CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

DATE: FRIDAY 31, MAY 2024

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 where necessary.

SECTION A

QUESTION ONE

You are a senior audit manager in Rukundo Partners CPA, a firm of certified public accountants in Rwanda. Your firm was appointed on 1 May 2024 to audit the financial statements of Gahondo Decent Furniture (GDF) Limited, a company incorporated in Rwanda whose draft financial statements are for the year ending 31 March 2024. The predecessor auditor resigned immediately after the previous audit following the end of their tenure and the professional clearance procedures have just been concluded.

GDF is a major retailer of furniture and the company is based in Gahondo. The principal activity of GDF is the making of a variety of furniture (chairs, tables, beds etc.) which is retailed in Kigali and nearby districts to exclusive shops with orders received through mail and web sales. Other sources of income for GDF include furniture-making demonstration sessions for vocational schools and fees collected through tours of the company's factory. All activities of GDF grew rapidly in fame in the early 2000s. In the last five (5) years, other companies involved in the same products as GDF have started operations in Rwanda with stiff competition that has significantly reduced GDF's market share.

GDF makes two main variations of furniture namely the "office furniture" and "home furniture". The sales of "office furniture" contribute to 70% of the total sales and the remaining 30% income is earned from the sale of "home furniture". All furniture is made from hard wood as the main material. GDF imports all hard wood from the rainy forests found in the Democratic Republic of Congo (DRC) in the Northern part of DRC where transportation of the wood is by road covering over 2,000 kilometers to Rwanda. In the contractual terms with the owners of the forests in DRC, it is stipulated that the trees are planted, maintained and harvested specifically for GDF's use and the settlement of the forest owners (which is paid in Rwandan Francs) is based on a cost-plus arrangement after harvest. The cost of hard wood imported from DRC has risen sharply over the last year as the cutting of trees by local village workers in DRC forests has come under criticisms from a DRC labor action group. The group is lobbying the DRC government to ban the export of trees, claiming that the local workers are being exploited and that sustaining the forests is seriously under threat.

Demand for the "office furniture" fell considerably in the year ended 31 March 2024 following a press report published which claims that the vanish used in the making of the furniture has an environmental contamination that causes significant breathing complications to human beings who are a few meters close to the vanished furniture. The financial statements of GDF for the year ended 31 March 2024 recognized a material impairment loss attributable to the equipment used exclusively for the production of the office furniture. However, management believes that the bad/negative publicity will gradually be forgotten and the sales of the office furniture will return to normal level by the end of 31 March 2025.

All products of GDF are highly regulated by the Government of Rwanda with licenses renewed every ten (10) years only after a successful government-led inspection of the company manufacturing facilities has been done. Government inspections fees are charged sat fixed prices and a company has to pay the fee before the inspection is made. Any suspicion of poor quality products can result into significant penalties, litigations and/or suspension of the company activities. The company was due for an imminent government inspection by the end of the financial year (31 March 2024).

Since last year, GDF remunerates the Managing Director a "performance bonus". Under this this arrangement, the Board approves the bonus to be paid to the Managing Director based on a percentage of the reported draft profit figure reported at the end of the financial year. A significant amount of bonus to the Managing Director has been approved by the Board based on the draft profit reported in the financial statements in the year ended 31 March 2024.

Required:

As the senior audit manager in charge of the audit of GDF:

(a) Identify and describe the matters specific to this audit that you consider relevant to help your team in the planning of the initial audit engagement of GDF as a new audit client of your firm (10 marks)

(b) In order to help with the planning of the final audit of GDF, **evaluate the principal audit risks that need your consideration during the conduct of the audit of GDF's financial statements for the year ended 31 March 2024** (25 marks)

(c) Describe the audit work to be performed in respect of the carrying amount of the following items in the financial statements of GDF for the year ended 31 March 2024:

(i) Finished office-furniture (5 marks)

(ii) Equipment used in the production of office-furniture (5 marks)

(iii) The bonus payable to the Managing Director (5 marks)

(Total: 50 marks)

SECTION B

QUESTION TWO

You are a manager in Bizimana & Katungi Associates, a firm of Certified Public Accountants based in Kigali, Rwanda. On 1 July 2022, your firm was appointed as new auditors for Gasabo Transporters Limited (GT Ltd), a company seeking for listing on the Rwanda Stock Exchange. This will be the first external audit for GT Ltd as its size did not formerly require an audit but now an external audit is required as part of the stock listing requirements. GT has a financial year ending 31 December 2022.

GT Ltd operates with a fleet of buses in various bus parks within Rwanda to transport passengers and goods across main routes and cities in Rwanda. GT Ltd has a head-office in Kigali and 12 bus-point offices (these are small-sized operational bus-point offices) located in 12 cities of Rwanda. Each of the 12 bus-point offices is located within a bus park in that specific city and it is through these offices that a customer is required to make a travel booking. A booking is only confirmed if the customer has paid cash or a mobile money transfer is made for the travel and/or luggage for which a booking ticket is issued to the customer. Both the passenger/luggage booking system and the procurement system are directly integrated with the accounting software of the company using a computer system.

The company has developed its internal audit operation in recent years. Among the activities of the internal audit department are:

(i) The documentation and evaluation of the accounting and internal control systems, testing compliance with laid down procedures, identifying control weaknesses and recommending changes to control procedures;

(ii) Monitoring of computer operations through the use of embedded audit facilities;

(iii) Routine visits to any of the 12 bus-point offices selected for routine internal audit checks. A routine check includes among others spontaneous cash counts (for monies received from customers which are not yet banked at the time of the internal auditor's visit); a range of tests of controls; and substantive test procedures in areas such as reconciliations of the cash balances.

Gloria Uwase who is the Chief Finance Officer of GT Ltd M has informed the audit engagement partner that she believes that the external audit fee could be significantly reduced for GT Ltd in the first year of the external audit as she expected an effective coordination between the external auditor team and GT's internal audit team which will eliminate any un-necessary duplications of the external audit work.

Required:

(a) Explain the work your audit firm should conduct to assess the reliance that can be placed on the work of the internal auditors of GT Ltd specifically in the following areas:

(i) The internal auditor's role in obtaining and documenting the understanding of the accounting and internal controls of GT Ltd (4 marks)

(ii) The internal auditor's application of the computer assisted audit techniques (CAATs) in the conduct of their tests (4 marks)

(iii) The internal auditor's substantive tests performed on the cash management and related controls at the 12 bus-point offices (4 marks)

Since this is the first time GT Ltd is being audited, the CFO of GT Limited, Gloria Uwase has insufficient experience regarding the approaches used by external auditors to obtain sufficient and adequate evidence to support the audit conclusion.

Required:

(b) In relation to GT Ltd, **explain to Gloria Uwase, the FIVE techniques that may be used by the external auditor to obtain audit evidence in accordance with ISA 500 *Audit evidence*** (5 marks)

You are also the manager in charge of the audit of GMK Distributors Ltd, a large private company that distributes electronics that include TVs sets, music system machines and other related accessories in all main districts in Rwanda. GMK Distributors Ltd operates a central warehouse which is located in Kigali from where goods are distributed to its outlet shops located in the main districts of Rwanda. Your firm is currently planning the final audit for GMK for the year ending 30 June 2024.

Management of GMK conduct an annual physical count for all its stock held at the central warehouse and all outlet shops on 30 June. In the last two annual stock counts, the inventories of the TV sets and music system machines (which are recognised as the "closing inventories" of the company at the reporting date) have consistently averaged in the range of around FRW 1,300 million while the inventories of the other accessories are consistently in the range of FRW 450 million.

GMK's current financial year-end will be end on 30 June 2024. Together with the audit supervisor and an audit assistant, you have planned to attend GMK's physical inventory count on 30 June 2024.

Required:

(c) Explain, with reasons what information that you expect to be reported in the audit documentation (i.e. working papers) relating to the planned physical inventory count at GMK (8 marks)

(Total: 25 marks)

QUESTION THREE

Murenzi Electronics Limited (MEL), is a limited liability company based in the outskirts of Kigali. For the past 10 years, MEL has operated with two business segments which included selling household electronics as one segment and selling CCTV equipment as the second segment. These products are sold to both retailers and final consumers throughout Rwanda. In the past years, MEL has undergone several restructurings and currently the company is again undergoing another major restructuring after receiving the approval from the Board. In order to implement the restructuring plan, the company has obtained a bank loan from Kigali Finance Bank.

You are the manager in Jean Marie & Associates, a firm of Certified Public Accountants based in Kigali. You have been contacted by William Nkusi, the Finance Director of MEL to provide a report on the company's prospective financial information for the year ended 31 March 2025.

You held a meeting with William Nkusi last week where you were informed that the restructuring plan involves discontinuing the distribution of household electronics and maintain only the CCTV equipment business segment where the greatest opportunity for increasing the company's market share lies. MEL's business strategy is to become the market leader in Rwanda in selling Italian-made CCTV equipment. As part of this business strategy, MEL plans to offer an after-sales annual maintenance arrangement to the customer buying the CCTV equipment as this service is highly sought for in Rwanda. A major benefit of the restructuring plan is the expected reduction in the cost-base of the company. As part of the restructuring plan, the book-keeping accounting function and internal audit function will be outsourced.

You have received a copy of MEL's interim report for the six months to 31 March 2024 where the company's auditors SMAK Partners CPA provided an unmodified negative assurance opinion. Extracts of the contents in the Interim Financial Report include:

(1) The Executive Director's report (extract):
"The business environment for electronics in Rwanda has been very unstable in this period compared to last year with performance adversely affected by a significant decline in the household electronics market. MEL's plans to respond to this by focusing on gaining market share under the CCTV equipment sales segment and reduce the company's cost base".

(2) Financial statement extracts:

	6 months to 30 Sept 2023 (Un-audited)	**12 months to 31 March 2023 (Audited)**
	FRW million	**FRW million**
Statement of financial position (extracts):		
Intangible assets	99,678	86,666
Tangible non-current assets	83,085	76,161
Inventory	30,083	24,830
Receivables	71,506	59,926

Cash	9,908	28,411
Total assets	**294,259**	**275,995**
Ordinary share capital	36,290	36,290
Accumulated profits	106,363	106,244
Other reserves	7,163	10,863
	149,816	**153,397**
Long-term loans	78,071	54,554
Current liabilities	66,373	68,044
Total equity and liabilities	**294,259**	**275,995**
Profit or Loss (extracts):		
Sales Revenue:		
Continuing operations: CCTV equipment	175,362	347,143
Discontinued operations: Household electronics	-	77,952
Total revenue	**175,362**	**425,094**
Operating profit before interest and tax:		
Continuing operations: CCTV equipment	15,996	38,439

Required:

(a) **Explain the matters Jean Marie & Associates should consider before accepting the engagement to report on MEL's prospective financial information.** (12 Marks)

(b) If the engagement to examine the PFIs of MEL is accepted, **describe the examination procedures your firm should undertake in order to provide a report on a profit forecast and forecast statement of financial position for MEL for the year to 31 March 2025.** (13 marks)

(Total: 25 marks)

QUESTION FOUR

a) Mugoya Construction Company

You are an audit manager in Kayondo & Associates, a local firm of professional accountants providing audit and non-audit services to clients in Rwanda. Your firm was engaged on 1 January 2024 for the first time to audit the financial statements for Mugoya Construction Company (MCC) for the year ended 31 March 2024 after the audit term for the former auditor expired. Mugoya Construction Company (MCC) is among the leading construction companies in Rwanda with operations extending outside the country. MCC is listed on Rwanda stock market and in addition the company operates with an ISO certification.

The audit for the financial statements is at the completion stage. During the audit process you have established the following findings regarding internal control deficiencies of MCC:

(i) MCC management does not operate an internal audit function though the company is looking forward on implementing an internal audit function and seeks your advice.

(ii) MCC operates an Enterprise Resource Planning (ERP) system which is inefficiently applied by the employees in the management of important modules like inventory, non-current assets, accounts payable and accounts receivables.

(iii) MCC does not fully comply with Rwanda Revenue Authority regulations regarding tax compliance and the company has always received notifications of tax irregularities from RRA.

(iv) For the past two years consistently, MCC has always been listed by National Social Security Fund as one of the top fifty (50) defaulters for non-compliance to pension contributions for its employees in Rwanda.

(v) In the current financial year, due to high stock piled raw materials in the main stores, there has been a significant increase in the closing raw materials (which was valued to be three-times higher than the closing inventory balance for the prior year). The increase in the closing raw materials is highly material since there is no ongoing contracts running with any customer. The inventory count exercise highlighted many stocks line items that carried material discrepancies between the system and actual count.

(vi) In January 2024, due to non-compliance with the industrial regulator's standard operating procedures (SOPs), there was a major accident at the construction of a commercial building in Kicukiro where ten (10) MCC employees lost their lives on site. There has been a lot negative media publicity reporting this accident and the industrial regulators are investigating the cause of the accident. In addition, families of the lost staff members have taken the MCC to court.

(vii) In your review of the working papers of the prior year's auditor, MCC reported a high balance under its trade payables account compared to the trade receivables. In the current financial year, the trade payable figure is four times higher than the trade receivables balance.

MCC is governed by Board of Directors who are keen to discuss the auditor's report on the company's internal control deficiencies (i.e., the findings and recommendations for internal control deficiencies) with the aim of getting these deficiencies addressed / corrected by MCC's management as soon as possible.

The audit engagement partner, Fred Sibomana has scheduled to meet the Board of Directors for MCC in two (2) days from now where he is expected to present the auditor's report on the significant internal control deficiencies identified during the audit.

Required:

In preparation for the meeting with Board for MCC, **draft a management letter addressed to the Board of Directors of MCC in which you explain any FIVE identified deficiencies in the internal controls of MCC with appropriate recommendations to address the internal control deficiencies** (15 marks)

Note: This part of the question awards up to two (2) professional marks for the presentation format and quality of the explanation (2 marks)

b) Assume today is one week after our firm's completion of the audit for Mugoya Construction Company (MCC) for the financial year ended 31 March 2024. The audit report was issued with an unmodified opinion.

This morning, the Managing Director of MCC has contacted your firm's engagement partner (Fred Sibomana) with a request for our firm to conduct a forensic investigation in a suspected fraud that involves the operations director (Benard Mugisha) and the accountant (Joseph Kayibanda). In light of the fraud suspicion, the managing director of MCC has shared the following information with Fred Sibomana:

(i) Benard and Joseph are suspected to be involved in a fraud where fictitious expense claims on a weekly are being raised by Benard to the accountant (Joseph) to pay for transport costs for a large number of the construction workers that travel to/from MCC's construction sites. The claims are inflated in terms of the frequency (weekly claims rather than the same cost raised as a monthly claim) and in additional the number of the workers and transport cost per worker is twice inflated.

(ii) The suspected fraud is worrying the management of MCC as it is now reported that the transport costs for the construction works is a material cost in the company's financial statements.

(iii) MCC plans to take the matter to court and request the court to claim for a recovery of the financial loss suffered from the suspected fraudsters if evidence can show that fraud actually took place. If the engagement is accepted, our firm will therefore be required to act as expert witness during the court case.

Due to the urgency of the assignment, the Managing Director has proposed that if our firm accepts to the take on the engagement to conduct the forensic investigation, the company will pay a fee for this assignment that is 5 times higher than the recently paid audit fees. The managing director proposes to send to our firm a revised audit engagement letter that bears the terms and payment of the proposed fees if the assignment is accepted

Required:

Evaluate the ethical and professional issues raised by the request for your firm to conduct the forensic investigation in suspected fraud taking place at MCC and recommend appropriate safeguards

Note: The information provided and answer in part (b) should NOT be used to answer (or to amend the answer) in part (a) (8 marks)

(Total: 25 marks)

End of Question Paper

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