

CERTIFIED PUBLIC ACCOUNTANT ADVANCED LEVEL 1 EXAMINATION A1.2: AUDIT PRACTICE & ASSURANCE SERVICES

TUESDAY: 7 JUNE 2016

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

Trimax & Associates, a member firm of iCPAR was the best evaluated firm to conduct the audit of Vicann Construction Limited (VCL) after a competitive bidding process. Trimax & Associates' contract is to run for the next three years commencing with the year ended 31 December, 2015.

VCL is one of the largest construction companies in Rwanda and is located in Gisenyi. VCL has been in business since 1994, and has positioned itself as a high quality output firm, which has made it very profitable. Its main business is construction and the manufacture of concrete products. It is a renowned construction firm and has had its hand on a number of projects both within and outside Rwanda. It is also an ISO 9001:2008 certified construction company.

As the audit manager at Trimax & Associates, the engagement partner has asked you to be in charge of this new assignment. He has availed you the permanent audit file which includes minutes of meetings he held with VCL's management before taking on the assignment. One of the issues of concern noted was the absence of an internal audit function. In your continued interaction with the management of VCL, they appear convinced to take on the implementation of the internal audit function, and the MD is seeking advice. The company's accounting system was also discussed. A bespoke Enterprise Resource Planning (ERP) system is in use but there is inefficiency in the management of some key modules especially inventory, non-current assets, accounts payable and accounts receivable.

The company's non-compliance with the Rwanda Revenue Authority regulations was also highlighted. You have come across correspondences notifying the company of irregularities in their compliance. The Social Security Fund recently published a list of the top 50 defaulters in the country and VCL was among them.

Recently, there was a deadly accident at one of the company's construction sites in which some employees lost their lives. Media reports seem to indicate that company officials were negligent. The families of the deceased staff members have taken the company to court.

A summary of the financial statements for the period ended 31 December 2015 is given as follows

	2015	2014
	Frw '000'	Frw '000'
Turnover	341,000	284,000
Cost of sales	(243,000)	(195,000)
Gross profit	98,000	89,000
Administrative costs	(15,231)	(12,314)
Sales and distribution costs	(1,200)	(953)
Other operating costs	(9,300)	(7,590)
Profit before tax	72,269	68,143
Corporation tax	(21,681)	(20,443)
Profit after tax	50,588	47,700

Upon the commencement of the audit, you were provided with the previous year's audited financial statements for analytical review. The following issues have been identified:

- Non-current assets increased from Frw 235 million to Frw 340 million but this has not been well explained.
- Inventories increased from Frw 1.2 million to Frw 4.5 million. This was due to the stock piling of raw materials this time round compared to last year. The change is material yet there are no ongoing contracts running with any client. The inventory count exercise highlighted many stock line items that carried material discrepancies between the system and actual count.

- The accounts payable exceeded the accounts receivable by over four times in ratio terms.

Required:

- Based on the above scenario, draft a management letter to Vicann Construction Limited. **(16 Marks)**
- Discuss the procedures that the audit team should perform in the audit of non-current assets for Vicann Construction Limited. **(12 Marks)**
- Discuss how VCL would test the effectiveness of the internal audit function if it was to set up one in future. **(8 Marks)**
- Discuss how your audit team would conduct the audit of Vicann Construction Limited's:
 - Revenue
 - Expenditure

(14 Marks)

(Total 50 Marks)

SECTION B

Attempt two questions from this section

QUESTION TWO

You are the Audit Partner of Ezela and Associates, and are in the process of reviewing the audit file of Kigali Graphics Limited (KGL) for the year ended 31 December, 2015.

KGL is a digital design company based in the heart of Kigali. The company is faced with several challenges.

The Chief Executive Officer and founder Mr. Justus Ndezimana has always found it hard to treat the company as a separate legal entity. He has always dictated the nature of employees working for the company and the majority of employees are either his relatives or women he has related with in one way or the other.

Justus always requests for funds from the Accountant for his personal use at short notice but wants this to be booked as company expenditure without any supporting documents. This practice has led to various financial management challenges. This, at times, has affected the cash flow operations of the company and at times brought some assignments to a standstill.

KGL management has informed you that one of their key printing customers who has been the biggest debtor closed operations in February, 2016. However, management does not want this disclosed at all and yet the amount was material.

Due to the unstable power, one of the company's printing machines was destroyed by fire that gutted the KGL company premises in early March, 2016. This was widely reported in the press but management does not want this disclosed as well. The latest Board minutes noted that the closure is a setback but they decided not to adjust the financial statements. The latest management accounts indicate that the turnover has greatly declined as a result of destroying of one of the printing machines. Management has already secured a loan for a new printing machine to restore and possibly increase their current capacity.

There have been continuous complaints about employee sexual harassment from top management championed by Justus. In addition, employees have been accused of spending a lot of their working time on social media.

Promotions are made without any performance appraisals and staff is reportedly dissatisfied by the decisions. Employees believe there is discrimination based on relations with the founder, tribe and religion hence recommendations and decisions for promotions are not fairly taken.

Some customers have questioned the quality of the work done. Customers have complained that delivery is not made on time as per the agreed terms and the quality does not match the current demand which is in contrast with their advertising messages. This is likely to reduce the number of potential customers which might impact the going concern assumption.

You have found it necessary to recommend corporate social responsibility as company practice. This, you believe will enable the company to get closer to the community and also receive constructive feedback. KGL's competitors have always given back to their communities through road maintenance, scholarships to disadvantaged children and such other gestures. The competitors' market shares have grown as a result of the communities feeling a sense of ownership of the competitors' activities in their communities.

Required:

- (a) Discuss the ethical issues highlighted in the Kigali Graphics Limited scenario above. **(12 Marks)**
- (b) Discuss the benefits of corporate social responsibility to Kigali Graphics Limited. **(5 Marks)**
- (c) Explain to your audit team how they would audit events occurring between the reporting date of Kigali Graphics Limited and the date of your auditor's report. **(8 Marks)**

(Total 25 Marks)

QUESTION THREE

You have recently been promoted to audit manager in the practice of Mango & Co, a four partner practice based in Kigali. One of your roles is to review audit files. The engagement partner is very keen on having complete and sufficient audit evidence on the permanent and current files. This has been as a result of the quality control assessment that was conducted by the iCPAR. The firm has been maintaining audit files with insufficient relevant supporting documents.

One of your clients, Joel Electrical Limited (JEL) has recently had some changes at board level. One of the issues noted in the draft management letter is that there are no clear separate roles between the management and board. This has created some mistrust between management and the board. However, there is no evidence, however, to confirm the existence of the mistrust.

You have also come across a working paper purportedly supporting the inventory balance in the statement of financial position. On further review it reveals that the amount is not independently supported by an inventory count.

A correspondence with the legal advisors of JEL indicates that the former were unable to confirm that the company's land titles were in the names of JEL. Also, there have not been any bank confirmations regarding bank balances. The audit team has not been able to carry out non-current assets verification due to time pressure.

During the course of the audit review, you come across a working paper highlighting the corporate governance issues with a recommendation of having a board orientation and governance training. The management response was that "we do not believe this is a priority for the company".

Required:

- (a) Describe the degree to which audit evidence can be considered trustworthy based on the scenario. **(10 Marks)**
- (b) Basing on the scenario, justify to your audit team, reasons for maintaining working papers. **(10 Marks)**
- (c) The Board of Directors of Joel Electrical Limited has requested that you conduct a workshop with the topic "Good Corporate Governance".

Required:

Discuss what you would share that the board needs to know regarding their duties. **(5 Marks)**

(Total 25 Marks)

QUESTION FOUR

Extra Telecom Limited (ETL) has been in existence for over 10 years. A recent investigative audit revealed that there has been a massive fraud which has been going on for over 3 years. This investigative audit was conducted by the risk management and crime department of the company. This department was able to uncover the fraud, a large sum of missing money from the regional offices and that senior management was negligent while conducting its day-to-day work. It is suspected that the head of procurement and head of information technology were involved and are reportedly said to have been receiving kickbacks from vendors. The management has hired an external firm to help it to get a thorough independent investigation with the objective of prosecuting the staff and external suppliers involved in the fraud.

Your firm Honest and Co, has been auditing the company for the last three years. The management of ETL did not want to disclose the fraud. Consequently, for the year ended 31 December 2015, you have issued a qualified opinion. This has upset senior management and are lobbying to have another firm contracted in future.

During the pre-audit meeting, management shared various actions and controls that have been put in place to ensure this does re-occur.

Required:

(a) Discuss as to whether the management of Extra Telecom should commission an independent investigation. **(10 Marks)**

(b) You are the audit manager in Honest and Co, write notes that you would discuss with your team on how one would plan the investigative audit of Extra Telecom Limited. **(8 Marks)**

(c) You have been invited for Extra Telecom's Annual General Meeting to provide insights on an adverse opinion. Share what your insights would be regarding adverse opinion. **(4 Marks)**

(d) Draft the audit opinion section in respect of the audit of Extra Telecom Limited with reasons. **(3 Marks)**

(Total 25 Marks)

End of question paper



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