
CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.2: AUDIT PRACTICE AND ASSURANCE
SERVICES

TUESDAY: 4 JUNE 2019

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

QUESTION ONE

STEEL ROLLING LIMITED

Steel Rolling Limited (SRL) is a member of SRG Group (SRG). SRL is a company in Rwanda that produces steel roofing products, accessories and structural steel products for markets in Rwanda and the Great Lakes region.

SRL is a private entity with a sound corporate governance structure. It has a board of 7 members, five of whom are non-executive directors while the other two are the managing director and executive director who oversee the day to day running of the business.

You are an audit manager at APK & Co., and you are responsible for the audit of SRL for the year ended 31 December, 2018. SRL's financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) and the law relating to companies for Rwanda.

The following notes were prepared by the engagement partner in relation to the audit of SRL.

1. SRL's revenue for the year was Frw 150 billion, an increase of Frw 25 billion as compared to the previous financial year and the profit before tax was Frw 45 billion. The cost of sales for the year was Frw 70 billion compared to Frw 50 billion. Total assets for the year were Frw 300 billion.
2. The company imports most of its raw materials from China and the European Union. The materials are shipped to the East African port and then moved by road from the port to Kigali. SRL makes orders for materials using an e-commerce platform and invoices are then dispatched by the supplier denominated in US dollars (USD). SRL then instruct their bankers to transfer funds to the suppliers and the inventory is recorded in the financial statements as goods in transit using the Rwanda Revenue Authority (RRA) exchange rate for imports. Once the materials are received at the factory and agreed to the local purchase order, the inventory is moved to the warehouse and an accounting entry is passed to move the materials from goods in transit to the inventory ledger from where the movement to the production line is then monitored.
3. APK & Co staff together with an inventory expert attended the inventory count on 31 December 2018. The reconciliation between the physical inventory and the inventory ledger indicated a variance of Frw 5.5 billion. Management requested that the reconciliation be done after the audit due to time constraints and this requires thorough analysis.
4. SRL is facing litigation claims from 2 of its former employees. The 2 were involved in an accident at work and could no longer work and therefore their contracts were terminated. SRL has always insured all its workers under the workman's compensation scheme with their insurers, BH Insurance. BH Insurance paid the two employees but they think the compensation given was too little to compensate for the loss incurred. SRL refused to pay the employees more money and they sued seeking a compensation of Frw 250 million. No provision has been made in the financial statements following the advice of SRL's lawyers. There are, however, court rulings

in favour of the employees of Gatera Steel Mills Ltd in relation to compensation of that nature.

5. SRL has a 10 year loan facility from the African Development Bank (ADB) to the tune of Frw 100 billion. The loan was acquired for purposes of both working capital and capital development. The loan was acquired in 2016 and the grace period was up to 31 December 2017. The principal and interest are payable on a quarterly basis in USD as per the loan schedule. Interest payable of Frw 2 billion has been recognised in profit or loss in this financial year which is the commencement of the loan repayment.
6. SRG runs a charity organisation, Steel Rolling Foundation (SRF). SRF is the charity arm for all the companies in the SRG Group. Each company in the group contributes 1% of their revenue to the charity. SRF offers scholarship to needy students in Rwanda and other related services. SRL contributed Frw 2.5 billion to SRF in this financial year. SRF is registered as an exempt organisation in relation to income tax. SRF is located at SRL and accountancy and other services are offered by SRL.
7. SRL's key management is entitled to a bonus at the end of year in case all set performance targets are met. This year's bonus is expected to be Frw 200 million if approved by the Board. A provision has been included in the financial statements to that effect.
8. The nature of SRL's operations involve a lot of accounting estimates, especially in the area of inventory and cost management techniques are used in arriving at cost of sales, markups and margins. International Standards on Auditing (ISA) now require auditors to obtain/ prepare more documentation in relation to the audit of accounting estimates.
9. SRL has invested Frw 500 million in treasury bonds to hedge against any occurrences of failure to meet its obligations. These are for a period of 3 years and interest and principal are receivable at the end of the investment period. SRL has an option to terminate the contract before the end of the three year period but the intention is to hold it to maturity.
10. SRL also has equity interest of 500 shares in Kenya Breweries Limited (KBL). KBL is listed on the Nairobi Stock Exchange (NSE). SRL accounts for its equity interest as available for sale investments.

The following is an extract of SRL's statement of profit or loss and other comprehensive income for the year ended:

	2017	2018
	Frw 'billion'	Frw 'billion'
Revenue	150	125
Cost of sales	<u>(70)</u>	<u>(50)</u>
	80	75
Other expenses	<u>(35)</u>	<u>(40)</u>
Profit before tax	<u>45</u>	<u>35</u>

REQUIRED:

Prepare brief notes for the audit team on the following:

- (a) The possible and actual risks of material misstatement of the financial statements of SRL. **(14 Marks)**
 - (b) The audit evidence expected on the current audit file in relation to the audit of inventory. **(8 Marks)**
 - (c) Appropriate audit opinion in relation to the:
 - (i) Un-reconciled inventory of Frw 5.5 billion. **(6 Marks)**
 - (ii) Litigation claim of Frw 250 million. **(4 Marks)**
 - (d) Design audit procedures for the audit of:
 - (i) Transactions and balances in relation to SRF. **(7 Marks)**
 - (ii) Litigation claims. **(3 Marks)**
 - (e) Discuss the additional documentation requirements expected of APK in relation to auditing of accounting estimates. **(8 Marks)**
- (Total 50 Marks)**

SECTION B

QUESTION TWO

Your firm Ngoga Consulting Limited (NCL) has been appointed to prepare the financial statements for Rwanda Supermarkets Limited (RSL) for the year ended 31 December, 2018. RSL runs 2 supermarkets in Kigali offering products for commercial and domestic use.

The finance department of RSL is under staffed and hence the need to support them in preparing the financial statements to be audited by PKL & Co. The management of RSL also suspects that some staff in the finance department together with others in other departments misappropriated funds. NCL is expected to carry out an investigation alongside the preparation of the financial statements. The management have proposed that RSL's financial statements be prepared in accordance with Generally Accepted Accounting Principles (GAAP) but NCL are of the view that the statements should be prepared in accordance with International Financial Reporting Standards (IFRS) and must comply with the law relating to companies of Rwanda (The Companies Act) as this is the applicable framework. NCL is also expected to support the finance department during the audit by PKL & Co. This will involve, among other things, preparing all necessary supporting working papers for the amounts in the financial statements.

The engagement partner's review of the accounting system of RSL revealed the following:

RSL has a system where clients make advance cash deposits on RSL's bank accounts as prepayment for goods. The accounting entry made in the system is to credit the income and debit the RSL bank account. The client's Shopping Card is then credited with the amount deposited in the bank to enable him/ her make purchases using the card. The outstanding amount on client cards at the end of the year was Frw 150 million.

RSL acquired land for its warehouse on a 5 year lease period at a cost of Frw 25 million per annum (principal amount of Frw 20 million and interest of Frw 5 million). RSL has already expensed Frw 50 million and a corresponding entry passed in the bank account in the accounting system. No other transactions have been passed in the accounting system.

RSL sells some goods under warranty under which customers are covered for the cost of repairs of any defects within 30 days from the date of purchase. RSL normally get on average 10 major defects in a year costing around Frw 5 million.

REQUIRED:

- (a) Discuss with RSL the matters to be agreed on prior to the engagement. **(5 Marks)**
 - (b) Discuss with your team the process to follow in investigating the suspected misappropriation of funds at RSL. **(8 Marks)**
 - (c) Advise RSL on the possible misstatements arising from your review of RSL's accounting system and how they can be corrected. **(12 Marks)**
- (Total 25 Marks)**

QUESTION THREE

You work for The Rwanda Bureau of Standards (RBS) as the head of internal audit. Part of RBS's internal audit department's mandate is to carry out audits of other RBS's departments. RBS has 5 departments and these include: operations, human resource, administration, finance and internal audit. All departments report to the executive director with the expectation of the internal audit which reports to both the executive director and the Board. The internal audit department prepares a work plan annually on how they intend to carry out the audit activity of the various departments. The work plan is approved by the finance department, executive director and the Board. The internal audit reports are submitted to the executive director, the Board and the Office of Internal Audit at the Ministry of Finance.

Your team completed the audit fieldwork of the finance department activities for quarter 1 (January 2019 to 31 March 2019) in May 2019 and the report is needed by end of June 2019. The audit was carried out by two staff, Rukundo and Ntambara, and was supervised by yourself. The purpose of the audit engagement was to provide RBS with the assurance that risk management, governance and controls over the finance department are in place and functioning as intended, and make recommendations for improvement in case of any deficiencies.

The objectives of the audit were to: examine the expenditure incurred during the period to ascertain whether they were properly recorded, reported, authorised and supported with sufficient appropriate accountabilities in accordance with the Finance and Administration Manual (FAM) and other regulations.

Verify whether the statutory obligations due to Rwanda Revenue Authority (RRA), Rwanda Social Security Board (RSSB), local and urban authorities are deducted and remitted in accordance with the respective laws of Rwanda.

A risk based approach was adopted by the team and the audit was done in accordance with International Standards on Auditing (ISAs) and as per the local regulations and Acts of Parliament.

These were the findings of the team:

- Payment vouchers are filled in a chronological order as per Section 6 of FAM;
- There were missing payment vouchers worth Frw 100 million contrary to Section 9 of FAM;
- Remittances to statutory bodies, such as, RRA and RSSB are filed on time and as required as per the Acts;
- And there was an inadequately supported supplier expenditure of Frw 500 million contrary to Section 10 of the FAM.

REQUIRED:

- (a) Explain to the internal audit department staff the possible ethical threats they may encounter as they carry out their audit mandate and the appropriate safeguards. **(6 Marks)**
 - (b) Prepare an Internal Audit report highlighting the observations and recommendations arising from the internal audit of the finance department. **(19 Marks)**
- (Total 25 Marks)**

QUESTION FOUR

You have been hired as a quality reviewer of Mugabo & Co. This follows the results of the periodic review inspections carried out by the Institute of Certified Public Accountants of Rwanda (iCPAR) carried out in January 2019

Mugabo & Co has 3 audit partners, 2 of whom are full time and 30 permanent staff and with over 150 clients.

The report indicated the following areas of concern:

1. Mugabo & Co has a habit of accepting audit engagements for which they have no capacity to carry out, especially in the insurance sector. iCPAR's review of audit files for work done in this sector indicated that the work did not meet the required standards though the engagements are already concluded and audit reports signed off.
2. Mugabo & Co is also taking on clients considered to be of a high risk nature and yet there are no safeguards to mitigate the occurrence of such risks and reducing engagement risk to zero is very rarely attainable or even cost effective.
3. A good number of staff are yet to attain professional qualification but are already handling critical clients. There is evidence of client complaints about the qualifications and experience of staff deployed on assignments compared to the audit fees charged by the auditor.

Mugabo & Co needs to resolve these issues before the next review as re-occurrence will not only attract penalties for non-compliance but also require a review of the firm's license for the following year.

REQUIRED:

Prepare a presentation to Mugabo & Co on the following:

- (a) The key issues necessary for attaining quality work for each audit engagement. **(8 Marks)**
 - (b) Engagement characteristics to look out for in relation to risk consideration before accepting an assurance engagement. **(8 Marks)**
 - (c) Ways of improving the quality of staff in the firm. **(9 Marks)**
- (Total 25 Marks)**

