
**CERTIFIED PUBLIC ACCOUNTANT
ADVANCED LEVEL 1 EXAMINATIONS**

A1.2: AUDIT PRACTICE & ASSURANCE SERVICES

TUESDAY: 9 JUNE 2015

INSTRUCTIONS:

- 1. Time Allowed: 3 hours 45 minutes (15 minutes reading and 3 hours 30 minutes writing).**
- 2. This examination has two sections; A & B.**
- 3. Section A has one Compulsory Question while section B has three optional questions to choose any two.**
- 4. In summary attempt three questions.**
- 5. Marks allocated to each question are shown at the end of the question.**
- 6. Show all your workings**

SECTION A

Compulsory question

QUESTION ONE

You are the Audit Manager of Prime Partners, and have accepted to audit Kigali Airways Ltd for the year ended 31 December 2014.

Kigali Airways Ltd is listed on the local stock exchange market. The company runs passenger airline services through several countries and cities using planes of various sizes. It sells tickets from a number of locations such as from airports, shopping centers across the cities and also online sales.

It does not operate the airports from which passengers journey begin or ends as these airports are property of the respective countries and the agreement to use them is part of the franchise Kigali Airways Ltd has been granted.

Kigali Airways Ltd is one of the newer Airline service providers in operation and was only awarded a three year franchise to operate its routes, on the basis that, if it delivered efficient timely service based on sound financial accountability that demonstrates good value-for-money to customers, it would be awarded a five year extension to the franchise. The existing franchise expires on 31 December 2015.

In order to start planning the audit in more detail, you have held a meeting with the Finance Director of Kigali Airways Ltd and have established the following facts:

- The company operates in three main airports which are provided as part of the franchise. Its main assets are the aircrafts of various sizes and ages, most of which were obtained from the previous franchisee.
- Tickets for the journeys are sold through ticket offices in the main airports and from agents' shops near intermediate stops. The income is passed over on a weekly basis with an agreed percentage commission deducted.
- These arrangements have mainly been inherited from the previous franchisee. Passengers can also book online via a national website run by a centralized agency that boasts faster processing than any other provider, although its final certification by another assurance provider is still outstanding following its introduction at the start of the franchise.
- The National Passenger Transport Regulator has introduced a new set of ticket types and tariffs designed to simplify the process of buying tickets, which all franchisees committed to implement by 2014. Kigali Airways Ltd has charity initiative in place where for each Frw 10,000 of any ticket purchased, they will donate Frw 500 towards the charity.
- All aircrafts are operated by two pilots and two airhostess who also check and sells tickets on the aircraft for passengers unable to acquire them well in advance of the journey. Such tickets are usually sold without any of the discounts available for booking a number of days in advance.

- Around 35% of Kigali Airways Ltd revenue comes from season tickets purchased in advance by regular commuters who can buy three, six and twelve month tickets.

On enquiry about the general state of the company's finances and systems, you are informed that they are "fine" although the company's Audit Committee has raised concerns about the Internal Audit function given it's apparent "...revolving door..." staff turnover issues and whether or not they are on top of the regulator's stringent requirements for internal control reviews.

You have read in the press about the Regulator deciding to hold an official inquiry into an incident where one of the company's aircraft struck a group of Runway Maintenance Engineering staff in January 2014 resulting in the deaths of two engineering staff.

One particular press report noted that the aircraft involved "was so old that it carried a pre 1995 registration plate." The Finance Director seems angry about this, "the press says our pilot are negligent...it's tragic but the runway works were taking place late at night; we were not informed in advance about them; and the signage was totally inadequate,...I think they hate us because we are new to the market and trying to do something good for the passengers."

REQUIRED:

Draft the report for the Engagement Partner to deliver to the rest of the partners which addresses the following issues:

- (a) Determine and justify the Auditor's assessment of detection risk for Kigali Airways for Ltd for the year ended 31 December 2014. **(4 Marks)**
- (b) (i) List ten inherent, control and detection risks which would particularly concern you as an auditor of Kigali Airways Ltd and for each risk state why it would be a cause for concern. **(15 Marks)**
- (ii) For each risks identified in part b) i) above state how, it would affect your approach to the audit in terms of the investigations you would carry out. **(15 Marks)**
- (c) Explain the work required to verify the opening balances for Kigali Airways Ltd **(4 Marks)**
- (d) Discuss the initial work that you should do regarding the carrying value of non-current assets (i.e. Aircrafts) in the financial statements in respect of:

- (i) Valuation
- (ii) Completeness and existence **(6 Marks)**
- (iii) Explain why you might encounter difficulties in dealing with (i) and (ii) above. **(6 Marks)**

(Total 50 Marks)

SECTION B

Attempt two questions from this section

QUESTION TWO

Your firm, FS Certified Accountants has been offering consultancy services to Lepilo Ltd for the past ten years. The services offered include the provision of internal audit services and the preparation of the financial statements of Lepilo Ltd. You have been in charge of all the work carried out at Lepilo Ltd. The income that FS Certified Accountants gets from the provision of the current non audit services is 13% of the total revenue of your firm.

Another firm of accountants, YY& Partners has been providing external audit services to Lepilo Ltd. Lepilo Ltd has grown from a small company with two shareholders to one that has been listed on the Rwanda Stock Exchange. The financial year end of Lepilo Ltd is 30 September and the financial statements for the year ended 30 September 2014 will be the second ones to be audited after obtaining the listing.

It is now 20 October 2013 and YY & Partners have tendered their resignation as auditors of Lepilo Ltd. They have indicated that they will not seek re election at the next AGM at which the financial statements for 2013 will be presented. The Managing Director of Lepilo Ltd Anderson Peter is worried that the company will not have statutory auditors to audit the financial statements for the year ended 30 September 2014.

Your firm has responded to the advertisement by Lepilo Ltd for reputable firms of Certified Accountants to offer audit services. Your firm has been shortlisted for consideration as auditors of Lepilo Ltd. Anderson Peter has e-mailed Lomombo, the engagement partner, informing him of the fact that your firm has been shortlisted to be the auditors of Lepilo Ltd. In his e mail, he has requested Lomombo to treat this as a matter of urgency and that he expects a response from Lomombo before the end of October 2013 so that the matter is taken to the Annual General Meeting slated for 15 November 2013.

Pikiso has suggested that Lomombo immediately prepares an engagement letter and he has expressed his happiness that your firm will be the auditors because of the vast experience you have gained from the other services that you have been offering. He would like you to continue offering the other services as this will be cost effective for Lepilo Ltd.

Lomombo responded to the email from Pikiso and sought for permission from him to communicate with YY& Partners before he could respond. Pikiso responded in the negative and stated that there is no need for your firm to communicate with the outgoing auditors as they resigned of their own will and if Lomombo wanted he could obtain a copy of the letter of resignation from him.

You receive the following e-mail from Lomombo, the engagement partner, who is away on a business trip.

From: Lomombo @yahoo.com

Date: 27 October 2013

Subject: LEPILO Ltd AUDIT APPOINTMENT

Hi Munduri, remember the bid for audit services to Lepilo Ltd that we submitted a few weeks ago.

I have just received an e-mail from Pikiso the Managing Director of Lepilo Ltd informing me that our firm has been shortlisted and that we need to respond and confirm our willingness to provide audit services to Lepilo Ltd in a few days time.

I will only be back in the office after the deadline and so please get the file for Lepilo Ltd from my secretary and go through the correspondence. I would like to deal with all ethical and other matters that should be looked into before we reply.

I will appreciate your early response to enable me send a reply to Pikiso by close of business tomorrow.

I have forwarded the e-mail from Pikiso to you for your information.

Lomombo.

REQUIRED:

- a) Discuss the ethical matters that you wish to bring to the attention of Lomombo. **(12 Marks)**
- b) Describe four (4) possible matters that would have caused YY & Partners to resign as auditors of Lepilo Ltd. **(6 Marks)**
- c) Recent years have seen an increasing debate on whether assurance providers should offer other services in addition to carrying out the statutory audit. In the United States the Sarbanes Oxley Act prohibits auditing firms from carrying out other services for their audit clients.

REQUIRED:

Evaluate the arguments **for** and **against** the prohibition of auditors providing non audit services for their audit clients. **(7 Marks)**

(Total 25 Marks)

QUESTION THREE

You are the audit manager in your firm of Chartered Accountants and you were assigned to the audit of Kivu Ltd. This is the first time your firm is auditing the financial statements of Kivu Ltd and the audit is about to be concluded.

You are reviewing the working papers for the audit for the year ended 31 March 2015. The audit was supervised by Manda who is audit senior in your firm. An extract of the figures for noncurrent assets and revenue sections of the audit file contains the following information:

	2015	2014
	Frw	Frw
Revenue	545,000	324,000
Profit before tax	132,000	98,000
Property plant and equipment	254,000	214,000

You have made the following observations from a review of the working papers:

- 1) In the audit procedures for sales revenue you note that there is no evidence of work on cut off having been carried out. You are concerned about the 68% increase in revenue from 2014 to 2015.
- 2) Manda conducted a physical inspection of selected tangible noncurrent assets for the purposes of testing the assertion of valuation of noncurrent assets. You come across a note on the results of the physical inspections which states that equipment valued at Frw 64 million is in an unusable condition and based on his enquiries Manda concluded that the equipment does not have any use to Kivu Ltd.
The recoverable amount for this equipment is estimated at Frw 43 million. The equipment was previously revalued and there is an amount of Frw 9 million relating to this equipment included in the balance of the revaluation account at the period end.
- 3) The schedule of uncorrected errors indicates that a total of Frw 13 million remains uncorrected at the conclusion of the audit. The performance materiality level for this audit is Frw 15 million and the Chief Finance Officer of Kivu Ltd has refused to make corrections in the ledger and the financial statements. He is concerned that any correction of the errors will result in a reduction in the profit for the year.
- 4) You observe that there is no evidence of any work performed on the opening balances for 2015. This is despite the fact that the previous year's financial statements were not audited by your firm.

REQUIRED:

- a) Describe what is meant by impairment and why companies such as Kivu Ltd are required to conduct impairment reviews. **(5 Marks)**
 - b) Discuss the importance of reviews of audit working papers explaining how this is achieved in your firm of Chartered Accountants. **(5 Marks)**
 - c) For each of items 1 to 3 above, state your review points clearly stating the work that Manda should perform and where relevant, possible action that should be taken if the matters remain unresolved at the conclusion of the audit. **(9 Marks)**
 - d) Discuss the importance and relevance of your firm performing audit procedures on the opening balances for 2015 clearly describing the audit procedures that should be conducted as required by ISA 510 Initial Audit Engagements – Opening Balances **(6 Marks)**
- (Total 25 Marks)**

QUESTION FOUR

You are the Audit Manager in charge of the audit of Masumbuko Ltd for the year ended 31 December 2014. The review of subsequent events disclosed the following items:

- 1. January 10 2015:** The government approved a plan for the construction of a new highway. This will result in compulsory acquisition of property owned by Masumbuko Ltd. The amount of compensation cannot be estimated at this point although construction of the highway will begin in November 2014.

2. January 11 2015: The auditor discovered that a loan of Frw 80,000,000 to the company by the CEO on 14 June 2014 was obtained by him from a loan on his personal life assurance policy. The company pays premiums on the life assurance policy. The loan was recorded in the accounts as “loan from directors” but the CEO’s source of funds was not disclosed.

3. January 12 2015: At 31 December 2014 a specific provision on a debt of Frw 20,000,000 had been provided at 50% resulting in a total provision of Frw 10,000,000. On 12 January 2014 the company’s lawyer advised that nothing is likely to be recovered from the debtor and thus the provision should be adjusted to 100% although the this will be determined by outcome of a court case.

4. January 20 2015: A customer, Gikongoro Ltd with a material account receivable balance was unexpectedly declared bankrupt. The bankruptcy arose from substantial losses incurred from speculating on derivative instruments. No amount is expected to be received on liquidation of the customer’s business. The CEO of Masumbuko Ltd has a significant interest in Gikongoro Ltd.

5. January 28 2015: During the month of January, sales were substantially low, resulting in reduced production requirements. A substantial number of workers were laid off and this resulted in strikes by the remaining employees. The employees laid off have filed a law suit against the company.

REQUIRED:

Assume that the items described above came to your attention prior to completion of your audit work on February 15 2015. For each item:

a) Give the audit procedures, if any, that would have brought the item to your attention. Indicate other sources of information that may have revealed the item. **(10 Marks)**

b) Discuss the disclosure that you would recommend for the item, listing all details that you would suggest should be disclosed. Indicate those items or details, if any, that should not be disclosed. Give your reasons for recommending or not recommending disclosure of the items or details. **(10 Marks)**

c) State the consequences, if any, for the audit report if any of the adjustments or disclosures you recommend are omitted. **(5 Marks)**

(Total 25 Marks)

End of question paper

