ICPAR

Unlimited possibilities

CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

DATE: FRIDAY 31, MAY 2024

MARKING GUIDE AND MODEL ANSWER

SECTION A

MARKING GUIDE AND MODEL ANSWER TO QUESTION ONE: GAHONDO DECENT FURNITURE (GDF) LIMITED

MARKING GUIDE	**Marks**
Q1 (a): Matters specific to the planning of an initial audit engagement for GDF	
Award up to 1 mark for every well explained matter "specific to the initial audit engagement for GDF". Only 0.5 marks where a matter is only identified but not well developed/explained with reference to the information given regarding Lite Co (maximum of 10 marks)	10

Note: **Do Not Award -** Points that are generalized and therefore not aligned/related to the specific information regarding GDF as provided in the scenario (including speculative issues)

Q1 (b): Risks of material misstatements (ROMMs) to be considered when planning the final audit for GDF

Award up to 3 marks (except where it is stated otherwise on items of New audit client, related party disclosure and on bonus paid to senior and management bias; 4 marks maximum for these three points (cumulatively) throughout the question).

Using the ROMM marking guide provided below for the following ROMMs specific to the audit of GDF (but are not limited to):

- New audit client (under detection risk) – maximum of 4 marks
- Cost/value for the main raw material (hard wood) on importation of the hard wood
- Estimated cost of transportation of the hard wood
- Closing value of hard wood (included within closing inventory)
- Measurement of finished closing inventory (furniture)
- High competition – impairment loss for equipment
- Poor publicity – impairment loss for equipment
- Going concern uncertainty disclosures
- Provision for penalties - Side-effects (significant breathing complications) of office-furniture
- Provision for government inspection costs
- Related party disclosure – bonus paid to senior management **(award to a maximum of 4 marks)**
- Management bias - **award to a maximum of 4 marks for points on management bias (cumulatively) throughout the question**

Any other valid ROMMs raised by the student that are relevant to the audit of GDF relating to the information provided in the scenario (where applicable using the ROMM marking below). For example, the use of a “management bias” and/or “management under pressure” as a valid point(s) where the student refers to the “bonus paid t the Managing Director”

Where correctly applied, award 1 mark for each valid point referencing to "materiality" item well developed - to a maximum of 2 marks (across the entire question)

The ROMM marking guide for each correctly identified audit risk award is provided as below:

(i) Accounting treatment: Award up to 1 mark for a reasonable/correct reference to the accounting treatment relevant in the circumstances otherwise its 0.5 marks where they only attempt but do not well develop the accounting treatment or no mark for a wrong accounting treatment (Note: no penalty for a wrong quotation of the IFRS number and/or title since it's the guidance for the accounting treatment that is of importance here)

(ii) Risk of material misstatement (ROMM): Award up to 1 mark for a well-developed risk of material misstatement where they use the specific information provided in the scenario for GDF to "identify" the potential ROMM (taking 0.5 marks of the allocated 1 mark) and go ahead to explain or recognize how this is a ROMM (taking the other 0.5 marks of the allocated 1 mark)

(iii) Where the financial statement risks are correctly identified in the audit risk assessment, award 0.5 marks for every correct financial statement risk arising from the ROMM (e.g., assets are "overstated" - goes for 0.5 marks and expenses are "understated" - gets the other 0.5 marks) picking the "double-entry application" or a full 1 mark for a correct "disclosure" impact

*Note: **Do Not Award:***

- Generic (speculative) risks developed from rote-learning which are not supported by the information given in the scenario
- Government regulations of DRC and/or Rwanda may not permit the ease transportation or importation of the hard wood without a correct justification for associated risks of material misstatements (e.g. potential ban of exportation of the hard wood by DRC based on the lobby group's request as this may be more of a business risk)
- Foreign currency transactional risks regarding the settlement for the hard wood imported from DRC and GDF settles the owners of the forests in DRC using Rwanda Francs
- Any other points that are irrelevant and/or invalid to the information provided regarding GDF

MAXIMUM MARKS for Q1 (b) - using the guide provided above 25

Q1 (c): Principal audit procedures - audit work to be performed in respect of the carrying amount of:

i. Finished office-furniture *(see marking guide for audit procedures below)* 5

ii. Equipment used in the production of office-furniture (see marking guide for audit procedures below) 5

iii. The bonus paid to the Managing Director 5

Award up to 1 mark for each valid audit procedure based on the model answer and/or any other valid audit procedure(s) provided by the student answers (where the 1 mark includes 0.5 marks for a correct "what - supported a valid source where applicable" and the other 0.5 marks for a valid "why or reason" relating to the financial statement assertion being tested. The procedure for the contract supporting the bonus paid to the Managing Director in c (iii) is awarded up to a maximum of 2 marks

Total marks for Question One **50**

MODEL ANSWER

MODEL ANSWER TO QUESTION ONE: GAHONDO DECENT FURNITURE (GDF) LIMITED

Part (a): Audit planning matters specific to a new audit engagement for GDF

- At the initial audit engagement, it is important to understand the entity and its business environment as this understanding would clearly have an impact on the audit strategy, for example this will help Rukundo Partners CPA to decide on the areas of audit risk, would facilitate analytical review, and would help to plan practical matters such as the use of auditor's experts.
- Rukundo Partners CPA must obtain evidence on the authenticity of the opening balances including a confirmation of whether they have been brought forward correctly, and whether accounting policies are consistent with the prior years.

- It is important to take into consideration the reasons why the predecessor auditor did not consider a re-appointment after their tenure has come to an end especially if there was a chance for a renewal of the audit engagement. The predecessor auditor’s decision not to seek for a re-appointment may have a bearing on our assessment of risk and planning of resources for the audit.

- As new auditors for GDF, we should consider the effect of any significant information received during the professional clearance process on our audit strategy and planning.

- It is important to request the predecessor auditor for permission to access and review their working papers as this will help Rukundo Partners CPA to plan its audit if there are any matters which would still be relevant to the current year, such as changes in accounting policies and/or correction of prior period errors. As new auditors for GDF, we should access the audit reports for the prior years to confirm if any auditor’s reports were modified and then determine the reason for the modification(s), as the matter(s) for modification may continue to be relevant in the current year under audit.

- Assess the impact of matters discussed with GDF during the appointment process on the audit strategy, e.g. there might have been a discussion of major events that took place in the current year under audit and/or accounting policies.

- Since our firm was appointed as auditors a month (1 May 2024) after the end of the financial year (30 June 2024), it is important to discuss with GDF the timelines for completion of the audit as a tight deadline may impact on the completion of audit procedures and/or adequate reviews on the audit work performed. It is important to minimize the detection risk and ensure that the overall quality of the audit is maintained.

- This is especially important given that this is the first-year audit and therefore the audit team will be working with a steep learning curve. Audit procedures may take longer than originally planned, and this implies sufficient time may be needed to extend procedures where necessary.

- As senior management members have earned a bonus based on the un-audited profit figure, they may exert considerable pressure on the audit team to ensure that the financial statements maintain the draft profit figure or a higher profit. It is important that during the audit process, the audit team members comply strictly to ethical guidelines and that independence is beyond question.

- Due to the fact that this is a new client and the nature of its activities, it is important at the audit planning stage to plan for a second partner review (Engagement Quality Control Review) in the first year of the audit. A suitable independent reviewer should be identified, and time planned and budgeted for at the end of the assignment.

Part (b): Risks of material misstatements assessed at the planning of the final audit of GDF

New audit client

This is the first time our audit firm is auditing the financial statements of GDF and therefore the learning curve is expected to be steep for the audit team in the first year of the audit. There is a risk that the auditors do not detect material misstatements in the opening balances for example if the closing balances of the prior year are not correctly brought forward as opening balances for the current year. This will imply that the balances affected by errors in the opening balances may remain undetected.

In addition, they may be changes in GDF's accounting policies in the current year which in accordance with IAS 8 Accounting policies, changes in estimates and errors require adjustments made to the related opening balances of the assets, liabilities and equity. The risk is that the auditors may not detect the changes in accounting policies if for example management has intentionally kept such information from the auditors as they are new auditors and this may due to management pressure leading to materially misstated financial statements.

Cost/value for the main raw material (hard wood) on importation of the hard wood

Importing hard wood from another country (DRC) and in the rainy forests is inherently risky as this is subject to conditions outside the control of GDF, for example transport restrictions in DRC and/or whether conditions in the rainy forests may impact on the timelines for delivery and associated cost. This may imply an increase in the cost of hard wood which is a main raw material used to make furniture. There is a risk of material misstatement if GDF has not correctly valued the hard wood to the lower of cost and net realizable value at the time of receiving the hard wood

Estimated cost of transportation of the hard wood

The hard wood imported from the rain forests in DRC and this is road transported over a very long distance of over 2,000 kilometers which is potentially a significantly high cost of transportation and must therefore be quantitatively material. Under IAS 2 "Inventories", the cost of inventory should include all direct and indirect costs incurred to get to goods ready for their sale. The cost of transportation of the hard wood from DRC to Rwanda should be included as part of the cost on inventory. The risk of material misstatement arises if GDF has wrongly classified this cost as an operational cost rather than capitalizing it within the cost of inventory. This will result in an understated cost of inventory and overstated operational costs.

Closing value of hard wood (included within closing inventory)

GDF's inventory is the furniture whose main raw material is the hard wood. Since the hard wood is imported before its mature for its use in the making of furniture, the stage of maturity of the hard wood is based on management estimation and this estimate is the basis for the valuation of the wood at each reporting date. There is a risk that management may wrongly estimate the age/status of the immature hard wood at the reporting date due to the subjectivity involved. This is highly susceptible as the senior management earns an annual bonus based on the profits which is affected by the value of closing inventory in the cost of sales figure. This may result into an over/under stated of inventory and profit if the estimate of the hard wood and generally closing inventory is not correctly done.

Measurement of finished closing inventory (furniture)

IAS 2 "inventories" requires the valuation of inventory at each reporting date to be based on the lower of cost and net realizable value (NRV) and hence where the NRV is lower than the cost, the inventory should be written down to its NRV with the loss in value recognized in the profit or loss. The NRV of GDF's furniture (as its inventory) may easily go down especially for the home-furniture as this is not an essential good for households or generally all the furniture due to emergency of a high competition which may be price-driven. There is a risk of material misstatement if GDF has not assessed and written down its inventory to a NRV where the NRV is lower than cost due to management bias for a high annual bonus driven by a high profit. This will result in an overstated inventory and profit.

High competition – impairment loss for equipment

IAS 36 "Impairment of assets" requires an entity to consider if there is any indicator for impairment of its assets and if this is the case, the entity is required to determine the recoverable amount of the related asset(s) where recoverable amount is the higher of value in use and fair value less costs of disposal for the related asset(s). Where the recoverable amount is less than the carrying amount of the asset(s), a write-down to the recoverable amount is required by recognizing an impairment loss in the profit or loss. The emergency of major competition in the furniture selling sector that resulted in a significant decrease in the GDF's furniture sales in the financial year is an indicator of an impairment loss. There is a risk of material misstatement if GDF has not assessed the recoverable amount or has determined a wrong amount of recoverable amount. This will result into overstated assets and profits.

Poor publicity – impairment loss for equipment

In addition, there has been bad press publicity for the office-furniture due to the environmental and health side-effects to human beings arising from the vanish used on the furniture causing significant breathing complications and GDF has recognized an impairment loss for the equipment used specifically to make the office-furniture. There is a risk that management has not correctly computed the impairment loss for these equipment if they wrongly include the assumption that the sales for office-furniture will grow to normal sales in future as this is subjective. This will result into overstated assets and profits.

Note: It is valid if alternatively, (or separately as a point under "management bias"), the candidate develops correctly this point as case for management bias to manipulate the financial statements in the interest of overstating profits to earn a high amount of annual bonus.

Going concern uncertainty - disclosures

In the recent years, there has been an entry of a high competition in the furniture selling business with a significant drop in GDF's market share. In addition, there has been a significant increase in the cost of hard wood imported from DRC which is a key raw material used in making the furniture. It is possible that GDF cannot increase its selling price for furniture to incorporate the increased cost of hardwood in fear of losing customers to its competitors. This consequently may lead to significant financial losses which is an indication of a risk for going concern uncertainty especially if the demand of the type of furniture sold by GDF goes down in favor of alternative products sold by the competitors. IAS 1 "Presentation of financial statements" requires an adequate disclosure for going concern uncertainty in the notes to the financial statements. There is a risk of material misstatement if GDF has not adequately disclosed the respective going concern uncertainty arising from the effects of the high competition and increased costs of hard wood. This results into a non-disclosure risk or inadequate disclosure of information in the financial statements

Note: Another valid point for going concern uncertainty can be credited where the candidate develops this point based on the issues such as

- *potential restriction of the importation of hard wood to GDF due to restrictive regulations by the DRC regulators; or*
- *labor shortages in DRC due to the impact of the pressure lobby group in DRC; and/or*
- *significant drop in sales of office-furniture due to the side-effects of significant breathing complications due to the vanish used in making the office-furniture which constitutes a major percentage (70%) of GDF's sales*

Provision for penalties - Side-effects (significant breathing complications) of office-furniture

IAS 37 “Provisions, contingent liabilities and assets” requires a provision for a liability to be recognized if there is a present (legal or constructive) obligation and it is highly probable the entity’s economic resources shall be required to settle the obligation and a reliable estimate of the obligation can be estimated. If a possible obligation, then a contingent liability is disclosed. The side effects regarding the significant breathing complications arising from the vanish used to make the office furniture may result into potential penalties by the government inspector/regulator considering that the press reports have been in the financial year when GDF is due for a government inspection which requires either a provision for the legal penalties to be recognized or a contingent liability to be disclosed. There is a risk that GDF has not recognized a provision for the potential legal penalties or disclosed the contingent. This results into understated liabilities and expenses

Note: Credit can also be awarded where the candidate develops a reasonable point regarding a provision or contingent liability where customers who have suffered the breathing complications raises a litigation claim against GDF and/or a management bias for intentionally not recognizing a provision in fear of not earning a high annual bonus

Provision for government inspection costs

In addition to the provision discussed above for potential legal penalties, GDF needs to recognize a provision for the major government inspection costs as this is highly probable that its economic resources will be needed to settle this obligation and these costs can be reliable estimated based on the stipulated government inspection fees. There is a risk that GDF has not made a provision for the government inspection costs given that the routine inspection is imminent or an inappropriate amount of the provision has been made. This will result into understated liabilities and expenses

Note: Credit can be awarded where the candidate:

- *raises the impact of the bad press regarding the significant breathing complication on the going concern status of GDF.*
- *Identifies a potential impairment loss on the trading license (as an intangible asset) due to the possible suspension of the license as a result of non-compliance to health and safety arising from the breathing complication suffered by the office-furniture customers*
- *Identifies the potential non write-down of the operating license to a nil value as its tenure has come to an end at the reporting date especially as the operating license has an estimated useful life of 10 years and the current license tenure has come to an end*

Related party disclosure – bonus paid to senior management

IAS 24 “Related Party Disclosures” includes key management personnel as an example of a related party. IAS 24 requires adequate disclosures for related party transactions in the notes to the financial statements including the nature of the transaction, monetary value of the transaction etc. Related party transactions are material by nature. The Managing Director of GDF qualify is a related party to GDF as a key management personnel holding a position in GDF that can influence key decisions in the company and therefore the annual bonus paid to them is a related party transaction that should be disclosed adequately. There is a risk that GDF has not made adequate disclosures regarding the annual bonus payment to the Managing Director and this is not in line with the requirements of IAS 24. This will result into inadequate disclosures in the financial statements

Do Not Award:

- *Generic (speculative) risks developed from rote-learning which are not supported by the information given in the scenario*
- *GDF being a new audit client for our audit firm and/or opening balances have not been audited by our firm (as these are potential detection risks but detection risks are not part of risks of material misstatements)*
- *Government regulations of DRC and/or Rwanda may not permit the ease transportation or importation of the hard wood without a correct justification for associated risks of material misstatements (e.g. potential ban of exportation of the hard wood by DRC based on the lobby group's request as this may be more of a business risk)*
- *Foreign currency transactional risks regarding the settlement for the hard wood imported from DRC and GDF settles the owners of the forests in DRC using Rwanda Francs*

Part (c): Audit procedures for:

(i) Finished office-furniture

- Obtain a detailed breakdown on the types of office-furniture to confirm the categories of office-furniture produced by GDF
- Obtain and review the physical stock count report to confirm the quantities of the different types of office-furniture that existed at the reporting date
- Review the market valuation report from an independent professional valuation expert to confirm the net market value of the finished office-furniture report
- Confirm the competence and independence of the professional valuation expert through a review of their professional qualifications and confirming that they comply to an ethical framework.
- Inspect the press cuttings regarding the report on the significant breathing condition to confirm the adverse implications of the press report to the market valuation of the office-furniture
- Request for management computation of the net realizable value for the closing office-furniture to assess the reasonableness for the management assumptions applied in the computations
- Obtain a detailed breakdown of the associated costs to sell to confirm whether these are related to the sale of the office-furniture
- Recalculate the net realizable value and any loss in the valuation of the office-furniture and compare with management's calculations for arithmetic accuracy

(ii) Equipment used to make office-furniture

- Agree the cost of the equipment less accumulated depreciation and impairment losses at the beginning of the year to prior year working papers obtained from the previous auditors (and/or from the published financial statements of the prior year)
- Recalculate the current year depreciation charge based on the historical cost and the estimated useful life of the equipment and compare with the depreciation charge computed by management
- Obtain a detailed breakdown of the equipment used in the making of office-furniture to the fixed assets register at the end of the reporting date to confirm accuracy of the closing balance.
- Obtain management computation of the impairment losses for the equipment and assess the reasonableness of the assumptions used by management in determining the recoverable amount of the equipment
- For the value in use computations, agree management's schedule of future cash flows estimated to be attributable to the equipment to approved budgets and forecasts.
- Confirm through enquiry of management that the period used for the estimated cash flows in the computation of the value in use is up to five years except where a period beyond five years can be justified.
- Scrutinize the sales for the office furniture post-year end to confirm whether there is a steady increase in the sales to justify any impact on the assessment of the recoverable amount for the equipment used to make the office-furniture.

(iii) The bonus paid to the Managing Director

- Obtain a copy of the agreement where the bonus arrangement is formally documented to confirm the date of the agreement, the basis (e.g., percentage used in supporting the bonus), date to make the payment and other terms and conditions for the arrangement
- Inquire of management / Board the specific rate (e.g., a specific percentage) to apply in computing the bonus.
- Obtain a copy of a minute of the Board meeting to confirm the approval of the management letter
- Recalculate the amount paid to the Managing Partner to confirm the mathematic accuracy
- Trace the amount paid as bonus to the managing director to cash book (post b/sheet paid)
- Confirm through a review of terms that a correct amount has been paid as the entitled bonus to the Managing Director in the current financial year (and this can also be extended to last year to confirm if their adjustment to the opening balance
- Assess the level of performance determined by management against the auditor's computed performance to confirm the accuracy of the performance target being confirmed and used in computing the bonus paid/payable to the Managing Director
- Obtain a review the accounting journal used to confirm the correct figures and entries have been made in the financial statements for the current year.
- Obtain a list / schedule of the disclosure information to be presented in the notes to the financial statements to assess whether these are in line with the disclosure requirements

MARKING GUIDE AND MODEL ANSWER TO QUESTION TWO

GASABO TRANSPORTERS LIMITED (GT LTD) AND GMK DISTRIBUTORS LTD

MARKING GUIDE	**Marks**
Q2(a): Extent to which your firm could place reliance on the work of internal audit in the areas below:	
Q2(a)(i): Obtaining and documenting the understanding of the accounting and internal controls of GT Ltd	
Award 1 mark for every valid point raised relevant to assess the internal auditors' processes applied in obtaining and documenting the understanding of the accounting and internal controls at GT Ltd and this should be specific to GT Ltd. Max is 4 marks	4
Q2(a)(ii): Performing procedures requiring the use of computer assisted audit techniques (CAATs)	
Award 1 mark for every valid point raised relevant to assess the procedures applied by the internal auditors of GT Ltd in using computer assisted audit techniques (CAATs) and these should be specific to GT Ltd. Max is 4 marks	4
Q2(a)(iii): Performing substantive tests on cash at each of GT Ltd.'s 12 bus-point offices	
Award 1 mark for every valid point raised relevant to explain the external auditor's assessment of the internal auditors' substantive tests conducted on the cash management and related controls at each of GT Ltd.'s 12 bus-point offices. Max is 4 marks	4
Q2(b): Techniques used by an external auditor to obtain audit evidence (GT Ltd)	
Award up to 1 mark for each well-developed/explained technique used by an auditor to gather sufficient and appropriate audit evidence. The 1 mark includes a 0.5 mark for "identifying" a correct technique while the other 0.5 mark is awarded for a valid example of how this technique will be applied specifically in the audit of GT Ltd. A max of 5 marks	5
Q2(c): Information that should be contained in the audit documentation (i.e. working papers) relating to the physical inventory count at GMK	
Award up to 1 mark for each valid piece of information that needs to be included in the audit documentation/working papers regarding the physical inventory count at GMK. The 1 mark comprises of a 0.5 mark for correctly identifying "WHAT" information is needed and the other 0.5 mark is awarded for "REASON/WHY" is the information needed. A max of 8 marks	8
Total marks for Question Two	**25**

MODEL ANSWERS FOR QUESTION TWO

Part (a): The external audit work conducted to assess reliance that our firm can **place reliance on the work of GT Ltd's internal audit in:**

(i) Obtaining and documenting the internal auditor's understanding of the accounting and internal controls of GT Ltd

If our firm (Bizimana & Katungi Associates) is to place reliance on GT Ltd's internal auditor's work regarding their obtaining and documentation of their understanding of the company's accounting and internal control systems, our firm needs to conduct the following assessment of the internal auditor's work:

- Test check the adequacy of the internal auditors' procedures applied in reviewing the company's accounting systems and internal controls and a confirmation that the internal auditors document their findings / results of the walk-through tests conducted.

- Take a sample of documentation / reports on the GT Ltd's internal auditors, and review them to consider the adequacy of the level of detail recorded and perform a walk-through test in order to satisfy ourselves as to the accuracy and relevance of the reported findings for our external audit planning purposes.

- An inspection to confirm that the documentation is reasonably updated to indicate as assessment by the internal auditors of the current / latest accounting and internal control systems used by GT Ltd

- A confirmation through inquiries and review of the documentation at GT Ltd the relevant evidence supporting whether the internal audit team members at GT Ltd. are appropriately supervised and that their work on the evaluation of the company accounting systems and internal controls is been properly reviewed.

(ii) The Internal auditor application of computer assisted audit techniques (CAATs) in the conduct of their internal audit work at GT Ltd

It is possible that since this is the first time, our firm will be auditing GT Ltd, the internal audit team of GT Ltd has more expertise in operating the computer systems of the company compared to our firm's computer audit specialists and hence our firm may need to rely on the results of the results processed through the use of the internal auditors' applied CAATs. However, our firm still needs to:

- Perform tests on the IT facilities / CAATs approaches used by the internal auditors of GT Ltd. in order to confirm that the internal auditors are using properly applied IT facilities and these are operating efficiently.

- Evaluate the general controls over computer operations at GT Ltd to ensure that the audit facilities / and hardware access are secure and are being restricted for use by only the internal auditors.

- An assessment of the internal auditors' involvement in the appropriate design of the tests (CAATs) used to perform on the IT systems at GT Ltd.

- A review the working papers documented by the internal auditors of GT Ltd.'s to ensure that the tests are properly conducted, supervised, documented and reviewed and that the conclusions made by the internal auditors are consistent with the evidence gathered.

(iii) Performing substantive tests on cash management and related controls at each of GT Ltd.'s 12 bus-point offices

It would be reasonable to place reliance on the routine substantive procedures performed by GT Ltd.'s internal audit staff at the 12 bus-point offices.

- Our firm (Bizimana & Katungi Associates) will rely on the work of the internal auditors at GT Ltd if the internal auditors performed sufficient substantive tests on cash management at the 12 bus-point offices including (for example):
    - Conducting surprise cash counts
    - Attending periodic cash counts (e.g. each quarter, at the year-end etc.) including follow up procedures such as cut-off tests and checking cash count sheets to the final cash balance

- Our firm will also need to perform similar procedures on a sample basis at some of the 12 bus-point offices (selected by our firm) to make a comparison of our findings with the findings obtained by GT Ltd.'s internal audit staff and plan to conduct further investigations in case of any significant findings.

- As assessment of whether the internal auditors at GT Ltd independently visit the sampled / selected offices from the 12 offices without any influence from the management so that we can confirm that the internal auditors have the ability to remain unpredictable to the management (and/or personnel at the 12 branch offices) of GT Ltd and are guided by their independent internal audit plan.

- Our firm will need to review the work conducted by GT Ltd.'s internal audit department and we would also perform additional procedures on the cash management at the bus-point offices if the work of the internal audit reveals material misstatements or other unusual matters.

Note: Credit should be awarded where a student raises another valid point other than these listed above as long as the point is supported by information in the scenario for example, whether the internal auditors have access to those charged with governance to make their *independent reporting relating to deficiencies in the cash management controls identified at the GT outlet offices; or make continued follow-up on the implementation of the recommendations proposed to improve internal controls over cash management.*

Part (b): Techniques used by an external auditor to obtain audit evidence

In accordance with ISA 500 "Audit Evidence", the following specific techniques may be used by the auditors to obtain audit evidence in the audit of GT Ltd's financial statements:

Inspection

This technique covers the physical review or examination of documents, records and tangible assets. An example specific to GT Ltd through a test of controls is the auditor inspecting a copy of payment vouchers for authorization.

Observation

This technique involves looking at a process/procedure being performed. An example specific to GT Ltd is the auditor's observation of cash counts conducted at the bus-point offices to confirm that internal control procedures are adhered to.

Enquiry and confirmation

This technique involves seeking relevant information from knowledgeable persons (inside and outside the client-entity) whether formally or informally, orally or in writing. The reliability of this technique depends on the qualification and integrity of the source e.g. seeking of formal presentations from GT Ltd.'s management on the estimated useful life determined for the company's fleet of buses.

Confirmation consists of seeking to corroborate responses to enquiry information in the accounting records for example, the auditor's confirmation of GT's bank balances through a confirmation request to the bankers of GT Ltd.

Computation and recalculations

This technique includes checking the arithmetic accuracy of source documents and accounting records or performing independent calculations for example the auditor conducting a recalculation of the depreciation charge of GT Ltd.'s categories of the property, plant and equipment at each office and comparing this with GT Ltd.'s depreciation charge to confirm arithmetic accuracy.

Analytical procedures

This technique includes the analysis of significant financial ratios and trends picked from the draft financial statements including the resulting investigation of fluctuations that are inconsistent with other information, or deviate from predicted amounts. An example would include a comparison of GT Ltd.'s material figures like the revenue for the current year against the prior year to identify if there are any significant variations compared to our understanding of GT Ltd.'s business and environment for further investigations at the planning stage of the audit.

PART (C): GMK DISTRIBUTORS LTD

Information that should be contained in the audit documentation (i.e. working papers) relating to the physical inventory count at GMK

In preparation for the forth coming physical inventory count at GMK at the year-end (30 June 2024), our audit documentation is expected to report information regarding the following:

- The adequacy of the planned / approved GMK's physical count arrangements, guidelines and instructions. These guidelines and stock take instructions should be obtained by our firm before attending the stock count in order to assess the adequacy of GMK's planned stock count procedures and to ascertain whether GMK's staff will carry out the stock count instructions properly.
- A list of the pre-selected (e.g. high value) items chosen and agreed upon by the GMK's management and the audit team to ensure that an adequate proportion of the final inventory value will be tested (to conclude satisfactorily on the population of these items to be counted)
- Results of our audit test counts (e.g. by serial numbers of the TV sets or component references and quantities) which will provide evidence as to the completeness and accuracy of the GMK's count records (i.e. GMK's rough count sheets). Our test counts will also enable us to assess whether GMK's count procedures and controls are working properly.
- The documentation for the sequential arrangement of GMK's stock count sheets (e.g., using a systematic number series for the count sheets) used in the documentation of the counting results which will help detect any additional count sheets used (if any) subsequent to stock count attended by the audit team.
- The details for the inventories identified during the stock count as damaged, obsolete or slow moving which will help the audit team to assess the adequacy of allowances/provisions for inventory items with net realizable value that is less than cost as this will require adjustment in the financial records of GMK.
- The details for inventory items owned by third parties to identify and confirm that inventories have been excluded from GMK's final inventory valuation sheets.
- The documents and details of the last goods movement references dated on or shortly before and after 30 June 2024 (including the last copy of the goods received note, stores requisition, dispatch note/sales invoice) as this information will be important to assess the accuracy of the year-end cut-off.
- Details regarding the movements, if any, of the stock items during the physical inventory counting exercise to ensure such inventory items are not omitted or double-counted in error.
- A copy of the floor plan/sketch of GMK's central warehouse in Kigali which should be received by the auditors before the stock count exercise commences to assess / confirm that

there will be complete coverage (by management of GMK and the audit team) of the physical inventory count (for example evidence of an adequate allocation of the stock count teams / personnel).

- Details (e.g. serial numbers) of the GMK's inventory held by third parties are required to confirm the validity of their inclusion in the final inventory value.
- Details of any situations where GMK's stock-count procedures have not been satisfactorily carried out (e.g. damaged items not set aside) as this information will be essential / required for the auditor's report to management with recommendations for improvements (e.g. in standing instructions for physical counts)

MARKING GUIDE AND MODEL ANSWER TO QUESTION THREE: MURENZI ELECTRONICS LIMITED (MEL)

MARKING GUIDE	**Marks**
Q3(a): Matters to consider before accepting the engagement to report on MEL's prospective financial information	
Award up to 1 mark for each specific matter that should be considered before accepting the engagement to conduct an examination of prospective financial information (a maximum of 12 marks). The 1 mark is split to include a 0.5 mark for "identifying a valid matter or issue relevant to the engagement to examine the prospective financial information of MEL" and the other 0.5 mark is awarded for an explanation of the reason (or justification) for the matter.	12
Note: In addition to the matters raised in the model answer, any other valid matter raised in the student's answer that is relevant and specific to MEL shall qualify for up to 1 mark	
Q3(b): Examination procedures on the PFIs of MEL	
Award 1 mark for every valid procedure that is relevant to apply in the examination of the PFIs for MEL. A maximum of 13 marks to be awarded	13
Note: In addition to the PFI examination procedures raised in the model answer, any other valid review procedure raised in the candidate's answer that is relevant and specific to examination procedures of the PFIs for MEL shall qualify for 1 mark	
Total marks for Question Three	**25**

MODEL ANSWER TO QUESTION THREE

Part (a): Matters to consider before accepting the engagement to report on MEL's prospective financial information

(a) Matters to be considered (before accepting the engagement)

- **The format of prospective financial information ('PFI') – a 'business plan'**. The form and content of this must be clarified as the procedures required to be undertaken for a profit forecast will be different from those relevant to a cash flow (say). This PFI could include any, or all, of the following elements:

- a statement of business objectives and goals;
- profit forecasts;
- budgeted balance sheets;
- cash budgets;
- capital budgets
- marketing plans
- goods delivery plans throughout Rwanda
- a statement of assumptions and variables.

- **The period covered by the information** – 'for the year to 30 September 2023'. Consideration should be made to confirm whether the potential providers of finance may require that certain elements (e.g. capital expenditure and cash flows) be projected for more than one year e.g. a minimum of three years.
- **The intended use of the PFI** – We need to confirm whether MEL intends to use the PFI to solely support raising finance for the business restructuring plan. In addition, we need to confirm whether a high degree of reliance by the providers of finance is likely to be placed on the report on the MEL's business plan.
- **Information about William Nkusi** – we need to determine if there is any relationship of the chief finance officer to MEL (e.g. whether William is on the MEL's management board) specifically confirming whether he is authorized by MEL to approach Jean Marie & Associates to undertake this assignment. If William is responsible for the preparation of the PFI on which Jean Marie & Associates is to report it may appear to impair Jean Marie & Associates' objectivity if William makes the appointment.
- **Recipients of the PFI report** – We need to confirm whether a specific bank and/or venture capitalist has been selected to receive and use the PFI report and whether any negotiations with MEL concerning the request for finance has commenced. It is important to consider whether MEL already has financial commitments to the potential recipients of the PFI report. Banks and venture capitalists may require business plans and reports thereon in a prescribed form.
- **Jean Marie & Associates' competence and experience** – Jean Marie & Associates should not accept the engagement unless the firm has experience of reporting on PFI. Even then, the firm must acquire sufficient knowledge of the MEL's business sector to evaluate whether all significant assumptions required for the preparation of the PFI have been identified.
- **MEL's business – its economic substance and stability**. There have already been a number of restructurings in the past years and there are again undergoing another major restructuring in the current year. MEL may therefore be less stable and have a greater exposure to business risks.
- **Management's competence, integrity and past record in preparing PFI** – MEL's rationale for the decisions to undertake recent restructurings should be documented. A comparison of forecasts with actual outcomes in the past should reveal whether management has the appropriate expertise in this area. That 'several' have been undertaken in recent years may have been planned as part of an overall strategy to consolidate on a core. However, if each

restructuring has been prompted by a ‘knee jerk’ reaction to a previous bad decision it is less likely that the PFI will be reliable.

- **Whether information will be for general or limited distribution** – this will determine the suitability of caveats and disclaimers restricting circulation of Jean Marie & Associates’ report thereon. The wording of these should be agreed with William (e.g. in a pro-forma report attached to the engagement letter).
- **Form of opinion required** – we need to consider the expectation of the form of opinion expected of our firm’s report on the PFI by MEL (or other users); for example, if the users expect the opinion to be worded as ‘properly compiled’ and/or ‘presented on a basis consistent with accounting policies normally adopted’ rather than an expression of assurance.
- **The nature of assumptions underlying the preparation of the PFI** – whether it will be possible for Jean Marie & Associates to distinguish between best-estimate and hypothetical assumptions and consider the risks of the engagement involved dependent on the nature of assumptions used to prepare the PFI.
- **Time available** – Jean Marie & Associates must have enough time to carry out all necessary procedures on the PFI before providing a report on it. Also, if the report is needed before the March 2024 figures are audited, the most recent audited (i.e. reliable) data available to Jean Marie & Associates will be for the year ended 31 March 2022.
- **The acceptability of any limitations** – when the form and content of the PFI has been determined, Jean Marie & Associates should clarify the scope of the engagement and whether there will be any restrictions placed on available information (e.g. if there will be access to board minutes).
- **Jean Marie & Associates should be allowed to communicate with SMAK Partners CPA**, the current auditors of MEL so as to inform them of the nature of the work they have been asked to undertake and to enquire if there is any reason why Jean Marie & Associates should not accept this assignment.
- **Jean Marie & Associates should not accept the engagement if problems in providing William with the required report are anticipated**. For example, if William requires assurance on MEL’s future solvency; or if assumptions used in the PFI are clearly unrealistic; or if management is not prepared to provide written acknowledgement of their approval of the PFI and the assumptions on which it is based; or if the PFI will be inappropriate for its intended use.
- We need to consider **why SMAK Partners CPA, MEL’s current auditors, have not been asked to report on the plans**. Perhaps their knowledge of the business would be incompatible with the PFI. We need to consider whether SMAK Partners CPA have previously reported on PFI for earlier restructurings.
- **We need to consider why a negative assurance (rather than a positive assurance) opinion was issued for MEL’s interim financial statements.** The expression of ‘negative assurance’ on the Interim Financial Report is a statement of what SMAK Partners CPA does not know (as opposed to a statement about what they believe – positive assurance).
- **Management integrity** - The Executive Director’s statement is not inconsistent with the information from William Nkusi. Presumably it is not inconsistent with the Interim financial statements – otherwise SMAK Partners CPA would have reported that fact.

- **The degree of secrecy required** – this may go beyond the normal duties of confidentiality not to disclose information to outsiders (e.g. if unannounced staff redundancies form part of the restructuring proposal).
- We need to consider if there may **be an opportunity for Jean Marie & Associates to offer external audit and other services** to MEL (e.g. the provision of internal audit services).
- **The objective of the reporting engagement** – for example, to ensure that:
  - assumptions are not unreasonable and consistent with the purpose of the information;
  - PFI is properly prepared on the basis of the assumptions;
  - PFI is properly presented and all material assumptions are adequately disclosed (as best-estimate or hypothetical assumptions);
  - PFI is prepared on a consistent basis with historical financial statements, using appropriate accounting principles.

Note: Although candidates may approach this part from a rote-learned list of 'matters to consider' it is important that answer points be tailored, in so far as the information given in the scenario permits, to the specifics of MEL.

Part (b): Examination procedures on the PFIs of MEL

The recommended PFI examination procedures have been arranged in three broad categories below *(note: this presentation format here is only for purposes of this model answer and therefore not a requirement for the candidates)*

General procedures on Profit forecast and forecast statement of financial position

- Meet with William and the MEL's management accountant to ascertain how PFI is prepared.
- Review the internal controls (including the role of MEL's internal audit department) over the preparation of PFI and assess the expertise and experience of persons involved.
- Consider the accuracy of PFI prepared in prior periods by comparison with actual results and discuss with management the reasons for significant variances.
- Compare accounting bases, policies, etc. used in the preparation of PFI with those used in the preparation of the financial statements (and Interim Financial Report).
- Compare the 31 March 2024 (unaudited) figures with the prior year's interim financial statements to the audited 31 March 2023 figures to make some assessment of the likely reliability of the 31 March 2024 (unaudited) figures.
- Check the arithmetic accuracy of PFI (i.e. re-perform calculations).
- Confirm the inclusion of an appropriate estimate of income tax expense (including deferred tax) in the profit forecast and forecast statement of financial position.
- Perform analytical procedures (e.g. calculate ratios and perform tests in total) to assess the reasonableness of the interrelationship between items in the statement of financial position and profit forecast. For example, interest charges should have increased in line with the 43% increase in interest bearing borrowings (FRW 78,071m ÷ FRW 54,544m = 1·43).

- Obtain written management representations regarding the intended use of PFI, completeness of significant management assumptions and management's acceptance of responsibility for PFI).

Specific procedures on profit forecast

- Discuss with William the basis on which profit has been forecast (e.g. if revenue has been extrapolated from 31 March 2022 or March 2023). If this is based on the figures in the 6-months to 31 March 2022, compare actual (unaudited) revenue and costs for the six months to same figures reported in the financials for 31 March 2022.
- Consider the implications of assumptions (e.g. if building system sales are assumed to grow without any further costs being incurred in product innovation).
- Consider the reasonableness of forecast trends in the light of current economic circumstances and externally forecast economic trends.
- Discuss with management the key variables which underlie the sales revenue. Note that revenue for the six months (unaudited) to 30 Sept 2023 is only 50·5% of the revenue for the total continuing for the 12 months to 31 March 2022 (this is 41% if discontinued operations are included) therefore any assumptions of growth will require close scrutiny.
- Review internal consistency of amounts based on common variables (e.g. based on the interest rates, depreciation rates etc.).
- Compare information used in sales forecasts with that provided by marketing department (or external marketing consultants) for consistency.
- Assess the adequacy of depreciation/amortisation charges against the capital expenditure budget (additions) and the consistency of rates used in the preparation of financial statements.
- Review cost levels against available information for reasonableness. For example:
  - consider the viability of the proposed work force structure and forecast wage rates; and
  - compare estimates of outsourcing costs with quotations received (if any).

Specific procedures on forecast statement of financial position

- Discuss with management the need for and adequacy of provisions for the discontinuance of household electronics.
- Critically assess the reasonableness of the value of intangible assets. The 15% (FRW 99,678m ÷ FRW 86,666m = 1·15) increase to 30 Sept 2023 may reflect development in intangibles identified with the sale of CCTV equipment such as licenses for additional sales outlets. However, intangible assets for those activities which are discontinuing may be significantly impaired.
- Agree the cash balance per the forecast statement of financial position to a cash flow forecast.
- Agree the movements in intangible and tangible non-current assets to the capital expenditure budget (for additions). Consider the reasonableness of disposal proceeds (in the cash forecast) and the consistency of gains/losses on disposals in the profit forecast.
- Agree validity of movements on reserves (net reduction) and accumulated profits (negligible increase). For example, agree to forecast profit and consider whether there is any 're-classifications' (e.g. of a revaluation surplus).

- Agree the movement of interest-bearing borrowings (in particular) to the cash flow forecast.
- Assess the impact of disposals of assets (for the discontinued operations) on existing interest-bearing borrowings. For example, consider whether the terms of the loans may make them repayable if securitised assets are disposed of.
- Discuss with management why equity finance is not being sought (at least in part) and confirm the rationale for loan finance to the approval in the Board minutes.
- Compare key ratios (ROCE, assets turnover, receivable days, inventory turnover, current ratio, debt/equity, etc.) as forecast at 31 March 2025 with 31 March 2024 (unaudited), March 2022 (unaudited) and 31 March 2022 (audited). For example, the change in current ratio is negligible (which is Sept 2023: FRW 111,496m ÷ FRW 66,373m = 1·68 compared to 31 March 2022: FRW 113,678m ÷ FRW 68,044m = 1·66).

MARKING GUIDE AND MODEL ANSWER TO QUESTION FOUR: MUGOYA CONSTRUCTION COMPANY (MCC)

MARKING GUIDE	**Marks**
Q4(a): Management letter to the Board of Directors for MCC	
Award as below:	
- 1 mark for each identified / explained deficiency of an internal control (maximum of 5 marks)	
- 1 mark for an explanation of the impact of the internal control deficiency on MCC's financial and / or operational status (maximum of 5 marks)	
- 1 mark for each correctly explained recommendation that is appropriate to remedy the internal control deficiency (maximum of 5 marks)	
- Up to a maximum of 2 professional marks will be awarded for the answer to Q4(a) where 1 mark is for the management letter format used and another 1 mark is for the "clarity" applied in the student's answer	
Maximum marks for Q4(a)	17
Q4(b): Ethical and professional issues raised by the request for your firm to investigate the suspected fraud	
Award 1 mark for correctly identifying that a fraud investigation is an example of a forensic investigation and so a "non-audit service" with ethical considerations for a firm of professional accountants	
Award 1 mark for justifying the need for a separate engagement letter for the forensic investigation (and not included as part of the audit engagement letter)	
Award up to 1 mark for each valid point raised as a relevant ethical and/or professional issue arising from the firm conducting the fraud investigation requested by MCC.	
Note: Specifically the 1 mark for a point on ethics is not given for a mere mention of the "type of ethical threat (e.g. stating self-interest threat" but the mark is awarded for "explaining how the ethical threat arises and its consequences of the ethical threat to the firm"	
Award 1 mark for any correct safeguard proposed to manage the ethical threat (to a maximum of 3 marks throughout this part of the question)	

Maximum marks for Q4(a)	8
Total marks for Question Four	**25**

MODEL ANSWER FOR QUESTION FOUR

Part (a): A draft management letter to MCC's Board of Directors regarding the identified internal control deficiencies in the audit of Mugoya Construction Company (MCC)

MUGOYA CONSTRUCTION COMPANY (MCC) - MANAGEMENT LETTER

MANAGEMENT LETTER

KAYONDO & Associates **Friday, 31st May 2024**
Audit and Non-audit services
P.O. BOX:
KN 512
Tel: + 0250 189 189 189
FAX:………………
Email: kayondoassociates@infos.rw

To: The Board of Directors,

Subject: Internal Control deficiencies at MCC identified during the audit of the financial statements for the year ended 31 March 2024

Introduction: During the engagement to audit the financial statements of Mugoya Construction Company (MCC), a number of internal control deficiencies have been identified. This is a draft management letter that presents a report to the Board of Directors of MCC, the auditor's findings of the internal control deficiencies that have been assessed to be of significant impact on MCC. In the draft report, an explanation of the impact of the internal control deficiencies is provided in addition to recommendations for MCC to take corrective action to address the identified internal control deficiencies.

Below are the significant internal control deficiencies identified during the audit of the financial statements of MCC for the year ended 31 March 2024:

No	Observations	Risk Implications	Recommendations
1	MCC does not currently have an internal audit function.	A lack of an internal audit function implies that there is no internal independent function that regularly reviews the adequacy of management's internal control systems and this may create loopholes for personal interests.	MCC should set up an independent internal audit function with among others a responsibility to regularly review the efficiency and effectiveness of the company's system of internal controls.
2	MCC does not effectively apply the Enterprise Resource Planning (ERP) accounting package and there is specific inefficient in application of the key ERP modules such as inventory, assets, payables and receivables.	Inventories, accounts payable and accounts receivable are key ERP modules to apply in the financial accounting system. A lack or inappropriate application of these modules may result in significant financial losses through theft of inventories, failure to track the collection of debtor balances and a potential failure to pay suppliers and therefore creating a negative impact on working capital.	MCC should invest in training the relevant employees on the effective use of all the ERP modules in order to make good use of the modules and avoid the likely financial loss implications.
3	MCC's non-compliance with the statutory regulations including tax regulations and social security fund regulations.	Non-compliance with the tax authorities such as Rwanda Revenue Authority and the Social Security Fund may affect the company's going concern and excessive financial penalties may be levied against the company. In addition, the company's going concern may be significantly affected for example where the tax authorities temporarily close the operations of the company or a loss of customers and key employees who will not want to be associated with a company that does not comply with tax regulations.	MCC should comply with the local tax regulations for it to safely stay in business.

No	Observations	Risk Implications	Recommendations
4	Overstocking of raw materials (a high stock piled of raw materials) at the reporting date.	The company's cash is held up in raw materials and the storage cost also increases. This may affect the company cash flows / liquidity leading to inability to settle other obligations when they fall due. In addition, depending on the nature of the raw materials, there is potential to incur losses arising from some materials becoming obsolete (like cement) in the absence of customers and/or a loss due to theft by employees in the absence of an effective ERP module on inventory controls	MCC can introduce effective inventory management systems such as the Just-In-Time (JIT). In this case, MCC will be stocking only what it needs in order to reduce storage costs and control cash outflows. In addition, MCC will reduce the exposure for any financial loss that can arise from stock going obsolete and/or theft.
5	Non conformity to the Standard Operating Procedures (SOPs) for the construction industry as set/ required for the industry	Non conformity to the industry's SOPs required in the construction work will result in high scrutiny of MCC construction work with a possibility of closure of the company if it is confirmed that the company does not comply with the regulator's SOPs. In addition, non-conformity to the SOPs may result in more accidents for the construction workers exposing the staff to a life-threatening working environment and potentially loss of lives. MCC will likely lose key employees or cannot attract quality employees in the construction department impacting on the quality of the construction work and potentially loss of reputation to the customers in the public.	MCC should develop internal control systems that ensure compliance to the SOPs specific to the construction industry. All construction supervisors should ensure the compliance to the SOPs by the construction teams is well tracked and internal remedies (such as disciplinary action is taken in cash of any non-compliance)

No	Observations	Risk Implications	Recommendations
		Furthermore, MCC is exposed to litigation claims from the families for the ten deceased persons which may result in a significant financial loss due to the legal costs and potential legal penalties.	
6	MCC operates with a poor working capital management for the past two financial years as a result of an “excess” of the accounts payable balance over the accounts receivable.	A poor working capital management system results in a “shortage of cash / liquidity” impacting negatively on the needed cash to finance the day to day operations. This may be due to poor internal controls or relaxation of the collectability of the trade receivables which may further exposes the company to potential bad debts. Due to potential liquidity challenges, this may lead to a poor credit rating for the company and consequently the suppliers may not be willing to provide credit facilities under convenient terms to MCC in future. In a long-term the financial implications arising from poor working capital management, the company’s going concern status may adversely be affected.	MCC should improve the system of the company’s working capital management. For example, Proper assessment of credibility when giving out credits and proper follow up to ensure prompt payments hence leading to an improved liquidity.

Conclusion
The above identified findings are only those weaknesses that were identified during the audit and only those assessed to have a material impact on the audited financial statements. Other deficiencies in the internal control may not have to be evaluated due to the fact that they do not have a material impact on the financial statements.

Part (b): Ethical and professional issues raised by the request for your firm to investigate the suspected fraud

An investigation into the alleged fraudulent activity is a forensic investigation. If Kayondo & Associates Ltd were to conduct the forensic investigation, this would be a non-audit service performed for an audit client. According to IFAC's *Code of Ethics for Professional Accountants*, before a firm accepts an engagement to provide a non-audit service to an audit client, a determination should be made as to whether providing such a service would create a threat to independence.

In addition, since a forensic investigation is a non-audit assignment, then it requires to have its separate engagement letter rather than including the terms of the forensic investigation assignment as part of the audit engagement terms. Our firm should MCC that when the engagement to conduct a forensic investigation is accepted, a separate engagement letter shall be made.

The self-review threat exists because the forensic investigation will determine the monetary amount of the fraud, and the amount which MCC Ltd will attempt to recover from the fraudsters. Given the potential scale of the fraud, it has been indicated that the amount of the fraud in the transport cost is material to the financial statements and therefore the audit team would be reviewing figures determined by members of the audit firm.

In addition, the forensic investigation team will, as part of their work, review systems and controls over the transport expenses claimed by MCC Ltd.'s employees. This means that the forensic investigation team are also exposed to a self-review threat, as they will be reviewing systems and controls which have been considered during the just concluded audit of MCC Ltd.'s financial statements. The forensic investigation team may be not be applying their professional skepticism during the review of the internal controls as they will be inclined to rely on the internal control results from the audit team that has just concluded. Alternatively, if the forensic investigation team identified gaps in MCC's controls that the audit team did not report then the team may not want to highlight these errors to MCC in fear of MCC losing trust in the audit engagement.

In requesting our firm to act as an eye expert used in the subsequent court proceeding may result in an advocacy threat arises because going to court and speaking as an expert witness in relation to the fraud may be perceived by third parties in an adversarial context that our firm promoting the interests of its client and supporting a position taken by management.

A self-interest threat could also arise, as the forensic investigation may be a lucrative source of income for Kayondo & Associates. This could create the perception that Kayondo & Associates is reliant on MCC Ltd for income and impairs the objectivity of the firm.

In addition, the self-interest threat may further be compounded if the total fees (including the audit fees and the fees for the forensic investigation) exceeds 15% of the total firm's revenue considering that MCC is a listed client. Though this is the first year, our firm has been auditors for MCC, the size of the company (trading in and outside Rwanda) is potential that the audit fees and fees from the forensic investigations will extend the IESBA threshold set of 15% in two consecutive years in the following year. This is also likely to be the case considering that our firm provides both audit and non-audit assignments and MCC is a prime client for both services with the weaknesses in the internal controls (as reported in the management letter)

The firm should evaluate the significance of these threats. In particular, the firm should consider the fact that transport claim expenses are material and potentially the amount stolen within the transport costs may be material. In addition, the firm will have to consider the degree of the management and auditor's subjectivity that may be involved in determining the amounts involved.

If the specific amount within the transport costs reported in the financial statements which is assessed to be fraud is material, and would involve significant judgements, then no safeguards would reduce the threat to an acceptable level then the request by MCC for our firm to conduct the forensic investigation should not be accepted by the audit firm.

Note: Credit will be awarded for other relevant ethical evaluations that are correctly explained for example potential management threat where the forensic investigation teams applies judgement in determining whether the transport expenses are genuine expenses for the company or fraudulent expenses which is a responsibility of management. In additional appropriate safeguards for the additional ethical evaluations will equally achieve additional marks.

It is likely, however, that the investigation would not involve a significant degree of judgement and the investigation could be performed as long as safeguards were used, such as:

- Having a senior member of the audit firm, who was not involved in the forensic investigation and the prior audit work on MCC, review the results of the investigation and the impact on the financial statements;
- Performing a second partner review on the audit of MCC Ltd; and
- Ensuring that the forensic investigation is not performed by anyone involved in the audit engagement. Since our firm provides audits and non-audit assignment, there is a separate department / office at the firm that provides the non-audit assignments which should be the team to use on the forensic investigations assignment (as a different team approach).

The ethical situation must be discussed with those charged with governance / the Board of Directors of MCC Ltd. Depending on any relevant regulation in Rwanda, it may not be possible for the audit firm to carry out this non-audit assignment as MCC is a listed company, or it may be permitted with the approval of those charged with governance (or an audit committee, if one exists).

Furthermore, the IFAC Code's fundamental ethical principles apply to all professional assignments, including a forensic investigation. One of the fundamental principles is that of professional competence and due care. Forensic investigations are specialist assignments and may require very specific skills, which will not be possessed by individuals unless they have undergone specific training. Kayondo & Associates must consider whether there are any members of the firm who possess the necessary skills before accepting the assignment.

It is likely that relatively senior staff will need to be assigned to the investigation, which will bring necessary authority and experience to the investigation team. It should be considered whether Kayondo & Associates is able to divert senior staff from other assignments at short notice. Resourcing the team could be a problem.

In addition, confidentiality is a crucial issue in such investigations as members of the investigation team will have access to sensitive information which will be used as evidence in court. Any breach of confidentiality could jeopardize the integrity of the legal proceedings against the fraudsters. Anyone involved with the investigation must be made aware of these issues and confidentiality agreements should be signed.

End of marking guide and Model answers