (staff, technical expertise and time) to conduct the assignment.
- Ensure that the outgoing auditor's removal or resignation has been properly conducted in accordance with national legislation. The new auditors should see a valid notice of the outgoing auditor's resignation or confirm that the outgoing auditors were properly removed.
- Ensure that the BCD Partners CPA ltd appointment is valid. BCD Partners CPA ltd should obtain a copy of the resolution passed at the general meeting appointing them as the company's auditors.
- Set up and submit a letter of engagement to directors of Byukusenge Company ltd detailing the scope and terms of the engagement.

**c) The required procedures for removal, replacement or resignation of BCD Partners CPA ltd should the disagreement with the client persist.**

In accordance with article 140 of the Company's Act, an auditor shall not be removed from office, unless:

i) at least ten (10) working days' written notice of a resolution to do so;

ii) has been given a reasonable opportunity to make representations to the shareholders on the removal, either in writing or by the auditor or his/her representative speaking at a shareholders' general assembly, whichever the auditor may choose.

A company shall not propose to appoint a new auditor in place of an auditor who is disqualified for re-appointment, unless:

i) at least ten (10) working days' written notice of intention to do so has been given to the auditor;

ii) the auditor has been given a reasonable opportunity to make representations to the shareholders on the appointment of another auditor, either in writing or by the auditor or his/her representative speaking at a shareholders' general assembly whichever the auditor may choose.

Where an auditor has given the member of the Board of Directors a written notice of unwillingness to be reappointed, the member of the Board of Directors, if requested to do so by the auditor:

i) distribute to all shareholders at the expense of the company a written statement of the auditor's reasons for unwillingness to be reappointed;
ii) permit the auditor or his/her representatives to explain at a shareholders' general assembly the other reasons for his/her unwillingness to be reappointed.

## QUESTION THREE

| **Marking guide** | **Maximum Marks** |
|---|---|
| a) State the steps you should take as an auditor to identify and assess the risks of material misstatement *(1 mark each)* | 4 |
| b) Discuss your responses to the risks of material misstatements identified at Kalembure Co Ltd during your audit planning *(1 mark per risk with a max of 2)* <br> ***NB: There are no marks for identifying the risks since they are already Given.*** | 10 |
| c) Describe at least 4 audit procedures to be conducted while reviewing the work of junior audit team members | 4 |
| **Total** | **20** |

**Model answers**

**a) ISA 315: *Identifying and Assessing the Risks of Material Misstatement* requires the auditor to take the following steps:**

- Identify risks throughout the process of obtaining an understanding of the entity and its environment
- Assess the identified risks and evaluate whether they relate more pervasively to the financial statements as a whole
- Relate the risks to what can go wrong at the assertion level
- Consider the likelihood of the risks causing a material misstatement

**b) Suggested responses to the risks of material misstatements identified at Kalembure Co Ltd during your audit planning.**

| Audit risks | Possible responses |
|---|---|
| A material inventory of Frw 100 million was found obsolete and partly damaged closely after the year end. | • Examine the instructions to identify slow moving and damaged inventory lines when attending the inventory count were properly followed.<br>• Increase the emphasis on reviewing the year end aged inventory analysis for evidence of slow-moving inventory.<br>• Ascertain sales values for items sold post year end that were in inventory at the year-end to ensure their net realizable value was higher than the cost recorded as part of the inventory value in the financial statements.<br>• Ensure that inventory is considered a significant risks area and plan test of controls and substantive procedures accordingly.<br>• Ensure that proper adjustments are passed during the audit. |
| A refurbishment of Frw 150 million, which amounts to 3% of total assets was booked as an expenditure. The management was not sure whether this was revenue or capital expenditure. | • Since the refurbishment cost is material (at least over 2% of total assets), management should book this as a capital expenditure.<br>• Obtain a breakdown of related costs and review accounting entries against invoices/details of work done to ensure expenditure is correctly treated as capital/revenue.<br>• Perform a detailed review of repairs accounts for any items which should be included in non-current assets<br>• Review the asset register to ensure that only capital items are included.<br>• Ensure that proper adjustments are passed during the audit |
| One of the major customers for Kalembure Co Ltd is in the process of declaring a bankruptcy and still owes a material receivable balance. | • Identify year end receivable balances still outstanding at the date of the audit by reviewing post year end receipts from customers. For amounts still outstanding establish whether these are provided for.<br>• Review aged receivables analysis and customer correspondence files for evidence of disputes with receivables and consider the adequacy of any related receivables allowance.<br>• Ensure that Kalembure's receivable balance is provided for. |
| There was a borrowing of a loan from a local bank and the company has not dully paid its instalments for the last 3 months from December 2021 to February 2022. | • Review correspondence with the bank/lender for any evidence of withdrawal or extension of facilities.<br>• If there are bank covenants linked to performance on which facilities depend, review compliance with these, and increase testing on areas where management could manipulate performance indicators (such as provisions). |

| Audit risks | Possible responses |
|---|---|
| The bank is threatening to report Kalembure Co Ltd into Credit Reference Bureau (CRB) for default. | • Review post year end results and cash flow forecasts (if prepared) for evidence the company can continue as a going concern.<br>• Assess the Kalembure's management plans to ensure compliance with loan agreement going forward.<br>• Check whether penalties were recorded in the books. |
| The Board of Directors of the company had committed to give a bonus of 10% of annual salary to all staff if the company's revenue grows by 8% in the year under audit. | • Focus on and increase testing on judgmental areas in the financial statements (e.g. provisions, revenue recognition accounting policies).<br>• Check for management override of controls particularly for revenue since the management has a motivation to ensure that the revenue targets are met. |

**c) Audit work performed by each assistant should be reviewed by personnel of appropriate experience to consider whether:**

- The work has been performed in accordance with the audit plan.
- The work performed and the results obtained have been adequately documented.
- Any significant matters have been resolved or are reflected in audit conclusions.
- The objectives of the audit procedures have been achieved.

The conclusions expressed are consistent with the results of the work performed and support the audit opinion.

## SECTION B

### QUESTION FOUR

| Marking guide | Maximum Marks |
|---|---|
| a) Explain at least 5 substantive audit procedures to be conducted over acquisition of the loan. | 5 |
| b) i) Define what is provision and contingent liability *(1 mark each)* | 2 |
| ii) Clearly explain the audit procedures to be carried audit provisions and contingent liabilities *(2 marks each)* | 10 |
| iii) Give other examples of accounting provisions and contingent liabilities (0.5 marks each) | 3 |
| **Total** | **20** |

**Model answers**

**a) The following are substantive audit procedures to be conducted over ABC Manufacturing Company ltd Company's acquisition of the loan:**

- Obtain/prepare schedule of loans outstanding at the period end date showing, for each loan: name of lender, date of loan, maturity date, interest date, interest rate, balance at the end of the period and security.
- Compare opening balances to previous year's papers to confirm that these have been carried forward accurately.
- Compare balances to the general ledger and investigate any differences.
- Agree name of lender etc., to register of debenture holders or equivalent (if kept).
- Trace additions and repayments to entries in the cash book to confirm the accuracy of the closing balance.
- Confirm repayments are in accordance with loan agreement to determine whether there may be any unrecognized penalties.
- Examine cancelled cheques and memoranda of satisfaction for loans repaid to confirm that there are no unrecognized liabilities.
- Verify that borrowing limits imposed either by the company's constitution or by other agreements are not exceeded.
- Examine signed Board minutes relating to new borrowings/repayments to ensure that transactions are authorized.
- Obtain direct confirmation from lenders of the amounts outstanding, accrued interest and what security they hold.
- Verify interest charged for the period and the adequacy of accrued interest to confirm that interest is not misstated.
- Review restrictive covenants and provisions relating to default:

– Review any correspondence relating to the loan.
– Review confirmation replies for non-compliance.
– If a default appears to exist, determine its effect, and schedule findings.

- Review minutes and cash book to confirm that all loans have been recorded.
- Review draft financial statements to ensure that disclosures for non-current liabilities are correct and in accordance with accounting standards. Any elements repayable within one year should be classified as current liabilities.

**b) In with IAS 37 Provisions, contingent liabilities and contingent assets, clearly explain the following:**

**i) Definition of provision and contingent liability**

A **provision** is a liability of uncertain timing or amount. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

A **contingent liability** is:
(a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
(b) A present obligation that arises from past events but is not recognized because:
(1) It is not probable that an outflow of resources embodying economic benefits will be
(2) required to settle the obligation; or
(3) The amount of the obligation cannot be measured with sufficient reliability.

**ii) The following are the audit procedures to be carried audit provisions and contingent liabilities for ABC Manufacturing Company ltd:**

- Obtain details of all provisions which have been included in the financial statements and all contingencies that have been disclosed.
- Obtain a detailed analysis of all provisions showing opening balances, movements and closing balances.
- Determine for each material provision whether the company has a present obligation as a result of past events by:
  - Review of correspondence relating to the item
  - Discussion with the directors. Have they created a valid expectation in other parties that they will discharge the obligation?
- Determine for each material provision whether it is probable that a transfer of economic benefits will be required to settle the obligation by:
  – Confirming whether any payments have been made after the end of the reporting period in respect of the item, or whether any events occurring up to the date of the auditor's report provide evidence regarding the provision
  – Review of correspondence with lawyers, banks, customers, insurance company and suppliers both pre and post period end
  – Sending a letter to the lawyer to obtain their views (where relevant)
  – Discussing the position of similar past provisions with the directors. Were these provisions eventually settled?

– Considering the likelihood of reimbursement

- Recalculate all provisions made to confirm accuracy.
- Compare the amount provided with any payments after the period end and with any amount paid in the past for similar items to obtain evidence of valuation.
- In the event that it is not possible to estimate the amount of the provision, confirm that this contingent liability is disclosed in the financial statements.
- Consider the nature of the client's business to determine whether other provisions may be required e.g. for warranties.
- Consider adequacy of disclosure of provisions, contingent assets and contingent liabilities in accordance with IAS 37.

**iii) Below are examples of accounting provisions and contingent liabilities**

Examples of provisions include:

- Accruals,
- Asset impairments,
- Bad debts,
- Depreciation,
- Doubtful debts,
- Guarantees (product warranties),
- Inventory obsolescence,
- Restructuring liabilities and sales allowances

Examples of contingent liabilities include

- Potential lawsuits (Local community and the client shown in the case study)
- product warranties
- pending investigation
- Etc.

## QUESTION FIVE

| Marking guide | | Maximum Marks |
|---|---|---|
| a) | Describe any three considerations that were made by your audit manager | 3 |
| | Give examples of other areas where a work of expert can be used in audit | 3 |
| b) | i) Define subsequent events and differentiate adjusting and non-adjusting events *(1 mark for definition and 1 make for the difference)* | 2 |
| | ii) Discuss the subsequent events identified at GCK Rwanda ltd and show their effect on the Company's financial statements (*1 mark for each effect with a maximum of 2 marks under each subsequent event)* | 6 |
| c) | Explain the content of the GCK Rwanda ltd management representation (2 marks each) | 6 |
| **Total** | | **20** |

**Model answers**

**a) The considerations that were made by your audit manager in determining the use of expert on inventory valuation and examples of other areas where a work of expert can be used in audit:**

When determining the need to use an expert, your audit manager should have considered the following:

- The engagement team's knowledge and previous experience of the matter – just in case you have experience such as GCK Rwanda ltd.
- The risk of material misstatement based on the nature, complexity and materiality of the matter being considered (inventory).
- The quantity and quality of other audit evidence expected to be obtained from the work of expert.
- Knowledge of the expert's qualifications, membership of professional body or industry association or licence to practice.
- Your audit firm's quality control policies and procedures provisions – particularly on use of work of expert.

**Examples of other areas where a work of expert can be used in audit are**

- Valuation of land and buildings
- Legal opinion on legal matters
- The current status of items based on preliminary or inconclusive data.
- Major sales or acquisition of assets occurred or planned
- Issue of new shares or debentures or agreement/plans to merge or liquidate
- Developments regarding risk areas and contingencies
- Unusual accounting adjustments made or contemplated

**b) i) In line with ISA 560: Subsequent events, differentiate adjusting and non-adjusting events.**

Subsequent events are events occurring between the period end and the date of the auditor's report and also include facts discovered after the auditor's report has been issued. Auditors shall consider the effect of such events on the financial statements and on their audit opinion.

- **Adjusting events** are those that provide evidence of conditions that existed at the balance sheet/ year end.
- **Non - adjusting events** are those which are indicative of conditions that arose after the balance sheet date/ year end.

**ii) The subsequent events identified at GCK Rwanda ltd and their effect on the Company's financial statements for the year ended 31 December 2021:**

| Subsequent event | Effect on the financial statements |
|---|---|
| accountant fraudulently diverting money to his/her personal account. | • This is an adjusting event since this occurred during the financial year between June and December 2021.<br>• In case the amount stolen can be estimated, a provision should be made.<br>• In case the amount stollen cannot be estimated confidently, a disclosure in the financial statements should be made. |
| A supplier suing GCK Rwanda ltd for contract breach. | • This is a non – adjusting event as the goods were delivered in the year 2022.<br>• There's no provision to be made on the financial statements; however, if the amount is material, a disclosure to the financial statements can be made and the auditor should assess the going concern risks from this case. |
| A material inventory that was destroyed due to an employee error of chemical mix up on 10 January 2022. | • This can either be an adjusting or non-adjusting event.<br>• The audit should check whether the inventory destroyed was there before the year end or after the year end.<br>• If the inventory existed before the year end, it should be written off for the current year's financial statements.<br>• If the inventory was acquired after the year, a disclosure should be made if it was material. |

**c) Written representations from GCK Rwanda ltd management should have the following content as required by ISA 240.**

- They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.
- They have disclosed to the auditor management's assessment of the risk of fraud in the financial statements.
- They have disclosed to the auditor their knowledge of fraud/suspected fraud involving management, employees with significant roles in internal control, and others where fraud could have a material effect on the financial statements.
- They have disclosed to the auditor their knowledge of any allegations of fraud/suspected fraud communicated by employees, former employees, analysts, regulators or others.
- Address the going concern risks by showing that they will support GCK Rwanda ltd for its operations in Rwanda.

**QUESTION SIX**

| **Marking guide** | | **Maximum Marks** |
|---|---|---|
| a) | Describe the mission of the Office of Auditor General *(1 mark each)* | 6 |
| b) | Identify the main audit issues that are generally reported by OAG | 5 |
| | Discuss how concerned public institutions can address them | 5 |
| | *(1 mark each for issue and recommendation)* | |
| c) | State the main objectives of INTOSAI *(1 mark each)* | 4 |
| **Total** | | **20** |

**Model answers**

**a) The mission of the Office of Auditor General as per the constitution and law no. 79/2013 of 11/09/2013.**

The Office shall have the following mission:

- To audit Government revenue and expenditure in the following organs:
  - Central Government.
  - Local Government.
  - Public and parastatal institutions.
  - Government projects.
  - An organ or institution that receives State budget allocations for the purpose of conducting public activity.
  - Any other entity in which the State holds shares.
- To carry out financial and property management audit to ensure compliance with applicable laws and regulations, proper use of finances and property and ascertain if finance and property were managed appropriately.

- To carry out the audit of accounts, efficient management of property and finance and that of functioning of all organs provided by the law.
- To conduct forensic audit or special audit of all the organs provided for by the law if the Office deems it to meet the public interest or if it receives a complaint or is requested to do so.
- To submit to both Chambers of Parliament State consolidated financial statements.
- To collaborate with other individuals and corporate bodies with similar responsibilities at both national and international level.

**b) As a CPA student, identify the main audit issues that are generally reported by the Auditor General and discuss how concerned public institutions can address them.**

| Audit issues | Recommendations to address them. |
|---|---|
| Irregular expenditure in form of unsupported expenditure and partially supported expenditure. | • Ensure that all expenditure are properly supported by the required and necessary evidence.<br>• Ensure that the filing system is modernized, including the use of cloud services for filing. Some expenditure become unsupported as a result of lack of supporting documents poorly filed.<br>• Ensure that all expenditure are properly authorized as required by the law.<br>• Competent accountants (CPA/CAT) should be hired by the governments to fix these loopholes in financial management. |
| wasteful expenditure, unauthorised expenditure and funds diverted or fraudulently utilized. | • Ensure that all expenditures are properly authorized as required by the law<br>• "Unnecessary, unlawful and wasteful expenditure should have been avoided if public entities exercised due care in their operations, coupled with prudent management of public resources,"<br>• The culprits should be prosecuted and this would improve accountability. |
| Exclusion of internally generated revenue and expenditure of Non-Budget Agencies from the national budget approved by parliament. | • This is incomplete accounting and all revenues should be booked.<br>• More qualified accountants (CPA/CAT) should be hired by the governments to fix these loopholes in financial management. |
| Persistent cases of delayed contracts, | • Ensure proper follow up of works from inception to completion.<br>• Ensure that all contract provisions are adhered to, including those relating to delays.<br>• Ensure timely payment of contractors since some delays are caused by the government delay in payment. |

| Audit issues | Recommendations to address them. |
|---|---|
| Abandoned works not yet resumed, cases of idle assets, stalled projects, and failure to seize or recover advance payment and performance guarantees | • Ensure proper planning of projects<br>• Ensure proper follow up of works from inception to completion.<br>• Ensure that all contract provisions are adhered to, including those relating to delays.<br>• Ensure timely payment of contractors since some delays are caused by the government delay in payment. |
| Poor compliance with financial management procedures. | • More qualified accountants (CPA/CAT) should be hired by the governments to fix these loopholes in financial management.<br>• Ensure compliance with financial management procedures. |

**c) The main objectives of international Organisation of Supreme Audit Institutions (INTOSAI)**

- **Professional Standards** – to establish effective frameworks for the adoption of professional standards that correspond to the demands and expectations of member institutions
- **Capacity Building** – to focus on institutional capacity-building activities of direct relevance to the majority of INTOSAI's members
- **Knowledge Sharing & Knowledge Services** – to build on the essential features of openness, sharing and cooperation.
- **Model International Organisation** – to promote the organization and governance of INTOSAI.

**END OF MARKING GUIDE AND MODEL ANSWERS**