
CERTIFIED PUBLIC ACCOUNTANT INTERMEDIATE LEVEL EXAMINATION

11.4: AUDITING

FRIDAY: 10 JUNE 2016

INSTRUCTIONS:

- 1. Time Allowed: 3 hours 15 minutes** (15 minutes reading and 3 hours writing).
- This Examination is divided into two sections (A & B)
- Section A has **three (3)** Compulsory Questions while Section B has four (4) questions to choose **two (2)**
- Five (5)** questions in total are to be attempted.
- All iCPAR Examination rules and regulations apply

SECTION A

Attempt all questions in this section

QUESTION ONE

Abacus Construction Limited (ACL) has appointed your audit firm, Flora & Associates to carry out an audit of their financial statements for the year ended 31 December 2015 and the following information has been made available.

ACL made a loss for the year ended 31 December 2015 unlike other years, which was attributed to the loss of one of their biggest client. The client also had a substantial debt balance which is still outstanding to-date. Recovery measures have been taken by management but they have not yielded any results.

ACL has had an overdraft facility for the past five years renewable annually after the bank's assessment of their financial performance. However, the credit officer at the bank has hinted on difficulty of renewing the overdraft facility because of the huge loss made. ACL has resorted to borrowing from money lenders to finance its activities who charge exorbitant interest rates. This situation is bound to worsen its financial woes.

ACL's key suppliers of construction materials have threatened to stop supplying them due to failure to receive payments on time. The few that are willing to continue supplying require cash payments before delivering the materials. The revision of payment terms from credit of one month to cash payment is causing delays in completion of key projects because of absence of construction materials brought about by lack of funds to pay the suppliers cash on delivery.

Key employees who have worked for the company since inception are being enticed by competitors, promising them better pay and other incentives like accommodation, medical insurance and lucrative out-of-office allowances. The company is currently negotiating with them for increments in their pay and the Managing Director hopes that they will reach an understanding very soon.

ACL has no insurance cover for its workers (workman's compensation) yet it is a requirement for construction companies. The insurance regulator has threatened to cancel their licence because of non-compliance.

ACL has contacted their insurer to speed up the process. A copy of the minutes for the meeting held between the insurer and ACL has been received by the firm.

The directors have provided your firm with the management accounts for the period of three months ended 31 March, 2016 which show an improvement in the performance of the company from the previous loss to a small profit.

One of the major shareholders has promised to lend money to ACL to settle their obligations as they look for alternative financing.

Required:

- (a) Explain the circumstances in the scenario that indicate that Abacus Construction Limited may not be a going concern. **(6 Marks)**
- (b) Discuss the procedures that Flora & Associates may adopt to satisfy themselves that Abacus Construction Limited may continue as a going concern. **(14 Marks)**

(Total 20 Marks)

QUESTION TWO

Harambe Limited was incorporated in 2012, as a money lending company based in Kibeho. The company is owned by three directors, Tanda, Rweza and Rugona. Rugona is the Managing Director in charge of the day-to-day management of the company. Your audit firm Hakks & Co, was appointed to carry out the audit for Harambe Limited for the year ended 31 December 2015.

The following issues were discussed in the pre-audit meeting on loans advanced to customers:

1. One of the major objectives of Harambe Limited was to carry out money lending business with an aim of earning interest which is receivable on a monthly basis.
2. Loans are issued out to clients at the discretion of the Managing Director and the interest charged depends on the client's bargaining power and the amount of loan applied for.
3. There are loan agreements in place specifying the loan amounts received, computed monthly interest and security. However, for clients who have done business with the company for long, the loans have been disbursed to their accounts without the clients signing new loan agreements.
4. For some of the Non-performing loans, the Managing Director has stopped the accountant from computing interest, and instead ordered him to emphasise the recovery of the principal.
5. According to the company's lending policies, all loans should be properly secured. The loan to be disbursed should not exceed 70% of the value of security especially for depreciable assets. In some cases, however, loans are disbursed without any security provided the clients are known to the Managing Director personally.
6. The accountant produces monthly loan portfolio reports detailing the borrowers, the amounts borrowed, interest rates and due dates.
7. All payments and receipts are supposed to be effected through the bank account. However postings are done in the cash book, the relevant ledgers and the bank statement.

Required:

- (a) Identify the objectives for the audit of loans advanced by Harambe Limited. **(3 Marks)**
 - (b) Explain the audit procedures you would carry out on loans advanced by Harambe Limited. **(12 Marks)**
 - (c) Identify the nature of audit evidence you would be expected to gather during the audit of Harambe Limited. **(5 Marks)**
- (Total 20 Marks)**

QUESTION THREE

The auditor shall perform the procedures required so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures.

Required:

- (a) Explain the auditor's responsibility for events occurring:
 - (i) Between the date of the financial statements and the date of the auditor's report. **(4 Marks)**
 - (ii) After the date of the auditor's report but before the date the financial statements are issued. **(2 Marks)**
- (c) Identify the audit procedures that the auditor should carry out between the dates of the financial statements to the date of the auditor's report. **(4 Marks)**
- (d) You are an audit senior at JED & Co, Certified Public Accountants. The audit manager has selected you to be part of the team to audit the Ministry of Health of Rwanda. While briefing you about the audit exercise, the manager informed you that public sector audit has a key role to play in safeguarding public assets, ensuring proper accountability, upholding appropriate standards of conduct in public

services and helping public services achieve value for money. He further informed you that public sector auditors are accountable for their performance and are duty bound to undertake their work in a professional, objective and cost effective manner and with due regard to the needs of the organisations they audit.

Required:

Discuss the duties to be performed by a public sector auditor in order to achieve the above role. **(6 Marks)**

- (e) The International Organisation of Supreme Audit Institutions (INTOSAI) for years has provided an institutionalised framework for Supreme Audit Institutions to promote development and transfer of knowledge, improve government auditing worldwide and enhance professional capacities.

Required:

Discuss the main objectives of International Organization of Supreme Audit Institutions. **(4 Marks)**

(Total 20 Marks)

SECTION B

Attempt any two questions in this section section

QUESTION FOUR

- (a) It is in the interest of both management and the auditor that the latter sends an engagement letter to management prior to performing an audit engagement. This helps avoid misunderstandings with respect to an audit engagement. An engagement letter confirms the auditor's acceptance of the engagement and such matters as may be agreed upon.

Required:

Explain the importance of an engagement letter. **(8 Marks)**

- (b) Computer systems will usually process information accurately, though they can be subject to systemic weaknesses, security and continuity problems. Effective corporate governance arrangements will often require auditors to provide assurance to those charged with governance or management as appropriate, about the reliability of the entity's information systems. Their importance extends beyond financial reporting and increasingly, businesses are becoming dependent on complex systems and the technology that underlie them.

Required:

Discuss the advantages and limitations of using computer-assisted auditing techniques [CAAT] **(12 Marks)**

(Total 20 Marks)

QUESTION FIVE

You are an Audit Manager at AT&Co, a firm of Certified Public Accountants responsible for the audit of Gat Company Limited. You have been in charge of their audit for the past three years. The audit for the current year has come at a time when there are five other audits that are going on. As manager, given that you are

responsible for the other audits, you feel that you may not have enough time to do the necessary tests to detect all the errors, fraud and material misstatements in the financial statements.

Required:

(a) Advise the audit team on the responsibilities AT& Co has in relation to the detection of fraud. **(4 Marks)**

(b) Explain to the audit team the actions that they should take should they discover potential errors or fraud. **(8 Marks)**

(c) Explain the risk assessment procedures that should be instituted AT&Co, to identify the risk of material misstatements due to fraud. **(8 Marks)**

(Total 20 Marks)

QUESTION SIX

Kwizera Company Ltd (KCL) carries out commercial farming. The company has never been audited because they feel it is a waste of resources. In June 2015, they applied for an agricultural loan from the Bank of Kigali to acquire more machinery for value addition and also boost the efficiency of its operations.

The bank has requested for audited financial statements before the loan is disbursed. The owners are distressed with the news and have come to your firm for help. After a meeting with their representatives, you have been requested to clearly explain the benefits of auditing the company's financial statements and the objectives of carrying out a statutory audit.

Required:

(a) Identify the objectives of carrying out a statutory audit. **(8 Marks)**

(b) Explain six advantages of having their financial statements audited. **(12 Marks)**

(Total 20 Marks)

QUESTION SEVEN

ISA 300: Planning an Audit of Financial Statements and ISA 315: Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment require the auditor to carry out a process of planning prior to any audit engagement.

Required:

(a) Discuss the importance of audit planning to the auditor when carrying out an audit engagement. **(14 Marks)**

(b) Describe the factors that an auditor should consider in deciding whether an error/ item is material. **(6 Marks)**

(Total 20 Marks)

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